40-7580

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11)
	)	
FANSTEEL INC., *et al.*,[1]	)	Case No. 02-10109 (JJF)
	)	(Jointly Administered))
	)	
Debtors.	)	

Objection Deadline: January 20, 2003 at 4:00 p.m. E.S.T.
Hearing Date: To Be Determined

NOTICE OF MOTION FOR ORDER APPROVING DEBTORS' SUCCESS-BASED EMPLOYEE RETENTION AND INCENTIVE PROGRAM FOR KEY EMPLOYEES UNDER 11 U.S.C. §§ 105(a) AND 363(b)

TO: ALL PARTIES REQUIRED TO RECEIVE NOTICE PURSUANT TO DEL. BANKR. LR 2002-1.

The captioned debtors and debtors in possession (collectively, the "Debtors") filed the attached "*Motion For Order Approving Debtors' Success-Based Employee Retention And Incentive Program For Key Employees Under 11 U.S.C. §§ 105(a) And 363(b)*" (the "Motion") with the United States Bankruptcy Court for the District of Delaware, 824 Market Street, Wilmington, DE 19801 (the "Bankruptcy Court"). The Motion seeks entry of an order approving debtors' success-based employee retention and incentive program for key employees under 11 U.S.C. §§ 105(a) and 363(b). Objections and responses to the Motion, if any, must be in writing and filed with the Bankruptcy Court no later than 4:00 p.m. Eastern Time on January 20, 2003. At the same time, you must also serve a copy of the objection or response on the undersigned Debtors' counsel.

[1]The Debtors are the following entities: Fansteel Inc., Fansteel Holdings, Inc., Custom Technologies Corp., Escast, Inc , Wellman Dynamics Corp., Washington Mfg. Co., Phoenix Aerospace Corp., and American Sintered Technologies, Inc.

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IF YOU FAIL TO RESPOND OR OBJECT IN ACCORDANCE WITH THIS NOTICE, THE COURT MAY GRANT THE RELIEF REQUESTED IN THE MOTION WITHOUT FURTHER NOTICE OR HEARING.

A HEARING ON THE MOTION WILL BE HELD ON OR AFTER JANUARY 28, 2003 AT THE COURT'S CONVENIENCE ONLY IF OBJECTIONS OR RESPONSES ARE TIMELY FILED.

IF OBJECTIONS ARE TIMELY FILED AND RECIVED, FURTHER NOTICE WILL BE GIVEN OF THE TIME AND DATE OF THE HEARING.

Dated: January 8, 2003

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Co-Counsel for the Debtors and Debtors in Possession

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In re:	)	Chapter 11
	)	
FANSTEEL INC., et al.,[1]	)	Case No. 02-10109 (JJF)
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Objection Deadline: January 20, 2003 at 4:00 p.m. E.S.T.
Hearing Date: TBD

MOTION FOR ORDER APPROVING DEBTORS' SUCCESS-BASED EMPLOYEE RETENTION AND INCENTIVE PROGRAM FOR KEY EMPLOYEES UNDER 11 U.S.C. §§ 105(a) AND 363(b)

The debtors and debtors in possession in the above-captioned case (the "Debtors") hereby move ("Motion") the Court for entry of an order approving a revised retention and incentive program for certain key employees that is primarily success-based (the "SB-KERP"), pursuant to 11 U.S.C. §§ 105(a) and 363(b). The relief sought herein supercedes the relief sought by the motion previously filed on November 7, 2002 (the "KERP Motion") [Docket No. 554]. The SB-KERP incorporates major substantive changes to the KERP made by the Debtors to address objections articulated by the Official Committee of Unsecured Creditors ("Committee"). Approval of the SB-KERP is sought by separate motion to ensure proper notice of these revisions. In support of their Motion, the Debtors respectfully represent as follows:

[1]The Debtors are the following entities: Fansteel Inc., Fansteel Holdings, Inc., Custom Technologies Corp., Escast, Inc., Wellman Dynamics Corp., Washington Mfg. Co., Phoenix Aerospace Corp., and American Sintered Technologies, Inc.

Jurisdiction

1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

2. The statutory basis for the relief requested herein is 11 U.S.C. §§ 105(a) and 363(b).

3. The United States District Court for the District of Delaware withdrew the reference of these bankruptcy cases, by order entered on January 22, 2002 [Docket No. 39]. The cases are being administered as bankruptcy cases by and under the Article III jurisdiction of the United States District Court for the District of Delaware [Docket No. 75].

Background

4. On January 15, 2002 (the "Petition Date"), the Debtors filed voluntary petitions for relief under Chapter 11 of 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"). The Debtors continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

5. The Debtors engage in the manufacturing and marketing of specialty metal products. At the Petition Date, they operated from 10 manufacturing facilities and employed 1,250 employees. Currently, Debtors have seven operations and approximately 962 employees. Different personnel operate the Debtors' seven distinct operating businesses. Debtors maintain separate books and records for each operation. Certain administrative functions are shared among the Debtors, including shared cash management systems, benefit plans and certain common senior management.

6. Each of the Debtors' seven operating businesses, standing alone, generates between $10-25 million in annual revenue in competitive and complex business environments.

Among other complexities, the Debtors' operations involve compliance with stringent environmental regulations under state and federal laws, including the Atomic Energy Act ("AEA").

7. Unforeseen AEA compliance issues precipitated the events leading to these bankruptcies. From the 1950's through 1989, Fansteel owned and operated a site in Muskogee, Oklahoma ("Muskogee Site") where, under license from the Nuclear Regulatory Commission ("NRC"), it processed tantalum ore for further processing at Fansteel's North Chicago Plant. Pure tantalum – which readily conducts electricity and is particularly valuable to the telecommunications industry – naturally occurs with other metals. Processing tantalum leaves behind uranium and thorium, each of which is radioactive

8. In 1989, Fansteel Inc. discontinued its operations at the Muskogee Site. The NRC requires, after a licensee ceases principal operations, that the licensee obtain approval of a decommissioning plan ("DP") and a decommissioning funding plan ("DFP"). The NRC expects (a) the DP to set forth the method by which the licensee plans to remediate its site and dispose of its radioactive material and (b) the DFP to specify how the licensee plans to fund the costs and expenses of decommissioning.

