

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MINNESOTA

In re:

Sheldahl, Inc.,  
Debtor.

Case No. 02-31674

Chapter 11 Case

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**RESPONSE OF JAMES E. DONAGHY TO STEERING COMMITTEE'S  
SECOND OMNIBUS OBJECTION TO CLAIMS**

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To: The Bankruptcy Court and the parties named in the attached service list.

James E. Donaghy ("Mr. Donaghy"), through his undersigned counsel, submits this Response to the Second Omnibus Objection to Claims, filed by the Steering Committee (the "Committee") on August 31, 2004 (the "Objection").

The Court will hold a hearing on the Objection at 1:30 p.m. on October 20, 2004, in Courtroom No. 228A of the United States Courthouse at 316 North Robert Street, St. Paul, Minnesota.

**A. Summary of Objection**

Among the claims referenced in the Objection are claims numbered 137 and 669, both filed by Mr. Donaghy. Since Claim No. 669 is an amendment of Claim No. 137, insofar as the Objection deals with Mr. Donaghy's claim, only the later filed proof of claim is relevant.

In the body of the Objection, the Committee alleges that the claims identified in Exhibit D to the Objection, including Claim No. 669, are claims as to which "the claimants assert are entitled to priority pursuant to section 507(a)(3)(A) of the Bankruptcy Code, either in whole or in part."<sup>1</sup> The Committee goes on to allege that each of the relevant claims is either "not entitled to priority, either in whole or in part," or is subject to recharacterization or adjustment so as to

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<sup>1</sup> See Objection at ¶19.

comport with the Debtor's schedules.<sup>2</sup> With respect to Mr. Donaghy's claim, the Committee notes that the proof of claim alleges that the amount of the claim is \$801,503, that the claim was scheduled as a non-priority claim in the amount of \$553,176, and that the claim should be allowed in an amount to be determined.<sup>3</sup>

In addition to the general allegation that Mr. Donaghy has improperly asserted that his claim is entitled to priority, the Committee cited additional grounds for objection in the comment section of Exhibit D. In particular, the Committee

objects based upon the adequacy of consideration for the underlying agreement. If and to the extent such claim is allowed, such claim should be subjected to the limitations imposed under section 502(b)(7) of the bankruptcy code. In addition, the Committee also seeks to disallow claim 137 as having been superseded [sic] by claim 669.<sup>4</sup>

Based on the foregoing, the relief sought by the Committee might be summarized as follows: (1) Claim No. 669 should be deemed as having supplanted Claim No. 137; (2) Claim No. 669 should be disallowed, at least to some extent, as the underlying contract was not supported by adequate consideration; (3) To the extent it is allowed, Claim No. 669 should be treated as a general unsecured claim; and (4) The amount of Claim No. 669 should be limited under the Bankruptcy Code Section that deals with the allowable amount of wage claims.

## **B. Response**

Before addressing the errors underlying the Committee's objection to Mr. Donaghy's claim, it might be helpful to outline the central facts established by a filed proof of claim, and to which the Committee does not object. In particular, there is no dispute over the fact that Mr. Donaghy's claim arises out of that certain Supplementary Executive Retirement Plan Agreement, dated March 5, 1996 (the "SERP"), a copy of which was appended to Claim No. 669, and is

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<sup>2</sup> *Id.*

<sup>3</sup> See Objection, Exhibit D at p. 1.

<sup>4</sup> *Id.*

attached hereto as Exhibit A. Instead, the Objection appears to be limited to the character and amount of that claim, and whether the underlying agreement represents an enforceable contract.

At this point, Mr. Donaghy is willing to concede that his claim is not entitled to priority, and contemporaneously with the filing of this Response is filing an amended proof of claim reflecting as much. Since the priority status of the claim is no longer at issue, therefore, the only remaining bases for the objection would seem to be limited to the allegation that: (1) the amount of the claim should be subject to the limitations provided for in Section 502(b)(7); and (2) the SERP does not represent a valid and enforceable contract in that it was not supported by adequate consideration. For the reasons detailed below, neither allegation is supported by the record, and the Committee's objection to Mr. Donaghy's claim should be overruled.

### **1. Claim No. 669 Does Not Relate to Wages**

Section 502(b)(7) of the Bankruptcy Code provides that claims for damages occasioned by the termination of an employment contract will not be allowed to the extent they exceed:

- (A) the compensation provided by such contract, without acceleration, for one year following the earlier of-
  - (i) the date of the filing of the petition; or
  - (ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus
- (B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates[.]

