UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

In re: **PATRIOT COAL CORPORATION, *et al.*,** **Debtors.**	**Chapter 11** **Case No. 12-51502-659** **(Jointly Administered)** **Objection Deadline:** **February 19, 2013 at 4:00 p.m.** **(prevailing Eastern Time)** **Hearing Date (if necessary):** **February 26, 2013 at 10:00 a.m.** **(prevailing Central Time)** **Hearing Location:** **Courtroom 7 North**

DEBTORS' MOTION FOR AUTHORITY TO IMPLEMENT COMPENSATION PLANS

TABLE OF CONTENTS

PAGE

Relief Requested 1

Background and Jurisdiction 1

Introduction 2

The Proposed Compensation Plans 6

A. Current Compensation and Retention Status 6

B. Development of the Proposed Compensation Plans 9

C. Description of the 2013 AIP 10

a. Eligibility 10

b. Terms 11

D. Description of the CERP 14

a. Eligibility 14

b. Terms 15

Basis for the Relief Requested 16

A. The Proposed Compensation Plans Constitute Ordinary Course Transactions Under Section 363(c)(1) of the Bankruptcy Code and Do Not Require Court Approval 16

B. Alternatively, the Proposed Compensation Plans Should be Approved under Sections 363(b)(1) and 503(c)(3) as in the Best Interest of the Debtors and their Estates and Creditors 20

1. The 2013 AIP is in the Best Interests of the Debtors' Estates 24

2. The CERP is in the Best Interests of the Debtors' Estates 26

C. The Court Has Inherent Authority under Section 105 to Approve the Proposed Compensation Plans 27

Request for Waiver of Stay 28

Notice 29

No Previous Request 29

TABLE OF AUTHORITIES

PAGE

CASES

Bird v. Crown Convenience (*In re NWFX, Inc.*),
864 F.2d 588 (8th Cir. 1988) 28

Carlson v. United States (*In re Carlson*),
126 F.3d 915 (7th Cir. 1997) 27

Habinger, Inc. v. Metro. Cosmetic & Reconstructive Surgical Clinic, P.A.,
124 B.R. 784 (Bankr. D. Minn. 1990) 17

In re AMR Corp.,
Case No. 11-15463 (SHL) (Bankr. SDNY November 29, 2011) 20

In re BMC Indus., Inc.,
Case No. 04-43515 (RJK) (Bankr. D. Minn. July 12, 2004) 24

In re Borders Grp., Inc.,
453 B.R. 459 (Bankr. S.D.N.Y. 2011) 21

In re Borders Grp., Inc.,
Case No. 11-10614 (MG) (Bankr. S.D.N.Y. Apr. 22, 2011) 24

In re Buffets Restaurants Holdings, Inc.,
Case No. 12-10237 (MFW) (Bankr. D. Del. Mar. 15, 2012) 24

In re Channel One Comm.,
117 B.R 493 (Bankr. EDMO 1990) 22

In re Chinichian,
784 F.2d 1440 (9th Cir. 1986) 28

In re Continental Air Lines, Inc.,
780 F.2d 1223 (5th Cir. 1986) 21, 22

In re Dana Corp.,
358 B.R. 567 (Bankr. S.D.N.Y. 2006) 19, 21

In re Delphi Corp.,
Case No. 05-44481 (RDD) (Bankr. S.D.N.Y. Sept. 27, 2007) 19

In re Falcon Prods, Inc.,
Case No. 05-41108-399 (BSS) (Bankr. E.D. Mo. June 2, 2005) 23, 28

In re Farmland Indus. Inc.,
294 B.R. 855 (Bankr. W.D. Mo. 2003) 23

In re Food Barn Stores, Inc.,
107 F.3d 558 (8th Cir. 1997) 21

In re Frontier Airlines Holdings, Inc.,
Case No. 08-11298 (RDD) (Bankr. S.D.N.Y. Apr. 14, 2008) 20

In re Global Home Prods.,
369 B.R. 778 (Bankr. D. Del. 2007) 19, 21

In re Hanson Indus., Inc.,
90 B.R. 405 (Bankr. D. Minn. 1988) 18

In re Husting Land & Dev., Inc.,
255 B.R. 772 (Bankr. D. Utah 2000), *aff'd*, 274 B.R. 906 (D. Utah 2002) 17

In re Interstate Bakeries Corp.,
Case No. 04-45814 (JWV) (Bankr. W.D. Mo. Feb. 17, 2005) 23, 28

In re Iridium Operating LLC,
478 F.3d 452 (2d Cir. 2007) 22

In re James A. Phillips, Inc.,
29 B.R. 391 (Bankr. S.D.N.Y. 1983) 18

In re Lightsquared Inc.,
Case No. 12-12080 (SCC) (Bankr. S.D.N.Y. Oct. 23, 2012) 23

In re Mesa Air Grp.,
No. 10-10018, 2010 WL 3810899 (Bankr. S.D.N.Y. Sept. 24, 2010) 19, 22

In re Nellson Nutraceutical,
369 B.R. 787 (Bankr. D. Del. 2007) 19

In re Nobex,
2006 Bankr. LEXIS 417, Case No. 05-20050 (MFW)
(Bankr. D. Del. Jan. 19, 2006) 22

In re Nortel Networks Inc.,
Case No. 09-10138 (KG) (Bankr. D. Del. Mar. 5, 2009) 24

In re Northwest Airlines Corp.,
Case No. 05-17930 (ALG) (Bankr. S.D.N.Y. Sept. 15, 2005) 20