9. Fansteel's original proposed DP contemplated construction of a processing plant to reprocess and sell the radioactive byproducts of tantalum processing, and its DFP contemplated that annual revenue from the reprocessing plant would recover, at minimum, the construction and operating costs of the processing facility. This DP was approved in 1997. The DFP was subject to periodic financial assurance reviews, which the NRC required Fansteel to update every thirteen months.

10. Unfortunately, the construction and start up of the DP's reprocessing plant was plagued by technical and operational difficulties, significantly reducing its processing capacity. There was also a significant decline in the price of tantalum during the second and third quarters of 2001 (in part due to repercussions from the beleaguered telecommunications industry), and operation of the reprocessing facility was determined to be uneconomic. Fansteel, as a matter of generally accepted accounting principles ("GAAP") in its financial statements for the quarter ended September 30, 2001, was required to write off costs expended to design and build the reprocessing plant (approximately $32 million), and to take an immediate reserve for anticipated costs of off-site disposal of the remaining radioactive residues and completion of site remediation, an approximately $57 million reserve. When combined with already recorded reserves, the net effect was to require Fansteel to take a total charge of $84 million.

11. In mid October 2001, Fansteel promptly informed its pre-petition lenders, Northern Trust Company ("NTC") and M&I Bank ("M&I"), of the prospective write-off and reserve required with respect to the Muskogee Site, and requested waivers of any events of default arising under the pertinent loan documents as a result thereof, as well as amendments to either: (a) to increase credit availability from NTC and M&I; or (b) to allow the Debtors to borrow funds from alternative sources on a secured basis. Either would have provided the Debtors with sufficient liquidity to avoid a bankruptcy filing. However, NTC and M&I refused these requests and on November 19, 2001 accelerated the pre-petition credit facility, froze the Debtors' accounts at NTC and M&I and set off amounts owed to NTC and M&I against those accounts. The recoverability of these set-offs is still disputed and unresolved. Without use of the pre-petition credit facility, the bankruptcy filing became inevitable.

The Need for a Key Employee Retention Plan

12. Notwithstanding the complexity of their technical and business environment, the Debtors are thinly staffed with management personnel. A General Manager runs each operating business. The General Manager of each business is responsible for essential operations, with functions such as legal, environmental, financial reporting and cash management functions centralized at the corporate level. No backup for key positions – General Manager, Sales Manager, Controller and Manufacturing Manager – exists in any of the Debtors' businesses.

13. Debtors' management personnel are fairly experienced in the industry and are known to the Debtors' competitors. They were recruited at mid-range compensation levels to work at the Debtors' facilities, many of which are located in rural areas or areas to which it is difficult to attract qualified personnel. Due to Debtors' thin staffing, each is vested with substantial responsibility and, as noted, has no backup. In addition, given the complexity of the business, there is a substantial learning curve for new employees, and the Debtors have a limited or even non-existent ability even to attract suitable candidates in view of their present financial situation. Not surprisingly, the consequences from their departure would range from, at the very least, extreme inconvenience to, in certain instances, enterprise-threatening.

14. There is no question that employees face uncertainty about their continued employment. The VR Wesson, Hydro Carbide, American Sintered Technologies, Washington Mfg, California Drop Forge and Wellman business have all been candidates for sale and the management of each of these businesses have participated in the sales process with Lincoln Partners L.L.C., the Debtors' investment banker, and prospective purchasers. Employees are

well aware that a successful Chapter 11 Plan may ultimately involve the sale of their business or a liquidation of selected subsidiaries or even the company as a whole.

15. At the outset of these cases, key managers were advised that the Debtors would formulate and seek approval of a key employee retention program ("KERP"). For the reasons explained below, Debtors were not in a position to propose such a plan until now. In the meantime, since the filing, one General Manager and two Sales Managers have resigned. The Debtors have been informed that other management personnel have received job offers or are exploring alternative employment opportunities. If a KERP is not approved, morale among key management is certain to deteriorate, defections will accelerate, and the Debtors' financial performance will suffer.

16. Pre-petition, the Debtors' management personnel received incentive compensation in the form of stock options and through a long-term incentive plan based on economic valued added principles (the "EVA Program"), with particular emphasis on annual improvements in operating profits and asset management. Currently the value of these programs to induce employees to remain is almost nil. First, existing stock options are effectively worthless. Second, the EVA Program has been affected by the necessary shift in management goals—during the duration of the bankruptcy so far—from achieving profits to achieving positive cash flow. Accordingly, EVA participants have struggled to meet the EVA financial criteria primarily because of the bankruptcy. Only four of the Key Employees' accounts have a positive EVA Program balance. Retaining this program is not, in management's judgment, a significant retention incentive at this time.

17. For all of these reasons, the Debtors have concluded in the exercise of their business judgment that following through on their pledge to implement a KERP is required in

order to induce key employees to remain and to retain the institutional stability necessary to successfully emerge from Chapter 11.

The Formulation of the Original KERP

18. As of the Petition Date, the Debtors had not formulated a KERP and, at that time, did not have the financial wherewithal to implement one. There was no DIP financing in place, or the prospect of DIP financing on the horizon. Potential DIP financers were concerned that the rights of the NRC would prime their rights.[2] Fansteel explored alleviating the concerns of the possible DIP financers by obtaining the NRC's consent to the proposed DIP financing, but it appeared unlikely that such consent could be obtained. Even if such consent were forthcoming, under the Hobbs Act, 28 U.S.C. § 2342, third parties arguably would have a period of time within which to challenge the consent of the NRC. As a result, at the beginning of these cases, possible DIP financers were unwilling to provide Fansteel with DIP financing until the NRC provided its consent and the challenge period under the Hobbs Act expired.