By its plain terms, Section 502(b)(7) only relates to claims arising out of "employment contracts." Since the SERP cannot be characterized as an employment contract, the cited section of the Bankruptcy Code has no bearing on Mr. Donaghy's claim.

For the purposes of Section 502(b)(7), the term "employment contract" should be limited to those agreements that "create[] the employer-employee relationship by its terms."<sup>5</sup> It has never been held to encompass agreements related primarily to the payment of retirement benefits, as

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<sup>5</sup> *In re Johnson*, 117 B.R. 461,466 (Bankr. D. Minn. 1990).

does the SERP. “On its face, section 502(b)(7) does not apply to vested retirement benefits. The statute, by its terms, refers to claims by employees, not by retired workers.”<sup>6</sup>

The SERP clearly purports to be an agreement for the payment of retirement benefits, and even any examination of its terms can only lead to the conclusion that it is not an employment contract. Among the significant provisions to consider in determining the character of the SERP are:

1. Payments under the SERP were not to commence until Mr. Donaghy’s employment was terminated.<sup>7</sup>
2. The specific disclaimer that “[t]he existence of this Agreement does not constitute a guaranty or contract of employment between [Mr. Donaghy] and [Debtor]...”<sup>8</sup>
3. The reference to “that certain employment agreement between [Mr. Donaghy] and [Debtor] dated March 1, 1988.”<sup>9</sup>

In sum, the SERP neither appears to be in the nature of an employment contract nor does it include terms that are typical of employment contracts. The Committee’s reliance on Section 502(b)(7), therefore, is misplaced.

## **2. The SERP is Supported By Adequate Consideration**

With respect to the Committee’s allegation that Mr. Donaghy’s claim should be disallowed as the underlying agreement was not one based on adequate consideration, the Objection is completely lacking in any factual basis for the charge. Without some factual basis on which the Court might be able to find that the consideration referenced in the written agreement is inadequate, this basis for objection should be given short shrift.

Contrary to the Committee’s bare assertion, the SERP was undoubtedly supported by adequate consideration. The fundamental consideration was the continuation of the employment relationship; in exchange for Mr. Donaghy’s agreement to continue working for the Debtor, the

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<sup>6</sup> *In re Prospect Hill Resources, Inc.* 837 F.2d 453, 455 (11th Cir. 1988).

<sup>7</sup> See SERP at ¶2.

<sup>8</sup> See SERP at ¶7.

<sup>9</sup> See SERP at ¶5.



## SUPPLEMENTARY EXECUTIVE RETIREMENT PLAN AGREEMENT

This Agreement, between Sheldahl, Inc., a Minnesota corporation ("Sheldahl"), and James E. Donaghy (the "Executive") is made and entered into this 5<sup>th</sup> day of March 1996.

WHEREAS, the Executive has, and is expected to provide, valuable services to Sheldahl as its Chief Executive Officer; and

WHEREAS, Sheldahl desires to provide the Executive with a meaningful pension benefit upon his termination of employment with Sheldahl, taking into account the benefits to which the Executive is otherwise due from other sources; and

WHEREAS, Sheldahl desires to encourage the Executive to continue his employment with Sheldahl.

THEREFORE, Sheldahl and the Executive hereby agree as follows:

1. Purpose. The purpose of this Agreement is to provide an unfunded deferred compensation benefit for the Executive, who is a member of a select group of management employees of Sheldahl as that term is used in the Employee Retirement Income Security Act of 1974, as amended.

2. Retirement Pension Benefit.

(a) If the Executive's employment with Sheldahl is terminated, whether voluntary or involuntary, (except in the event of Executive's death), he will be paid an annual retirement pension benefit equal to 50% of the average of the annual cash compensation (and excluding all non-cash compensation such as income recognized as a result of the exercise of stock options or the sale of stock so acquired) paid to Executive by Sheldahl for the five (5) calendar years preceding the calendar year which includes Executive's termination date but not less than \$137,500, less the Reduction Amount (defined in Section 3).

(b) If Executive's termination of employment occurs prior to his 65th birthday, he will be paid an annual pension benefit equal to \$137,500, less the Reduction Amount.