In re Pinnacle Airlines Corp.,
Case No. 12-11343 (REG) (Bankr. S.D.N.Y. May 11, 2012) 20

In re Residential Capital,
Case No. 12-12020 (MG) (Bankr. S.D.N.Y. Oct. 18, 2012) 24

In re The Great Atlantic & Pacific Tea Co.,
No. 10-24549 (RDD) (Bankr. S.D.N.Y. May 2, 2011) 24

In re Trilogy,
Case No. 09-42219, 2010 Bankr. LEXIS 5636 (Bankr. W.D. Mo. Aug. 31, 2010)..... 22

In re US Fidelis, Inc.,
Case No. 10-41902-705 (CER) (Bankr. E.D. Mo. June 16, 2010) 24

In re Velo Holdings, Inc.,
Case No. 12-11384 (MG) (Bankr. S.D.N.Y. June 6, 2012) 21, 24

In re Viking Offshore,
Case No. 08-312-H3-11 (LZC),
2008 Bankr. LEXIS 1360 (Bankr. S.D. Tex. April 30, 2008) 21

Marshack v. Orange Comm. Credit (*In re Nat'l Lumber & Supply, Inc.*),
184 B.R. 74 (B.A.P. 9th Cir. 1995) 18

Peltz v. Gulfcoast Workstation Group (*In re Bridge Info. Sys., Inc.*),
293 B.R. 479 (Bankr. E.D. Mo. 2003)... 17

Richmond Leasing Co. v. Capital Bank, N.A.,
762 F.2d 1303 (5th Cir. 1985) 23

Shields v. Cumberland Surety Ins. Co. (*In re Am. Coal Corp.*),
1996 Bankr. LEXIS 2013 (Bankr. D. Minn. Oct. 7, 1996).. 17

Steinberg v. Esposito,
33 B.R. 812 (Bankr. N.D. Ill. 1983) 28

Streetman v. US (*In re Russell*),
154 B.R. 187 (W.D. Ark. 1995).. 17

United States ex rel. Harrison v. Estate of Deutscher,
115 B.R. 592 (Bankr. M.D. Tenn. 1990) 17, 18

Walter v. Bank (*In re Walter*),
83 B.R. 14 (B.A.P. 9th Cir. 1988) 22

STATUTES & RULES

11 U.S.C. § 363(c)(1).................... 16

28 U.S.C. § 157(b)(2) 2

28 U.S.C. § 1334.................... 2

28 U.S.C. § 1408.................... 2

28 U.S.C. § 1409.................... 2

Bankruptcy Rule 6004(h).................... 29

Fed. R. Bankr. P. 1015(b) 2

Section 105(a) of the Bankruptcy Code.................... 1, 27

Section 363 of the Bankruptcy Code 1, 16, 17, 20, 21,22

Section 363(b) of the Bankruptcy Code.................... 20, 22

Section 363(b)(1) of the Bankruptcy Code.................... 20

Section 363(c) of the Bankruptcy Code.................... 16, 17

Section 363(c)(1) of the Bankruptcy Code 16

Section 501(c)(1) of the Bankruptcy Code 21

Section 501(c)(2) of the Bankruptcy Code 21

Section 503 of the Bankruptcy Code 1, 20, 21, 22

Section 503(c)(3) of the Bankruptcy Code 20, 21, 22

Section 1107(a) of the Bankruptcy Code.................... 1, 16

Section 1108 of the Bankruptcy Code 1, 16

Patriot Coal Corporation and its subsidiaries that are debtors and debtors in possession in these proceedings (collectively, "**Patriot**" or the "**Debtors**") respectfully represent:

Relief Requested

1. By this motion (the "**Motion**"), the Debtors seek entry of an order (the "**Proposed Order**"),[1] pursuant to sections 105(a), 363 and 503 of title 11 of the United States Code (the "**Bankruptcy Code**"), (a) approving and authorizing a chapter 11 incentive plan (the "**2013 AIP**") and a critical employee retention plan (the "**CERP**" and, together with the 2013 AIP, the "**Proposed Compensation Plans**"), (b) authorizing the Debtors to make payments under the Proposed Compensation Plans, to the extent earned, to the participants in such plans (the "**Proposed Plan Participants**"), and (c) granting certain related relief.

Background and Jurisdiction

2. On July 9, 2012 (the "**Petition Date**"), each Debtor commenced with the United States Bankruptcy Court for the Southern District of New York (the "**SDNY Bankruptcy Court**") a voluntary case under chapter 11 of Bankruptcy Code. On December 19, 2012, the SDNY Bankruptcy Court entered an order transferring these chapter 11 cases to this Court (the "**Transfer Order**")] [ECF No. 1789].[2] The Debtors are authorized to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

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[1] The Proposed Order granting the relief requested in this Motion will be provided to the Core Parties (as defined below). A copy of the Proposed Order will be available at *www.patriotcaseinfo.com/orders.php*.

[2] Pursuant to the Transfer Order, all orders previously entered in these chapter 11 cases remain in full force and effect in accordance with their terms notwithstanding the transfer of venue.

These chapter 11 cases are being jointly administered pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure and the SDNY Bankruptcy Court's Joint Administration Order entered on July 10, 2012 [ECF No. 30].

3. Additional information about the Debtors' businesses and the events leading up to the Petition Date can be found in the Declaration of Mark N. Schroeder pursuant to Local Bankruptcy Rule 1007-2 of the SDNY Bankruptcy Court, filed on July 9, 2012 [ECF No. 4], which is incorporated herein by reference.