19. While no DIP facility was in place, management's overriding concern was to preserve the business. Management was concerned not just with ensuring adequate cash flow, but that the lack of DIP financing would send a message to Debtors' creditors and vendors that Debtors' continuation as an on-going business was implausible. Faced with this situation, Debtors' management gave priority to stabilizing the businesses --by cost-cutting, accelerating collection on receivables, improving certain operations, fostering relationships through their critical vendors programs, re-establishing confidence with customers and vendors[3], and

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[2] For example, Foothill Capital Corporation and The CIT Group/Business Credit, Inc., which refused to lend without the affirmative consent of the NRC, specifically expressed such concerns.

[3] For example, note that each of the non-lender members of the Official Committee of Unsecured Creditors was a critical supplier of goods to Debtors ("Critical Vendor"). All Committee members, with the exception of the lenders - NTC and M&I - are being paid their pre-petition amounts due, pursuant to this Court's orders authorizing payments to Critical Vendors (District Court Docket Nos. 29 and 132).

marketing assets in order to raise money for working capital. All of these efforts were undertaken at the same time that Debtors' management personnel were spending valuable time and resources continuing to seek financing.

20. The lack of DIP financing took a toll on the Debtors' management and operations that cannot be over-emphasized. From November 19, 2001 through May 2002, the Debtors operated with no access to external financing, while contending with a severe recession in the industries served by many of its businesses and a catastrophic downturn in aerospace business following September 11, 2001. The lack of DIP financing in conjunction with their lenders' confiscation of the Debtors' cash left the company in continual jeopardy of not meeting payroll or post-petition creditor obligations.

21. Finally, in May 2002 – four months after the commencement of these bankruptcy cases – Debtors were able to obtain DIP financing from Congress Financing Corp. In spite of the economic uncertainty facing the Debtors, through highly focused management, the Debtors have not had to resort to borrowing, and five of its seven business have been profitable during the bankruptcy. Management's responsible decision not to seek a KERP on the Petition Date when no DIP financing was available should be applauded, not used against it.

22. In addition to the issues with financing, the Debtors' management has continued to address many significant operating issues during a severe economic downturn in many of its end-user markets, including continuing to effectuate cost containment programs and proceeding with strategic decisions to close two non-performing operations, as well as the strategic sale of a subsidiary. In addition, extensive efforts to prepare a revised decommissioning plan for the Muskogee site have required significant management resources, with a completed

plan anticipated to be filed with the Nuclear Regulatory Commission in January 2003. These are all essential elements of a successful emergence from Chapter 11.

23. On August 19, 2002, this Court entered an order authorizing the employment and retention of Executive Sounding Board Associates Inc. ("ESBA") as the Debtors' restructuring consultant and financial advisors. One of the enunciated tasks with which ESBA was to assist the Debtors was in the formulation of a KERP.

24. The KERP initially proposed by the Debtors was conservative. Only twenty-five persons were classified by the Debtors as key employees for purposes of the program (the "Key Employees"). The Key Employees are generally the top three persons at each business unit. At the corporate level, the designated Key Employees are the head of tax and audit, the lead person for environmental compliance, the Chief Financial Officer and Chief Executive Officer.

25. The retention program for Key Employees consisted of a stay bonus and severance payments. The stay bonus rewarded employees for their continued commitment in three stages:

- For continued employment through December 31, 2002 (5-10% of annual base pay for 23 of the Key Employees, 20% for the CFO and 0% for the CEO);
- For continued employment through December 31, 2003 (10-15% of annual base pay for 23 of the Key Employees, 30% for the CFO and 0% for the CEO); and

- For continued employment through Chapter 11 Plan[4] confirmation or sale (15-20% of annual base pay for 16 of the Key Employees, 50% for 7 General Managers and the CFO, and 100% for the CEO).

26. The total retention payment under the KERP was $1.6 million, representing approximately 1.2% of 2001 revenues. The program also had a severance component, under which Key Employees would be compensated for having their employment terminated without cause, in amounts ranging from 50% of base salary (general managers) to 100% of base salary, less amounts already paid under the SB-KERP (all other Key Employees except the CEO), to 150% of base pay (CEO). These figures are well within accepted and customary parameters for debtor in possession retention and severance programs.

The Committee Objection and the Formulation of the SB-KERP

27. The Committee objected to the KERP as "extraordinary" and "lavish," arguing that no business justification had been established, that it was too vague, that it was unnecessary because Debtors' employees will not leave and are fungible, and that the KERP was unaffordable and would jeopardize reorganization. These arguments are addressed in detail below. While the Debtors believe each of these attacks on the KERP was unjustified, they commenced working with their advisors to reshape the KERP in a manner that would address the Committee's concerns.

28. On December 4 and 5, 2002, the Debtors met with the Committee to discuss a business plan for the coming year through the contemplated filing date of a Chapter 11 Plan.

[4] A "Chapter 11 Plan" is a plan approved pursuant to 11 U.S.C.§1123.

The initial plan of operating conditions and forecasted results ("Initial Business Plan") was submitted for Committee review on December 5, 2002. This Initial Business Plan incorporates cash flow targets for use as financial benchmarks in measuring the Debtors' progress toward reorganization.

29. In conjunction with the Initial Business Plan, the Debtors reshaped the KERP to be primarily success-based. Instead of providing for fixed compensation, the SB-KERP makes most compensation contingent on the Debtors' success in meeting cash flow targets under the Initial Business Plan and effecting a Chapter 11 Plan and adjusts such compensation on a sliding scale commensurate with the degree of such financial success. Like the original KERP, the SB-KERP is again limited to 25 Key Employees (although one, the CEO, receives nothing until the effective date of a Chapter 11 Plan).

30. Categories of payments and contingent payments under the SB-KERP are detailed in Exhibits "1", "2", and"3" hereto. A further breakdown of payment ranges to specific identified recipients has been provided to the Committee. In summary, the SB-KERP is divided into three phases:

- Phase I, the smallest component, is a fixed payment to recognize the commitment and exceptional efforts of Key Employees during the first twelve months of the bankruptcy, and to provide incentives to remain despite the lack of job security. For continued employment through December 31, 2002, Key Employees will receive a fixed payment on February 15, 2003 based on 5% of annual base pay (16 Key Employees), 10% of annual base pay (7 General Managers), and 20% of annual base pay (CFO). The CEO receives nothing in Phase I. The total amount of Phase I compensation is $223,792.