3. The Reduction Amount for purposes of this Agreement shall mean an amount which for calculation purposes only equals the sum of (a) the aggregate of twelve (12) monthly payments received by Executive or/and Anne Donaghy under Executive's Dupont Employee Pension Plan or any other deferred compensation plan attributable to contributions by Dupont or its affiliates ("Dupont Plans") and (b) an amount which equals the one year value of a joint and



100% survivor annuity on the lives of Executive and Anne Donaghy which could be purchased with Executive's vested benefits attributable to (i) Company contributions in Company Sponsored Employee Plans and (ii) Executive's \$15,600 automatic deferral (the "Automatic Deferral") to Company Sponsored Employee Plans as required under his Employment Agreement with Sheldahl dated March 1, 1988, calculated, in each case, as of the date of Executive's termination of employment. The following additional rules apply to the calculation of the Reduction Amount:

(a) The monthly payments under the Dupont Plans shall be \$4,583 (\$55,000 annually) during Executive's life and \$1,833 (\$22,000 annually) upon his death.

(b) The annuity valuation shall be based upon Executive's and Anne Donaghy's ages as of Executive's termination date, provided, however, that if Anne Donaghy is not surviving on such termination date, the annuity shall be a single life annuity on the life of Executive.

(c) "Company Sponsored Employee Plans" shall include all qualified and non-qualified employee pension benefit plans, as defined in Section 3(2)(A) of the Employee Retirement Security Act of 1974.

(d) For purposes of Section 3(b)(i), "Company contributions" shall not include any salary reduction or deferred compensation amounts elected by Executive or other contributions made by Executive.

Nothing herein shall affect Executive's right to receive any amounts included in the Reduction Amount nor any elections made with respect to the receipt or deferral of such amounts.

4. Payment of Retirement Pension Benefits. Retirement pension benefits payable to Executive under Section 2(a) or 2(b) above shall continue for Executive's life and, after his death, if he is survived by his spouse, Anne Donaghy, shall continue to be paid to her for the duration of her life. All payments under this Agreement shall cease as of the date of the death of the survivor of Executive and Anne Donaghy. The annual pension benefits payable to Executive in any calendar year pursuant to Section 2(a) or 2(b) above shall be paid to Executive or to Anne Donaghy in twelve (12) equal monthly installments, commencing the first day of the calendar month following the date of Executive's termination of employment.

5. Forfeiture of Benefits. Notwithstanding anything herein to the contrary, no retirement pension benefits shall be payable to the Executive or his spouse or beneficiaries under this Agreement if Executive's employment is terminated for Cause, as defined in that certain employment agreement between Executive and Sheldahl dated March 1, 1988.

6. Assignment of Benefits. Neither the Executive, nor his spouse may assign or alienate benefits payable under this Agreement, whether voluntary or involuntary, or directly or indirectly, except that the Executive may assign the retirement pension benefits payable under this

Agreement to a trust or similar investment entity provided such trust or entity was established by the Executive and the sole beneficiaries thereunder during the Executive's lifetime are limited to the Executive and/or his immediate family (as defined in Code Section 267).

7. No Guaranty of Employment. The existence of this Agreement does not constitute a guaranty or contract of employment between the Executive and Sheldahl and nothing in this Agreement shall modify or amend any employment agreement between the Executive and Sheldahl or to otherwise restrict or interfere with the right of Sheldahl to terminate the employment of Executive or the right of Executive to terminate his employment with Sheldahl in accordance with the terms of any employment agreement then in existence, or, in the absence of any such employment agreement, at any time at its or his will.

8. Funding of Payments. In order to assure the performance by Sheldahl or its successor of its obligations under this Agreement, Sheldahl may deposit in trust an amount equal to the maximum payment that will be due Executive under the terms hereof. Under a written trust instrument, the Trustee shall be instructed to pay to Executive (or to Anne Donaghy, as the case may be) the amount to which Executive shall be entitled under the terms hereof, and the balance, if any, of the trust not so paid or reserved for payment shall be repaid to Sheldahl. If and to the extent there are not amounts in trust sufficient to pay Executive or Anne Donaghy under this Agreement, Sheldahl shall remain liable for any and all payments due to Executive or to Anne Donaghy. In accordance with the terms of such trust, at all times during the term of this Agreement Executive and Anne Donaghy shall have no rights, other than as unsecured general creditors of Sheldahl to any amounts held in trust and all trust assets shall be general assets of Sheldahl and subject to the claims of creditors of Sheldahl.

9. Restrictions on Competition. So long as payments are being made to Executive under this Agreement, Executive shall not, without the prior written consent of Sheldahl, accept employment or render service to any person, firm or corporation directly or indirectly in competition with Sheldahl or affiliate thereof, in the United States or any of its territories or possessions, or directly or indirectly enter into or in any manner take part in or lend his name, counsel or assistance to any venture, enterprise, business or endeavor, either as proprietor, principal, investor, partner, director, officer, employee, consultant, advisor, agent, independent contractor, or in any other capacity whatsoever for any purpose which would be competitive with the business of Sheldahl or any affiliate thereof, or any of their respective successors, provided, however, that the foregoing shall not be deemed to prohibit Executive from acquiring an equity interest not in excess of 5% in any company, the shares of which are listed on any national stock exchange or are traded and quoted on the National Association of Securities Dealers Automated Quotations System.