4. This Court has subject matter jurisdiction to consider and determine this matter pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

Introduction

5. Tangible progress has been made in these cases to date. Much work remains, however, and this will demand extraordinary amounts of time, dedication and patience from the Debtors' employees. The efforts of the Proposed Plan Participants (as defined below), in particular, will be a critical factor in the next few months of these chapter 11 cases. Notwithstanding the extraordinary effort that will be required, the Proposed Plan Participants have suffered a significant reduction in compensation. Prior to the filings, a material percentage of the Proposed Plan Participants' compensation was in the form of annual incentive and retention programs, but at present they are only being compensated through base salary. (*See* Declaration of Bennett K. Hatfield, dated February 12, 2013, attached hereto as Exhibit A ("**Hatfield Decl.**") ¶¶ 8-10.) Furthermore, long-term equity incentive opportunities are no longer

available. Indeed, some employees used personal cash savings to pay taxes on equity awards that vested prior to the filing of these chapter 11 cases, resulting in significant personal losses. (Hatfield Decl. ¶ 10.) For employees who have been with Patriot over the past three years, the loss of these incentive and retention opportunities has resulted in a 20% decrease in average compensation from 2010-2011 to 2012-2013.[3] (Hatfield Decl. ¶ 10.) Additional cuts in benefits announced by the Debtors stand to exacerbate this decline.

6. Although compensation and long-term incentive prospects have diminished, it is now more important than ever for the Proposed Plan Participants both to remain in their positions and to perform their responsibilities at the highest level possible under increasingly difficult circumstances. Anything less would be critically damaging to the Debtors' restructuring. The Debtors fully appreciate that in these difficult and trying financial times, all stakeholders will need to make sacrifices, and the Proposed Plan Participants are no exception. As set forth below, in addition to the fiscal year 2012 incentive compensation that will not be paid, the Proposed Compensation Plans, if approved, would on average still compensate Proposed Plan Participants at well-below market levels and, for those participants that have been with Patriot since 2010, at levels below their actual historical compensation for 2010 and 2011.

7. With all of these considerations in mind, the Debtors' management team, with oversight from the compensation committee of the Debtors' board of

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[3] As adjusted for increased annual health care premiums and an announced across the board reduction in salaries of 2.5%, effective March 1, 2013. (*See* Hatfield Decl. ¶ 9.)

directors, undertook a comprehensive analysis of the Debtors' current compensation programs. The Debtors received input and guidance from Towers Watson ("**Towers**"), their independent compensation advisor, and the Debtors' restructuring professionals. The analysis was telling. In short, a great majority of the Proposed Plan Participants are working for significantly below-market pay despite the longer hours, stressful conditions, and reduced job certainty resulting from these chapter 11 cases.[4] As fiduciaries, the Debtors cannot jeopardize enterprise value or their reorganization by allowing the erosion of employee confidence and morale to continue. Moreover, the loss of a handful of key employees – already a painful reality – could quickly cascade into broad-based departures across the Debtors' businesses, unraveling their restructuring from the inside. Put simply, maintaining the compensation status quo would pose a severe risk to a successful reorganization and is therefore not a viable option. (Hatfield Decl. ¶ 11.)

8. Instead, in consultation with their advisors, the Debtors have elected to establish the Proposed Compensation Plans in order to motivate and encourage the retention of critical employees during this uncertain period and to focus their attention on achieving important business objectives. The Proposed Compensation Plans are largely a continuation in structure of the Debtors' prepetition incentive and retention practices, but have been substantially reduced in cost and tailored to reflect the business realities of the restructuring process. The maximum aggregate cost of <u>both</u> Proposed Compensation Plans is lower than the cost of a single year of the Debtors'

[4] Based on sample of the 151 (out of an aggregate of 288) Proposed Plan Participants for whom benchmarking data was available. (Declaration of Nick Bubnovich, dated February 12, 2013, attached hereto as Exhibit B ("**Bubnovich Decl.**") ¶¶ 17-18.)

prepetition annual incentive program alone.[5] Moreover, in an important act of leadership, the six members of the Debtors' executive management team have voluntarily asked to be – and are – excluded from participation in the Proposed Compensation Plans.

9. Importantly, the Debtors have consulted with the official committee of unsecured creditors (the "**Creditors' Committee**"), whose professionals reviewed drafts of the Proposed Compensation Plans, reviewed the Debtor's rationales and analyses, and offered numerous comments and modifications. The Debtors have attempted to accommodate the Creditors' Committee's reactions, reshaping earlier forms of the plans into what is now presented to the Court. As a result of this process, the Creditors' Committee supports the approval of the Proposed Compensation Plans as a reasonable exercise of the Debtors' business judgment. (Hatfield Decl. ¶ 23.)

10. Retaining and motivating the Proposed Plan Participants is in the best interests of all stakeholders, and is essential to a successful reorganization that maximizes estate value. Moreover, the Proposed Compensation Plans come at a modest cost that is far outweighed by the ongoing contributions these employees provide and the damage to an enterprise caused by critical employee departures. (Hatfield Decl. ¶ 38.) The Proposed Compensation Plans, developed through a deliberate process and designed to achieve carefully-defined and rigorous performance targets, reflect a sound exercise of the Debtors' business judgment and should be approved.

[5] Based on actual incentive compensation payments in 2010 and 2011. (Hatfield Decl. ¶ 22 fn 4.)