- Phase II provides incentives to remain and to achieve the Initial Business Plan cash flow goals by awarding to Key Employees as of December 31, 2003 contingent sliding scale compensation based on the targeted cash flow benchmarks for that date. The sliding scale ranges from 0% to 10% of annual base pay (16 Key Employees), 0% to 15% of annual base pay (7 General Managers), and 0% to 30% annual base pay (CFO). The CEO receives nothing in Phase II. Total amounts to be paid in Phase II range from $0 to a maximum of $370,959 if 100% of the targeted cash flow is achieved. The sliding payment scale is as follows:

a. No payouts would be made to any eligible employees unless their individual business unit's cash flow was at least 75% of the operational cash flow target set forth in the Initial Business Plan.

b. If operational cash flow exceeds 75% of target, payouts will be made to eligible employees based on the performance of their individual business units. These payments will be made on the following sliding scale:

Attainment of Cash flow target	Payment of 12/31/03 amounts
75% - 79%	70%
80% - 89%	75%
90% – 94%	85%
95% - 99%	90%
100%	100%

- Phase III comprises success payments contingent upon the effectiveness of a plan or sale[5] of a Key Employee's business unit.

[5] "Sale" of an individual business unit, for the purposes of the SB-KERP, is defined to include the shutdown of an operation, other than corporate services. No such shutdowns are anticipated at this time; however, management recognizes that, in the event that a unit's shut down is necessary in order to achieve broader corporate goals, the work required by pertinent Key Employees would be critical.

If a Chapter 11 Plan becomes effective after December 31, 2003, Key Employees will receive a success bonus of 15-20% of annual base pay (16 Key Employees), 25% of base pay (7 General Managers), 50% of base pay (CFO) and 100% of base pay (CEO) on the plan's effective date. The maximum amount payable upon the effective date is $1,007,959. (If a Chapter 11 Plan becomes effective or their business unit is sold on or before December 31, 2003, Key Employees will receive their maximum Phase II payment, as well as their Phase III payment.)

In gross, the minimum amount of all SB-KERP retention payments is $223,792. The maximum amount of such payments is $1,602,710. The maximum amount would be paid only if (1) Business Plan targets are 100% achieved and a Chapter 11 Plan becomes effective or (2) a Chapter 11 Plan becomes effective on or before December 31, 2003. The 25 Key Employees, all of whom have been identified to the Committee, comprise 2% of the Debtors' workforce.

31. The SB-KERP continues to provide for Severance Payments. In the event of termination without cause before the closing date of these bankruptcy cases,[6] the CEO would receive 150% of his base pay, or $600,000, over and above any prior retention payments, and continued benefits for eighteen months. The CFO would receive 100% of base pay, or $216,132, over and above any prior retention payments, and continued benefits for twelve months. General Managers would receive 50% of base pay, ranging from $40,000 to $92,500, over and above prior retention payments, and continued employee benefits for six months. All other Key Employees would receive 100% of their allotted retention payments (less amounts previously paid), and continued benefits for three months.

[6] The term "cause" as applied to the CEO and CFO is limited to instances of fraud, gross negligence or conviction of a crime during the pendency of these Cases. For all other Key Employees, the term "cause" shall mean grounds for dismissal applying reasonable industry standards.

Relief Sought By The Debtors

32. By this Motion, the Debtors seek Court approval of the SB-KERP pursuant to 11 U.S.C. §§ 363(b) and 105. The Court has well-established authority to approve such programs as a valid exercise of a debtor's business judgment. Such approval is warranted where, as here: (1) the SB-KERP is essential to retain a limited number of key employees whose continued and uninterrupted services are critical to a successful emergence from Chapter 11, (2) the terms of the SB-KERP – both in amount and in terms of disbursement – are in accord, if not conservative in comparison to, other programs proposed and approved in bankruptcy cases in this district and elsewhere; and (3) the reformulated SB-KERP is, far more than customary, a success-based incentive plan, and thus the great majority of the compensation to be paid hereunder will become due only if the Debtors succeed in achieving their financial targets and in effectuating a Chapter 11 Plan, to the benefit of the company and its creditors alike.

Argument and Authorities

A. The Court Has Authority to Approve the SB-KERP Under Bankruptcy Code §§ 363(b)(1) and 105(a)

33. Pursuant to Bankruptcy Code §§ 363(b) and 105(a), the Court has authority to approve the implementation of the proposed SB-KERP. Bankruptcy Code § 363(b)(1) provides, in pertinent part:

> [t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.

11 U.S.C. § 363(b)(1). Courts have evaluated employee retention and benefit plans under Section 363(b) as a proposed use of the Debtors' property outside the ordinary course of their business. See The Dai-Ichi Kangyo Bank, Ltd., Chicago Branch v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.), 242 B.R. 147 (D. Del. 1999) (affirming approval of retention, severance and retirement program); In re Buyer's Club Markets, Inc., 5

F.3d 455, 458 (10th Cir. 1993) (postpetition severance plan was a transaction out of the ordinary course of business and required notice and hearing); In re Media Central, Inc., 115 B.R. 119, 126 (Bankr. E.D. Tenn. 1990) (same); In re Century Brass Prods., Inc., 107 B.R. 8, 11 (Bankr. D. Conn. 1989) (same).

34. A business judgment standard is applied to a proposed use, sale, or lease of property of the estate under Bankruptcy Code § 363(b). Montgomery Ward, 242 B.R. at 153 (applying business judgment test to proposed employee retention, severance and retirement plan); In re Delaware & Hudson Ry. Co., 124 B.R. 169, 1796 (D. Del. 1991); In Re American West Airlines, Inc., 171 B.R. 674 (Bankr. D. Ariz. 1994) (applying business judgment test to employee retention and severance plan), In re Interco, 128 B.R. 229 (Bankr. E.D. Ms. 1991) (same).