10. Title to Certain Tangible Property. All tangible materials (whether original or duplicate) including, but not in any way limited to, equipment purchase agreements, file or data base materials in whatever form, books, manuals, sales literature, equipment price lists, training materials, customer lists and records, customer files, correspondence, documents, contracts,

orders, messages, memoranda, notes, agreements, invoices, receipts, lists, software listings or printouts, specifications, models, computer programs, and records of any kind in the possession or control of Executive which in any way relate or pertain to Sheldahl's business, including the business of the subsidiaries or affiliates of Sheldahl, whether furnished to Executive by Sheldahl or prepared, compiled or required by Executive during his employment with Sheldahl, shall be the sole property of Sheldahl. At any time upon request of Sheldahl, Executive shall deliver all such materials to Sheldahl.

11. Trade Secrets and Confidential Information. Executive will not, without the express written consent of Sheldahl directly or indirectly communicate or divulge to, or use for his own benefit or the benefit of any other person, firm, association or corporation, any of Sheldahl's or its subsidiaries' or affiliates' trade secrets, proprietary data or other confidential information including, by way of illustration, the information described in Section 10, which trade secrets, proprietary data and other confidential information were communicated to or otherwise learned or acquired by Executive in the course of his employment with Sheldahl, except that Executive may disclose such matters to the extent that disclosure is required (a) in the course of his employment with Sheldahl or (b) by a court or other governmental agency of competent jurisdiction. As long as such matters remain trade secrets, proprietary data or other confidential information, Executive will not use such trade secrets, proprietary data or other confidential information in any way or in any capacity other than to further Sheldahl's interests.

12. The Complete Agreement. This Agreement represents the complete Agreement between Sheldahl and Executive concerning the subject matter hereof and supersedes all prior agreements or understandings, written or oral. No attempted modification or waiver of any of the provisions hereof shall be binding on either party unless in writing and signed by both Executive and Sheldahl.

13. Notices. Any notice required or permitted to be given hereunder shall be in writing and shall be effective three business days after it is properly sent by registered or certified mail, if to Sheldahl to President, Sheldahl, Inc., 1150 Sheldahl Road, Northfield, Minnesota 55057, or if to Executive at his residence address, or to such other address as either party may from time to time designate by notice.

14. Assignability. This Agreement may not be assigned by either party without the prior written consent of the other party, except that no consent is necessary for Sheldahl to assign this Agreement to a corporation succeeding to substantially all the assets or business of Sheldahl whether by merger, consolidation, acquisition or otherwise, so long as such successor corporation expressly assumes all of the obligations of Sheldahl under this Agreement. This Agreement shall be binding upon Executive, his heirs and permitted assigns and Sheldahl, its successors and permitted assigns.

15. Applicable Law. It is the intention of the parties hereto that all questions with respect to the construction and performance of this Agreement and the rights and liabilities of the parties hereto shall be determined in accordance with the laws of the State of Minnesota.

SHELDAHL, INC.

By James S. Womack  
James S. Womack, Chairman of the Board

James E. Donaghy  
James E. Donaghy

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MINNESOTA

In re:

Sheldahl, Inc.,

Debtor.

BKY 02-31674

PROOF OF SERVICE

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The undersigned states that she is an employee of Henson & Efron, P.A., and in the course of said employment, on the date indicated below, she served the following:

**Response of James E. Donaghy to Steering Committee's Second Omnibus Objection to Claims; and Proof of Service**

on the entities named below and/or on the attached service by enclosing true and correct copies of same in an envelope, properly addressed and postage prepaid, and depositing same in the United States mail, unless otherwise noted; and that she certifies the foregoing under penalty of perjury.

United States Trustee  
300 South Fourth Street  
1015 U.S. Courthouse  
Minneapolis, MN 55415

Lorie Klein  
Moss & Barnett  
90 S Seventh St, Ste 4800  
Minneapolis, MN 55402-4129

Sheldahl, Inc.  
1150 Sheldahl Road  
Northfield, MN 55057

James L. Baillie  
Fredrikson & Byron  
200 South Sixth St, Ste 4000  
Minneapolis, MN 55402

Dated: September 21, 2004

/e/ Tawney Jameson