The Proposed Compensation Plans

A. Current Compensation and Retention Status

11. Historically, the Proposed Plan Participants were compensated through salaries, cash incentives, and equity awards. The Debtors' prepetition incentive and retention programs, and the current status of those programs, are summarized as follows:

- Long Term Equity Incentive Plan (the "**LTIP**"): The LTIP was an equity incentive plan under which participants were eligible to receive equity-based awards (e.g., restricted or deferred stock units and stock options), the value of which was tied to the price of a share of Patriot common stock. *LTIP participants have lost millions of dollars in previous equity grants that, as of a result of the Debtors' bankruptcy, are valueless. Further, the Debtors have discontinued the LTIP such that (i) no additional awards will be granted and (ii) only time-vested restricted stock awards (which are of de minimis value) will be delivered upon the scheduled vesting, distribution, or exercise dates of outstanding awards.*

- Annual Incentive Plan (the "**Prepetition AIP**"): The Prepetition AIP was an annual cash incentive plan developed to motivate participants to achieve specified performance objectives. Participants were eligible to receive annual cash bonuses under the plan, if earned, in target amounts ranging from 5% to 60%, and maximum amounts ranging from 7.5% to 90%, of their base salaries. The Prepetition AIP was in effect, with minor modifications from year to year, since 2008. *No incentive payments were paid pursuant to the 2012 Prepetition AIP, despite the fact that participants earned approximately $3 million under the 2012 program.*

- Retention Programs (the "**Prepetition Retention Programs**"): The Debtors maintained two separate Prepetition Retention Programs. An initial retention program was adopted in 2009 to retain personnel essential to productivity and profitability at individual mines. A second retention program was adopted in June 2012 to target additional employees with critical skills. Participants in the Prepetition Retention Programs were eligible to receive cash retention payments in amounts ranging from 15% to 60% of their base salaries, subject to their continued employment through specified dates. *No retention payments payable after the Petition Date have been paid.* (Hatfield Decl. ¶ 8.)

12. In addition to decreased cash and equity-based compensation resulting from post-filing suspension of incentive and retention plans, the Proposed Plan Participants have faced a reduction in benefits, including the loss of significant retirement savings invested in Patriot stock through Patriot's 401(k) and employee stock purchase plans and personal accounts and an average approximately $3,000 annual increase in out-of-pocket healthcare costs. (Hatfield Decl. ¶ 9.) The Proposed Plan Participants will continue to experience compensation reductions as a result of an announced 2.5% across-the-board salary cut, effective March 1, 2013, and reduced hourly wage rates for certain non-union job classifications as well as additional rollbacks in benefit programs. (Hatfield Decl. ¶ 9.) For example, the Debtors have announced that they will seek several benefit reductions for non-union salaried employees, including terminating eight traditional retiree health plans, eliminating the Medical Premium Reimbursement Program, and eliminating life insurance coverage for active employees upon retirement. (Hatfield Decl. ¶ 10.)

13. At the same time, the Proposed Plan Participants have been required to undertake significant efforts to stabilize operations and lay the necessary groundwork for a successful reorganization. As set forth in greater detail in the declaration of Mr. Hatfield, many of these employees have worked tirelessly to achieve this result, including in many instances shouldering responsibilities that are "above and beyond" their historical day-to-day duties as a result of a shrinking workforce and the addition of various bankruptcy-related tasks.[6] (*See* Hatfield Decl. ¶¶ 12-16.)

[6] Due to accelerating attrition related to the Debtors' financial distress, corporate headcount has decreased 11% since 2011. (Hatfield Decl. ¶ 14.)

14. Thus, it is not surprising that, since the Petition Date, the Debtors have lost over 25 key employees through voluntary departures, including the Vice President of Kentucky Operations, the Vice President Controller, the Vice President of Human Resources, the Vice President of Sales, and the Vice President of Financial Planning & Analysis. (Hatfield Decl. ¶ 14.) Patriot is currently experiencing historically unprecedented levels of attrition among corporate employees. (Hatfield Decl. ¶ 14.) Many departing employees, including mine foremen, managers, engineers, accountants, and attorneys, have expressly cited the lack of stability at Patriot as a reason for their resignations, often accepting lower paying positions at companies in less convenient locations in exchange for greater job security. (Hatfield Decl. ¶ 15.) A number of these critical employees explained that the lack of retention or incentive compensation at Patriot was an important factor in their decision to leave the company. (Hatfield Decl. ¶ 15.)

15. Maximizing value for the Debtors' estates will largely depend on Patriot's ability to minimize the loss of additional critical people. (Hatfield Decl. ¶ 17.) Indeed, the further loss of critical employees could mean the difference between a mine operating profitably or incurring substantial financial losses or facing safety issues. (Hatfield Decl. ¶ 17.) Most, if not all, of the Proposed Plan Participants have remained with the Debtors during these challenging times with the expectation that the dramatic reduction in compensation they experienced in 2012 would be mitigated going forward by the implementation of chapter 11 incentive and retention plans. (Hatfield Decl. ¶ 17.) Indeed, without the Proposed Compensation Plans, the Debtors are at risk of losing an unacceptable number of the Proposed Plan Participants to

competing employers able to offer market compensation and/or job security that a company in chapter 11 cannot match. Moreover, even as to the employees who would decide to stay, the demoralizing effect of working more for less, and the impact that would have on overall operating results, cannot be overstated. (*See* Hatfield Decl. ¶¶ 16-18.)

B. <u>Development of the Proposed Compensation Plans</u>

16. In an effort to maximize estate value by stemming further attrition, the Debtors and their advisors carefully considered compensation programs that would effectively incentivize non-insider employees in a manner tailored to the Debtors' changed circumstances as well as market practice. (Hatfield Decl. ¶¶ 19-22.) Various iterations of the programs were discussed at several meetings of the Compensation Committee, which were attended by the CEO, the Senior Vice President of Law and Administration, the Vice President of Human Resources, and other members of management. (Hatfield Decl. ¶ 19.)