35. In Interco, American West Airlines, and Montgomery Ward Holding Corp., all of the courts acknowledged that the determination of whether to approve such programs turns on the facts and circumstances of each particular case. Montgomery Ward, 242 B.R. at 154-155; Interco, 128 B.R. at 233; American West Airlines, 171 B.R. at 678. Although the Committee attempts to limit the application of Montgomery Ward to "unique problems" related to "national notoriety and infamy as a failing business in the ultra-competitive retail industry," the decision cannot be read so narrowly. It goes without saying that employee retention and severance programs are not limited to national retailers; to the contrary, the lower court expressly stated that "in every major case that I have, particularly, the retail cases, we have this type of a program early on in the case because of the free-fall Chapter 11 problems that we have, including the public's perception and creditors, vendors, et cetera's perception of this company." Montgomery Ward, 242 B.R. at 152 (emphasis added). Moreover, this Court proceeded to hold that "a

bankruptcy court may consider several factors, none of which are dispositive in and of themselves, and all of which are intended to merely guide the bankruptcy judge in assessing a Section 363(b) motion in light of the particular facts and circumstances of each case." Id. at 155.

36. While the debtor carries the burden of demonstrating that the particular use, sale or lease will assist the debtor's bankruptcy goals, however, a party objecting is required to produce evidence that supports their objections. Id. at 155 (affirming employee incentive plan; Debtors presented ample evidence that sound business purpose justified Debtors' employee incentive program through testimony of Debtors' Executive Vice President of Human Resources and by Ernst & Young, compensation consultant of Debtors; creditor, Bank Group, failed to produce any evidence at the hearing to controvert testimony of the Debtors' witnesses). See also In re Delaware & Hudson Ry. Co., 124 B.R. at 176; In re Lionel Corp., 722 F.2d at 1071.

37. Authority to approve the SB-KERP also exists pursuant to Bankruptcy Code § 105(a). That section provides in pertinent part that "the Court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Under this section, the Court has expansive equitable powers to fashion any order or decree which is in the interest of preserving or protecting the value of the debtor's assets. See, e.g., In re Chinichian, 784 F.2d 1440, 1443 (9th Cir. 1986) ("Section 105 sets out the power of bankruptcy court to fashion orders as necessary pursuant to the purposes of the Bankruptcy Code."); Bird v. Crown Convenience (In re NWFX, Inc.), 864 F.2d 588, 590 (8th Cir. 1988) ("The overriding consideration in bankruptcy . . . is that equitable principles govern."); In re Cooper Properties Liquidating Trust, Inc., 61 B.R. 531, 537 (Bankr. W.D. Tenn. 1986) ("Bankruptcy Court is one of equity and as such it has a duty to protect whatever equities a

debtor may have in property for the benefit of their creditors as long as that protection is implemented in a manner consistent with the bankruptcy laws.").

B. A Sound Business Purpose Exists For The SB-KERP

The SB-KERP is amply supported by the Debtors' sound business judgment. As set forth above, the Debtors can and will present evidence to support the following contentions.

1. The SB-KERP is Needed to Retain Key Employees

As detailed above, and as presented in part by ESBA to the Committee in December 2002, the Debtors' businesses are comprised of seven separate and distinct operating businesses, and:

(a.) Each of these businesses is thinly staffed and there is no back up for the key positions.

(b) The businesses are extremely complex and there is a significant learning curve for new employees, especially employees with little or no experience in the relevant industries.

(c) The businesses operate in a competitive environment, in which Debtors' competitors know the Key Employees.

(d) Since the beginning of the bankruptcy, one General Manager has resigned and two Sales Managers have resigned, and Debtors believe that other Key Employees have explored other employment opportunities.

(e) Key Employees are well aware that their continued employment is uncertain, not simply generally as a corollary to being employed by a Chapter 11 debtor, but specifically based on the participation of the VR Wesson, Hydro Carbide, American Sintered Technologies, Washington Mfg, California Drop Forge and Wellman businesses in the sales process with Debtors' investment bankers and prospective purchasers.

(f) Key Employees are also aware that an ultimate Chapter 11 Plan may involve the sale of their business or a liquidation of Fansteel or selected subsidiaries.

(g) Key Employee total compensation package has diminished because the value of Debtors' employee incentive program has been wiped out by the Debtors' financial situation.

(h) In view of the company's financial position, diminished compensation packages and lack of meaningful incentive plans, it would be extremely difficult to hire qualified replacements at similarly priced compensation levels for Key Employees' positions.

2. The Terms of the SB-KERP Are Reasonable

(a) The amounts to be paid under the SB-KERP are consistent with a fair rate of compensation for the Key Employees. Over the period of 1999 – mid 2001, Debtors recruited numerous general managers, sales managers, manufacturing managers and controllers. Through discussions with executive recruiters and candidates, Debtors determined that their compensation levels for these positions were appropriate under then-existing business conditions. Now, without the benefit of the pre-bankruptcy bonus and incentive plans, Debtors believe their compensation package to be at the low end of the spectrum. The SB-KERP would restore a semblance of competitiveness to the Debtors' pay structure and help insure management stability.

(b) The retention incentives in the SB-KERP are well within accepted and customary parameters of employee retention programs for Chapter 11 debtors, and are fairly conservative.[7]

(c) The severance payments in the SB-KERP are also well within accepted and customary parameters for such programs for Chapter 11 debtors.

(d) The cost of replacing a Key Employee is generally 150% of that employee's salary.[8] Here, the retention program ranges from a total of 100% of annual base pay (for the chief executive officer, in the sole event that a plan is confirmed, and the chief financial officer) to 30% for other Key Employees. Again, according to the ABI panel, this is at the low end of retention programs.

(e) The amounts to be paid under the SB-KERP are within the capacity of the Debtors to pay, particularly as revised to make most payments contingent upon meeting minimum cash flow targets and pegging such payments to the degree to which such targets are attained.