17. A benchmarking analysis performed by Towers demonstrated that the current compensation for most Proposed Plan Participants is materially below the market median for their positions. (Bubnovich Decl. ¶¶ 18, 27.) The Debtors, in consultation with Towers, designed the 2013 AIP to compensate key employees at levels more commensurate with (though most often still below) the market. (*See* Bubnovich Decl. ¶¶ 18, 27.) The 2013 AIP is structured to (a) motivate eligible employees (the "**2013 AIP Participants**") to achieve critical financial and operating goals key to achieving the Debtors' business plan that would benefit all stakeholders and position the post-emergence company for long-term viability, and (b) be as

consistent as possible with market practice and the Debtors' prepetition compensation program (albeit materially lower). (Hatfield Decl. ¶¶ 18, 20, 25-26.)

18. Similarly, the Debtors modeled the CERP to (a) retain critical employees essential to the Debtors' ability to meet business objectives that would allow for a successful emergence from chapter 11; (b) achieve an appropriate balance of retaining employees critical to the reorganization efforts while protecting creditor interests; and (c) be consistent with market practice. To encourage eligible employees (the "**CERP Participants**") to remain with the Debtors during this challenging and uncertain period, the timing of CERP payouts is aligned with the anticipated progress of the restructuring process. (Hatfield Decl. ¶¶ 21, 36.)

19. The Proposed Compensation Plans were not drafted in a vacuum, but rather are the result of a lengthy, iterative process among the Debtors, their advisors, the Compensation Committee, and the Creditors' Committee professionals over the course of several months. Following a series of meetings and constructive discussions resulting in various modifications, the Creditors' Committee supports approval of the Proposed Compensation Plans as an exercise of the Debtors' reasonable business judgment. (Hatfield Decl. ¶¶ 23-24.)

C. Description of the 2013 AIP

a. Eligibility

20. The 2013 AIP continues, on a modified and substantially reduced basis, the Debtors' Prepetition AIP for approximately 225 employees who are best positioned to help maximize the Debtors' financial and operational performance for the benefit of all stakeholders. (Hatfield Decl. ¶ 25.) The 2013 AIP Participants comprise

approximately 5% of the Debtors' workforce, including critical salaried employees in operations management, finance, human resources, legal, engineering, and sales. (Hatfield Decl. ¶ 25.) The 2013 AIP Participants are the same employees who would have been eligible to participate in the Debtors' Prepetition AIP with a notable exception – the Debtors' top six executives participated in the Prepetition AIP, but have voluntarily withdrawn themselves from consideration for participation in the Proposed Compensation Plans. (Hatfield Decl. ¶ 25; Bubnovich Decl. ¶ 9.)

b. <u>Terms</u>

21. The 2013 AIP is based on the Debtors' long-standing Prepetition AIP but has been reduced in cost and modified to focus the 2013 AIP Participants on performance targets that are critical to a successful reorganization. (Hatfield Decl. ¶ 26, Bubnovich Decl. ¶¶ 9-11.) The Debtors relied on Towers' expertise in setting compensation opportunities at or below market levels. (Hatfield Decl. ¶ 26.) Towers undertook: (a) a thorough benchmarking survey to measure existing compensation levels for 2013 AIP participants against compensation opportunities available for similarly-situated employees at other companies, and (b) a review of incentive programs approved in comparable chapter 11 cases. (Bubnovich Decl. ¶¶ 15, 17.) As set forth more fully in the declaration of Mr. Bubnovich, Towers determined that the Debtors' peer firms routinely offer incentive-based cash bonuses to employees holding responsibilities comparable to the 2013 AIP Participants. (Bubnovich Decl. ¶ 18.) In addition, Towers determined that the 2013 AIP Participants, who currently receive base salary only, would be significantly undercompensated absent some form of incentive-based compensation. (Bubnovich Decl. ¶ 18.) Indeed, even if the Proposed

Compensation Plans are implemented, nearly all 2013 AIP Participants for whom benchmarking data was available would continue to be compensated at below-market rates. (Bubnovich Decl. ¶ 18; Hatfield Decl. ¶ 26.)

22. The 2013 AIP consists of two six-month performance periods (January 1, 2013 to June 30, 2013 and July 1, 2013 to December 31, 2013) The cost for each six-month period would total at most $875,000 for all 225 participants, and would be paid 30 to 60 days following the end of each performance period. The average cost per 2013 AIP Participant would be only $7,526. These proposed award levels are very low when compared with compensation opportunities available to similarly-situated employees in the marketplace. (Bubnovich Decl. ¶¶ 14-18; Hatfield Decl. ¶¶ 26-27.)

23. The two most significant performance metrics under the 2013 AIP are liquidity and a modified measure of EBITDA[7] (adjusted to add back retiree health care and multi-employer pension plan cash spending, referred to as "EBITDAP"). This modification to EBITDA was made in order to maintain a balanced focus on decision – making with regard to the Debtors' 1113/1114 process. Payouts on account of these metrics require meeting the liquidity and EBITDAP objectives in the Debtors' five-year business plan, with each one weighted at 30% in calculating total incentive compensation. The EBITDAP and liquidity metrics are net of 2013 AIP costs and are particularly aggressive in light of the ongoing depression in the coal markets. (Hatfield Decl. ¶ 28; Bubnovich Decl. ¶¶ 10-11.)

24. Three additional objective metrics under the 2013 AIP include (a) safety incidence rate, (b) environmental incidence rate, and (c) Mine Safety and Health

[7] As defined in the DIP credit agreements.

Administration ("**MSHA**") compliance rate, with each such metric weighted at 5% in determining total incentive compensation. As with the financial metrics, payouts on account of these environmental and safety metrics require achieving the corresponding targets in the Debtors' five-year plan, which are critical to the Debtors' operational success. (Hatfield Decl. ¶ 29; Bubnovich Decl. ¶¶ 10-11.)

25. The remaining 25% of incentive compensation opportunities under the 2013 AIP is based on the attainment of qualitative individual objectives pertaining to strategic areas important to the Debtors' businesses. This metric is weighted less heavily than under the Prepetition AIP to reflect the Debtors' business judgment that objective financial and operational metrics are of comparatively greater significance during restructuring. (Hatfield Decl. ¶ 30; Bubnovich Decl. ¶ 10.)

26. The amounts payable under the 2013 AIP generally range from 1.25% to 15% of the participant's annual base salary.[8] Compensation under the 2013 AIP would be capped at the threshold payouts for meeting the objectives in the Debtors' five-year plan – a significant departure from the prepetition practice of awarding incentive compensation in amounts of up to 300% of threshold for exceeding business plan objectives. For most of the seventy 2013 AIP Participants who are also CERP Participants, compensation opportunities under the 2013 AIP would be 83% less than their maximum prepetition incentive opportunities. For most other 2013 AIP Participants, the amounts payable would be 67% less than their maximum prepetition opportunities. (Hatfield Decl. ¶ 31; Bubnovich Decl. ¶¶ 12-13.)

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[8] One recent hire has been added to the 2013 AIP with a potential incentive compensation of 20% of base salary. (Bubnovich Decl. ¶ 12 fn 2.)

27. The following table provides additional information on the performance metrics under the 2013 AIP:

Performance Metrics and Goals **Proposed 2013 AIP**				
Performance Area	**Metric**	**Weight**	**January – June 2013 Threshold**	**July – December 2013 Threshold**
Financial	EBITDAP (as defined in the DIP credit agreements, with EBITDAP adding back retiree health care and multi-employer pension plan cash spending) under five-year plan	30%	$75.1M	$72.4M
	Liquidity (as defined in the DIP credit agreements) under five-year plan	30%	$205.8M	$100.6M
Safety	Debtors' overall safety incidence rate	5%	3.27	3.27
MSHA Compliance	Debtors' overall MSHA incidence compliance rate	5%	0.95	0.95
Environmental	Debtors' overall environmental incidence rate under the Surface Mining Control and Reclamation Act	5%	0.0092	0.0092
Individual	3 - 5 specific qualitative goals per individual, aligned with key strategic areas of importance to the Debtor	25%	TBD	TBD

(Hatfield Decl. ¶ 32.)

D. <u>Description of the CERP</u>

a. <u>Eligibility</u>

28. The Debtors seek approval of the CERP for approximately 119 of the Debtors' non-insider employees who are vital to the Debtors' businesses and reorganization. Comprising less than 3% of the Debtors' workforce, in areas such as mine operations and management, finance, human resources, legal, engineering, and sales, the CERP Participants have been carefully identified as the employees who, in

the management's assessment, are most critical to the Debtors' businesses, sought-after in the recruiting market and costly to replace. (Hatfield Decl. ¶ 35.) In particular, management selected high-performing employees who possess critical skills and institutional knowledge needed to guide the Debtors' performance during this bankruptcy process. (Hatfield Decl. ¶ 35.) Defections among the CERP Participants would cause the Debtors to incur significant costs in recruiting and attracting qualified replacements,[9] and there is a genuine risk that qualified replacements could not be found. The loss of any of the CERP Participants could have a material detrimental impact on the Debtors. (Hatfield Decl. ¶ 35; Bubnovich Decl. ¶¶ 20-21.)

b. Terms

29. The CERP is designed to incentivize the CERP Participants to remain with the Debtors and, like the 2013 AIP, to achieve a successful emergence from chapter 11. (Hatfield Decl. ¶ 36.)

30. The maximum cost of the CERP totals approximately $5.2 million, with payouts made in three cash installments tailored to retain employees over the course of these bankruptcy proceedings. CERP Participants are eligible for retention compensation equaling between 11% and 45% of annual base salary, with the specific award percentage based on the participant's importance to the Debtors and the difficulty of replacing the participant, as determined by the Debtors through the exercise of their business judgment. The first and second installments, each equal to 25% of the award, would be payable as of March 31, 2013 and September 30, 2013,

[9] For example, replacing an employee earning an annual salary of $60,000 would cost approximately $46,000 in recruiting fees, interviewing time, training, and lost productivity, according to the Debtors' estimates. (Hatfield Decl. ¶ 34 fn 8.)

respectively. The aggregate cost of each of the first two installments would total a maximum of approximately $1.3 million.[10] The final installment of up to $2.6 million, or 50% of the award, would not be payable until the later of March 31, 2014 or 90 days after the Debtors' emergence from chapter 11. (Hatfield Decl. ¶ 37; Bubnovich Decl. ¶ 23.)