B. The Committee's Objections to the Original KERP Have Been Addressed

The Committee objected to the original KERP on the basis that no sound business purpose had been established, that the plan was too vague, that the plan was unnecessary and that the Debtors could not afford it. The revised SB-KERP, as presented in this renewed Motion, address these issues:

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[7] See Trends in Employee Retention in Chapter 11, West's 05060, ABI-CLE 15, 2002. (Attached hereto as Exhibit 4).
[8] Id

1. Sound Business Purpose: The Committee argued that to establish a sound business purpose, Debtors must provide an analysis of market rates of compensation of comparable employees in comparable markets, as well as demonstrate the necessity of each employee to the Chapter 11 effort. This Court's decision in Montgomery Ward holds otherwise, in that "a bankruptcy court may consider several factors, none of which are dispositive in and of themselves, and all of which are intended to merely guide the bankruptcy judge in assessing a Section 363(b) motion in light of the particular facts and circumstances of each case." 242 B.R. at 155. Notwithstanding, the Debtors will present evidence that the SB-KERP is required to maintain relatively competitive rates of compensation for the Key Employees. In addition, the Debtors stand ready to present evidence as to the "necessity" of each and every Key Employee, if so required.

2. Vagueness: The Committee complained that the recipients were not identified, or the means of choosing them articulated. To the extent there was any validity to this objection, it has been remedied. The Debtors have identified each Key Employee individually to the Committee and broken down the application of the SB-KERP to each individual's compensation.

3. Necessity: The Committee argued that the KERP was unnecessary because the cases have already been pending for nearly a year, and Key Employees have not left for other employment. As set forth above, this is misleading. One General Manager and two Sales Managers have left the company. Another General Manager has remained based on assurances that a KERP would be implemented. All Key Employees understood at the outset of

the case that a KERP would be proposed, and those who have remained have worked exceptionally hard and with extraordinary success during the pendency of the cases to date. Failure to approve a KERP at this juncture would send morale plummeting and accelerate departures. The fact that most Key Employees stayed without a KERP being approved on the Petition Date should not be held against them: Key Employees should be applauded, not punished, for their commitment to their employer, putting the business first, and not holding creditors over the barrel to obtain a KERP on the Petition Date.

The other prong to this Committee argument is that the Key Employees are replaceable. The evidence will show otherwise. The businesses are complex and thinly staffed, meaning that there are no backups. Each of the Key Employees has significant institutional knowledge—which can involve both technical and operational knowledge, as well as knowledge about relationships with customers and vendors. Thus even technically qualified employees would have a steep institutional learning curve, during which time the company may or may not be critically impacted. In addition, many Key Employees are located in rural locations to which it is difficult to attract qualified personnel. Finally, the expense incurred in hiring replacement personnel would almost certainly be in excess of the payments that existing Key Employees would receive under the SB-KERP.

4. Affordability: The Committee argued that the Debtors did not demonstrate that they can afford the program in view of their operating losses, and that instituting the program would impede rather than promote reorganization by saddling the Debtors with financial disincentives to sell businesses. First, the evidence will show that the

Debtors can afford the program. The Initial Business Plan includes KERP payments, and under the SB-KERP, the amount of such payments is pegged to achieving the Initial Business Plan targets. Thus, the revision to a primarily success-based formula virtually ensures that the company will have the capability of making the payments. This is not altogether surprising: although the company shows a $6.9 million loss through October, $4.3 million is due to bankruptcy-related expenses and $1.2 million is related to the decision to shut down the Lexington operation due to the downturn in the mining and construction markets. Other extraordinary losses were incurred on a contract with Pratt & Whitney Canada that was terminated during the second quarter. Excluding these items, the company has operated at near breakeven levels in a difficult economic environment, and five of its seven businesses are operating profitably. The company still has not needed to draw on its DIP credit facility, even as it has experienced the worst industry downturn since the 1980's, made significant payments for bankruptcy related expenses, and has paid 80% of the prepetition debt for nearly all of its critical vendors.

While it is correct as a matter of mathematics that instituting the SB-KERP would create additional liabilities in the event of a sale, such an analysis does not take into account that the loss of Key Employees by failing to implement the SB-KERP would in the Debtors' business judgment be far more detrimental to the interests of the company and its creditors. In effect, the Committee's argument is self-fulfilling: without the SB-KERP, the likelihood of a fire sale is greatly increased, at values sufficiently low so that the absence of severance provisions could materially affect creditor recoveries. With the SB-KERP, this doomsday scenario is far less likely, to the substantial benefit of the company and its creditors. Whatever the reason for the Committee's antipathy to management and its apparent preference for a fire sale – perhaps due to the fact that nearly all of its members have already been paid as Critical Vendors and thus bear little further economic risk – such a strategy is not in the interests of the company or its other creditors.

Conclusion

The proposed SB-KERP is supported by sound business purposes, is essential to maintain institutional stability and enable the Debtors to achieve the goals of this bankruptcy, and contains reasonable terms. Accordingly, it is in the best interest of the estates that the Court authorize and approve the SB-KERP.

Notice

38. Notice of this Motion will be provided to (a) the Office of the United States Trustee; (b) counsel to the Official Committee of Unsecured Creditors; and (c) all parties who have requested notice pursuant to Rule 2002 of the Federal Rules of Bankruptcy Procedure. In light of the nature of the relief requested, the Debtors submit that no further notice should be required.

WHEREFORE, the Debtors respectfully request that the Court enter an order, substantially in the form attached hereto, (i) approving and authorizing the SB-KERP; (ii) authorizing the Debtors to make the payments hereunder without further order of the Court; (iii) allowing any Key Employee claims under the SB-KERP as administrative expense claims pursuant to sections 503(b)(1) and 507(a)(1) of the Bankruptcy Code; and (iv) granting such other and further relief as is necessary and proper.

Dated: January 8, 2003

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Counsel for Fansteel Inc., et al.
Debtors and Debtors In Possession

EXHIBIT 1

FANSTEEL SUCCESS BASED KERP

		Minimum Total Per Group	Maximum Total Per Group	Maximum Payment Range Among Individuals in Group
Phase I	Februrary 15, 2003			
	CEO	$0.00	$0.00	$0.00 (0% ABP)*
	CFO	$43,226.00	$43,226.00	$43,226.00 (20% ABP)
	General Managers (7)	$110,025.00	$110,025.00	$8,000.00 - $18,500.00 (10% ABP)
	Key Direct Reports to General Managers (13)	$57,332.00	$57,332.00	$2,922.00 - $6,750.00 (5% ABP)
	Key Corporate Personnel (3)	$13,209.00	$13,209.00	$3,480.00 - $5,150.00 (5% ABP)
	SUB-TOTAL	**$223,792.00**	**$223,792.00**	
Phase II	December 31, 2003 (Contingency**)			
	CEO	$0.00	$0.00	$0.00 (0% ABP)
	CFO	$0.00	$64,840.00	$64,840.00 (30% ABP)
	General Managers (7)	$0.00	$165,038.00	$12,000.00 - $27,750.00 (15% ABP)
	Key Direct Reports to General Managers (13)	$0.00	$114,663.00	$5,844.00 - $13,500.00 (10% ABP)
	Key Corporate Personnel (3)	$0.00	$26,418.00	$6,960.00 - 10,300.00 (10% ABP)
	SUB-TOTAL	**$0.00**	**$370,959.00**	
Phase III	Plan Effective Date or Sale (Contingency***)			
	CEO	$0.00	$ 400,000.00	$400,000.00 (100% ABP)
	CFO	$0.00	$ 108,066.00	$108,066.00 (50% ABP)
	General Managers (7)	$0.00	$ 275,062.00	$20,000 - 46,250 (50% ABP)
	Key Direct Reports to General Managers (13)	$0.00	$ 171,995.00	$8,766 - $20,250 (15% ABP)
	Key Corporate Personnel (3)	$0.00	$ 52,836.00	$13,920 - $20,599 (20% ABP)
	SUB-TOTAL	**$0.00**	**$1,007,959.00**	
	GRAND TOTAL	**$223,792.00**	**$1,602,710.00**	

* Percentage of Annual Base Pay per individual in group

** A sliding scale amount depending upon attainment of cash flow target of at least 75% from December 2002 proposed business plan (See Exhibit 2)

***Upon the effective date of a Chapter 11 Plan or "sale" (as defined at footnote 4, page 12, of the Motion) of a business unit. If a Chapter 11 Plan becomes effective, or if a business unit is sold on or before December 31, 2003, both the maximum Phase II payment and Phase III payment will be made; otherwise, amounts not paid as part of Phase II will be lost. Regardless of when a Chapter 11 Plan becomes effective or a business unit is sold, Phase III payments will be made.

Doc. 61416

EXHIBIT 2

DEBTORS' EXHIBIT 2

SLIDING SCALE FOR PHASE II

A.

No payouts will be made to any eligible employees unless their individual business unit's cash flow was at least 75% of the operational cash flow from the business plan presented to the Committee on December 5, 2002.

B.

If the operational cash flow exceeds 75% of target, payouts will be made to eligible employees based on the performance of their individual business units. These payments will be made on the following sliding scale:

Attainment of Cash flow target	Payout of 12/31/03 amount
75% - 79%	70%
80% - 89%	75%
90% - 94%	80%
95% - 99%	90%
100%	100%

EXHIBIT 3

SEVERANCE FOR TERMINATION WITHOUT CAUSE PRIOR TO CLOSING DATE OF CASES

		PAYMENT	
CEO	"Cause" means instances of fraud, gross negligence or conviction of a crime	$600,000	150% of annual base salary (over and above any amounts already paid as part of the KERP) and continuation of employee benefits for eighteen months from the date of termination
CFO	"Cause" means instances of fraud, gross negligence or conviction of a crime	$216,132	100% of annual base salary (over and above any amounts already paid as part of the KERP) and continuation of benefits for twelve months from the date of termination
General Manager	"Cause" means grounds for dismissal applying reasonable industry standards	Range: $40,000 to $92,500 (varies according to salary of each General Manager	50% of base salary (over and above any amounts already paid as part of the KERP) and continuation of employee benefits for six months from the date of termination
All Other Key Employees	"Cause" means grounds for dismissal applying reasonable industry standards	Range: $8,766 to $30,899 (varies according to the salary of each employee)	100% of KERP payment (less amounts already paid) and continuation of employee benefits for three months from the date of termination

EXHIBIT 4

American Bankruptcy Institute
New York City Bankruptcy Conference
May 6, 2001

Current Developments in DIP Financing and Cash Collateral Use, Including Critical Vendor, Employee Compensation and Other First-day Orders

Trends in Employee Retentions in Chapter 11

Robert J. Rosenberg -- Moderator
Latham & Watkins
Hon. Stuart M. Bernstein
U.S. Bankruptcy Court
Timothy Coleman
The Blackstone Group
James H.M. Sprayregen
Kirkland & Ellis, Chicago

I. Overview

a. Retention Bonuses intended to:

i. Encourage key employees to accept risk associated with working through a chapter 11

ii. Motivate key employees to reduce the amount of time a company is in bankruptcy

iii. Reduce the cost associated with replacing departed employees

1. The cost of replacing an employee is generally 150% of that employee's salary, not counting the loss of knowledge [FN1].