Basis for the Relief Requested

A. The Proposed Compensation Plans Constitute Ordinary Course Transactions Under Section 363(c)(1) of the Bankruptcy Code and Do Not Require Court Approval

31. Section 363(c) of the Bankruptcy Code authorizes a debtor in possession operating its business pursuant to section 1108 of the Bankruptcy Code to "enter into transactions . . . in the ordinary course of business without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing." 11 U.S.C. § 363(c)(1). Consequently, implementing the Proposed Compensation Plans, which continue the Debtors' prepetition compensation practices as lowered and modified to address the current business goals of the Debtors, are in the ordinary course of business and permitted pursuant to sections 363(c), 1107(a) and 1108 of the Bankruptcy Code, without application to the Court. Nonetheless, out of an abundance of caution and in recognition of the importance of this issue to certain constituencies, the Debtors have requested the Court's approval and authorization of the Proposed Compensation Plans.

[10] Because any amounts forfeited as a result of employee resignations would not be reallocated to other CERP Participants, these amounts reflect the maximum amounts that would be payable under the CERP. (Hatfield Decl. ¶ 35 fn 10; Bubnovich Decl. ¶ 23.)

32. Section 363 is designed to serve the "'overriding goal of maximizing the value of the estate' by striking the optimal balance between the interests of the debtor and the creditors." *Habinger, Inc. v. Metro. Cosmetic & Reconstructive Surgical Clinic, P.A.*, 124 B.R. 784, 786 (Bankr. D. Minn. 1990) (quoting *United States ex rel. Harrison v. Estate of Deutscher*, 115 B.R. 592, 599 (Bankr. M.D. Tenn. 1990)). "The 'ordinary course of business' standard is intended to allow a debtor the flexibility it needs to run its business and respond quickly to changes in the business climate." *Habinger*, 124 B.R. at 786. Thus, the Debtors have authority "to enter into transactions in the ordinary course of business without the approval of the court." *Shields v. Cumberland Surety Ins. Co.* (*In re Am. Coal Corp.*), 1996 Bankr. LEXIS 2013, *16 (Bankr. D. Minn. Oct. 7, 1996).

33. The Bankruptcy Code does not define "ordinary course of business." However, "through a synthesis of case law, courts have developed a workable analytical framework for determining whether an activity is within the debtor's 'ordinary course of business.'" *In re Husting Land & Dev., Inc.*, 255 B.R. 772, 778 (Bankr. D. Utah 2000), *aff'd*, 274 B.R. 906 (D. Utah 2002). A transaction qualifies as "ordinary course" if it: (i) "is of the type that is commonly undertaken within the debtor's industry," *Peltz v. Gulfcoast Workstation Group* (*In re Bridge Info. Sys., Inc.*), 293 B.R. 479, 486 (Bankr. E.D. Mo. 2003), and (ii) is ordinary and consistent with the reasonable expectations of creditors. *Streetman v. United States* (*In re Russell*), 154 B.R. 187, 292 (W.D. Ark. 1995); *see also In re Bridge Info. Sys., Inc.* 293 B.R. at 486 (courts look to "whether interested parties would reasonably expect[ ] the particular debtor in possession to seek court approval before entering in the questioned

transaction"); *In re James A. Phillips, Inc.* 29 B.R. 391, 394 (Bankr. S.D.N.Y. 1983) ("The touchstone of 'ordinariness' is [] the interested parties' reasonable expectations of what transactions the debtor in possession is likely to enter in the course of its business. So long as the transactions conducted are consistent with these expectations, creditors have no right to notice and hearing, because their objections to such transactions are likely to relate to the bankrupt's chapter 11 status, not the particular transactions themselves.").

34. An important characteristic of an "ordinary" postpetition business transaction is its similarity to a prepetition business practice. *Marshack v. Orange Comm. Credit* (*In re Nat'l Lumber & Supply, Inc.*), 184 B.R. 74, 79 (B.A.P. 9th Cir. 1995) (to qualify as ordinary course, payment must be consistent with the past practices and industry standards). Relevant factors in determining whether a transaction is ordinary include the type of business the debtor is engaged in as well as the size and nature of the business and transaction in question. *Harrison*, 115 B.R. at 598; *see also In re Hanson Indus., Inc.*, 90 B.R. 405, 413–24 (Bankr. D. Minn. 1988) ("[T]he size, nature, or both, of the transaction may be dispositive on the issue of ordinariness. What may be ordinary for a large, multinational corporation engaged in a number of businesses is distinctly different from what is ordinary in a smaller corporation with lesser capital, fewer employees and fewer business transactions.")

35. Here, the Proposed Compensation Plans reflect ordinary course transactions based on both industry and prepetition practices. As more fully set forth in the Bubnovich Declaration, the Debtors' industry peers almost universally provide incentive and retention compensation opportunities for their similarly-situated

employees. (Bubnovich Decl. ¶¶ 18, 28.) The Debtors' failure to implement a comparable plan would leave the Debtors at a commercial disadvantage as the "odd man out" in the highly competitive market for managerial talent. (Bubnovich Decl. ¶¶ 18-19, 27-28.) *See In re Nellson Nutraceutical*, 369 B.R. at 797–98 (Bankr. D. Del. 2007) (finding postpetition incentive plan modification to be ordinary course where based on record of market comparables analysis); *see also In re Global Home Prods.*, 369 B.R. 778, 786 (Bankr. D. Del. 2007) (finding compensation plans to be in the ordinary course of the debtors' businesses and noting that "[a]ll companies seek to retain employees they value by fairly compensating them.").