2. Companies cannot afford to be short-handed during crises

iv. General retention plan ranges are as follows:

Senior Management (Top Mgmt., EVP, SVP)	100-200% of Base Salary
Middle Management (VP)	25-75% of Base Salary
Broader Key Employee Groups	0-20% of Base Salary

II. Recent Large Retention Plans

a. K-Mart (not yet fully Court-approved)

i. $175.6 mm total bonus pool

ii. $1.5 mm discretionary pool for the CEO

iii. Up to $150 mm in stay bonuses for middle-tier employees (district managers, store managers, pharmacists, etc.)

iv. Plan implemented because market for talented retail employees is tight and K-Mart employees are well-trained and highly marketable

v. Remainder for other top tier employees

vi. Covers 9,994 of 240,000 employees

b. Arch Wireless

i. Plan covers 105 key employees, including 13 top managers

ii. Total retention payout of $6 million

iii. Amount as follows:

1. CEO -- 190% of base salary

2. CFO -- 197% of base salary

3. COO -- 160% of base salary
4. EVP, SVP -- 60-100% of base salary
5. VP and Directors -- 20-30% of base salary

iv. Timing as follows:

1. 25% - earlier of emergence or 6 months from filing
2. 25% - emergence from Ch. 11
3. 50% - May 15, 2003

v. Amount of retention approved by creditors in connection with restructuring of accrued operating performance bonus payment and renegotiation of operating bonus methodology going forward.

c. Dade Behring

i. $18.4 mm plan for 59 employees
ii. Tier 1: CEO: 333% of base salary; 11 senior executives: 275% of base.
iii. Tier II: 14 regional managers: 150% of base salary
iv. Tier III: 34 mid-level managers: 100% of base salary
v. Paid as follows:

1. 33% payable at effective date
2. 33% payable 6 months after effective date
3. 33% payable on April 1, 2003.

d. ICG Communications

i. CEO not included in program
ii. COO: 150% of base salary
iii. EVPs: 80-135% of base salary
iv. SVPs: 30-100% of base salary
v. VPs: 21-73% of base salary
vi. Balance of Employees

III. Trends and Issues in Employee Retention

a. 'Divide and Conquer' Method

i. Companies are increasingly being pushed by creditors to seek separate Court approval for retention plans for top executives from those for broader groups of employees.

ii. Plans for top executives generally draw more strenuous objections than those for other employees.

iii. An experienced workforce is critical to maintaining an operating business.

iv. 'Divide and Conquer' allows a Debtor to retain broad groups of key employees while top management negotiates for an acceptable package, but leaves management adrift.

b. Timing of Payment

i. Retention bonuses have traditionally been paid upon the successful restructuring of a company, typically the effective date of a transaction (i.e. the date of emergence from chapter 11)

ii. Recently key employees have been demanding, and receiving, bonuses being paid over time, with installments funded prior to a successful outcome.

1. In an uncertain economic environment, employees are concerned about the possibility of a long, drawn-out restructuring period.

2. In certain of the hardest-hit industries, such as telecom and steel, companies face the very real possibility of liquidation. Key employees must be afforded a measure of protection and reward for the risk of continuing to work in such situations.

c. Performance-Based Bonuses

i. Creditor groups are increasingly asking that retention bonuses be tied to financial performance or other operating metrics.

ii. Debtors prefer to separate one-time retention distributions from ordinary course performance bonuses.

iii. Introducing risk into the payment of retention bonuses defeats the intended purpose, which is to offer an incentive for key employees to remain on the job, despite the tremendous risk inherent in a crisis or reorganization situation.

iv. Creditors also have been tying approval of retention packages to restructuring of normal course operating bonus programs, especially for senior management.

d. Publicity

i. The popular press has been criticizing companies such as Polaroid, Bethlehem Steel and LTV for paying bonuses to executives during periods of employee layoffs and financial distress.

1. Such criticisms fail to take into account the importance of strong leadership to the preservation of the value of the estate in a crisis situation.

2. All such plans are carefully negotiated with creditors and do not represent a unilateral self-allocation of wealth by management.

3. Such bonuses are generally funded by monies pledged to the creditors; retention bonuses for key executives do not represent value that would otherwise be distributed to employees.

ii. Recently several companies have determined that pre-petition bonus payments may be appropriate in situations where employee attrition is a significant risk and where the complexity of the chapter 11 filing may lead to meaningful delays in implementing a bankruptcy court-approved retention program.

FN1. Source: Bruccoleri, Joe, Director of Retention Services, Drake Beam Morin, *The Baltimore Sun*, 1/6/2002

END OF DOCUMENT

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
FANSTEEL INC., et al.,[1]	)	Case No. 02-10109 (JJF)
	)	(Jointly Administered)
Debtors.	)	

ORDER APPROVING DEBTORS' SUCCESS-BASED EMPLOYEE RETENTION AND INCENTIVE PROGRAM FOR KEY EMPLOYEES UNDER 11 U.S.C. §§ 105(a) AND 363(b)

Upon the motion (the "Motion") of the debtors and debtors in possession in the above-captioned Chapter 11 case (the "Debtors"), seeking entry of an order approving Debtors' Success-Based Employee Retention and Incentive Program ("SB-KERP") for Key Employees under 11 U.S.C. §§ 105(a) and 363(b); and it appearing that the relief requested is in the best interests of the Debtors' estates, their creditors and other parties in interest; and notice of the Motion having been given to the Office of the United States Trustee, counsel to the Official Committee of Unsecured Creditors and all parties who have requested notice pursuant to Rule 2002 of the Federal Rules of Bankruptcy Procedures; and after due deliberation and cause appearing therefore:

IT IS HEREBY ORDERED that:

1. The Motion is granted in its entirety.

2. The Debtors are authorized to enter into the SB-KERP for the Key Employees as described in the Motion and the Exhibits attached thereto.

[1]The Debtors are the following entities: Fansteel Inc., Fansteel Holdings, Inc., Custom Technologies Corp., Escast, Inc., Wellman Dynamics Corp., Washington Mfg. Co., Phoenix Aerospace Corp., and American Sintered Technologies, Inc.

3. The Debtors are authorized to make payments under the SB-KERP without further order of the Court.

4. Key Employee claims under the SB-KERP shall be allowed as administrative expense claims pursuant to sections 503(b)(1) and 507(a)(1) of the Bankruptcy Code.

5. This Court shall retain jurisdiction to hear and determine all matters arising from the implementation of this order.

Dated:_________2003

____
The Honorable Joseph J. Farnan, Jr.
United States District Court Judge