36. Moreover, the Debtors have used a short-term, performance-based incentive program substantially similar (though at much higher payment levels) to the 2013 AIP for each of the years 2008-2012. Similarly, the Debtors' have maintained retention programs since 2009. (Hatfield Decl. ¶¶ 8, 31) The Proposed Compensation Plans are simply extensions of the Debtors' long-standing compensation practices—albeit lowered in cost and modified to reflect the current facts and circumstances of these chapter 11 cases—and reflect ordinary course business decisions. (Hatfield Decl. ¶ 22; Bubnovich Decl. ¶¶ 10-13, 22-23.) *See In re Dana Corp.*, 358 B.R. 567, 579–81 (Bankr. S.D.N.Y. 2006) (approving short-term incentive program that did "not differ significantly" from prepetition practice and thus fell "within the ordinary course of Debtors' business"); *In re Delphi Corp.*, Case No. 05-44481 (RDD) (Bankr. S.D.N.Y. Sept. 27, 2007), Hr'g Tr. 112– 13:23–1 ("[W]here an element of compensation has been followed and applied consistently over the course of a debtor's existence, both pre- and post-bankruptcy, I believe it requires less scrutiny and is more ordinary

course."); *see Mesa Air Group*, Case No. 10-10018, 2010 WL 3810899, at *3-4 (Bankr. S.D.N.Y. Sept. 24, 2010) (approving incentive payments that were "consistent with past practices and clearly tied to the performance of the Debtors" as ordinary course transactions).[11] Accordingly, because the Proposed Compensation Plans constitute ordinary course transactions that the Debtors could have implemented without Court approval (and because they are reasonable and appropriate), the Debtors respectfully request that the relief requested herein be granted.

B. Alternatively, the Proposed Compensation Plans Should be Approved under Sections 363(b)(1) and 503(c)(3) as in the Best Interest of the Debtors and their Estates and Creditors

37. Even if the payments under the Proposed Compensation Plans are viewed as "outside the ordinary course of business," which they are not, the Proposed Compensation Plans should, nonetheless, be approved under sections 363(b)(1)[12] and 503(c)(3) of the Bankruptcy Code. As detailed herein, the Proposed Compensation Plans are essential to a successful reorganization, and their modest cost is more than offset by their benefits. Thus, the Proposed Compensation Plans reflect a sound exercise of the Debtors' business judgment.

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[11] Chapter 11 incentive and retention payment programs, in some cases richer than the Proposed Compensation Plans, are routinely approved pursuant to debtors' first-day wages motions. *See, e.g.*, *In re Northwest Airlines Corp.*, Case No. 05-17930 (ALG) (Bankr. S.D.N.Y. Sept. 15, 2005) (approving numerous executive retirement, severance, and incentive programs for highly paid employees, including a cash incentive program for 350 officers and senior managers estimated to cost $20 million in prepetition earnings alone); *In re Pinnacle Airlines Corp.*, Case No. 12-11343 (REG) (Bankr. S.D.N.Y May 11, 2012) (approving severance program, annual bonus plan, and long-term incentive plan with target compensation opportunities set at prepetition levels); *In re AMR Corp.*, Case No. 11-15463 (SHL) (Bankr. S.D.N.Y November 29, 2011) (approving numerous incentive and severance plans); *In re Frontier Airlines Holdings, Inc.*, Case No. 08-11298 (RDD) (Bankr. S.D.N.Y April 14, 2008) (approving severance benefits for approximately 5,000 non-union employees).

[12] Section 363(b)(1) of the Bankruptcy Code empowers the Court to allow the debtor to "use, sell, or lease, other than in the ordinary course of business, property of the estate."

38. Section 503(c)(3) prohibits certain transfers "that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition."[13] The standards for approval under sections 503(c)(3) and 363(b) are the same—a transfer will be approved if made as a result of a sound exercise of the debtor's business judgment.[14] *See In re Velo Holdings, Inc.*, No. 12-11384, 2012 WL 2015870, at *9 (Bankr. S.D.N.Y. June 6, 2012) ("Courts have held that the 'facts and circumstances' language of section 503(c)(3) creates a standard no different than the business judgment standard under section 363(b)."); *In re Borders Grp., Inc.*, 453 B.R. 459, 473 (Bankr. S.D.N.Y. 2011) (same); *Dana Corp*, 358 B.R. at 576 (standard under 503(c)(3) is the Debtors' business judgment); *In re Global Home Prods.*, 369 B.R. at 783 ("If [the proposed plans are] intended to incentivize management, the analysis utilizes the more liberal business judgment review under § 363."); *In re Viking Offshore*, Case No. 08-312-H3-11 (LZC), 2008 Bankr. LEXIS 1360, at *4 (Bankr. S.D. Tex. Apr. 30, 2008) (standard under 503(c)(3) is substantially similar to the business judgment test under *Continental*); *In re Nobex*, 2006 Bankr. LEXIS 417, Case No. 05-20050, at *5-8

[13] Because the Proposed Compensation Plans apply only to non-insiders, sections 501(c)(1) and (c)(2) are inapplicable here.

[14] *Dana Corp.,* a non-binding New York lower court decision, describes six factors to consider when evaluating approval of a compensation proposal: (a) whether the plan is calculated to achieve the desired performance; (b) whether the cost of the plan is reasonable in the context of a debtor's assets, liabilities and earning potential; (c) whether the scope of the plan is fair and reasonable or discriminates unfairly among employees; (d) whether the plan is consistent with industry standards; (e) whether the debtor performed due diligence in investigating the need for the plan; and (f) whether the debtor received independent counsel in performing due diligence, creating, and authorizing the plan. *See* 358 B.R. at 576-77. While these factors have not been considered or adopted by the Eighth Circuit, for all the reasons described herein, the *Dana* factors support approval of the Proposed Compensation Plans.

(MFW) (Bankr. D. Del. Jan. 19, 2006) (approving incentive pay under section 503(c)(3) as within the "sound business judgment" of the debtors); *see also In re Nobex*, (Bankr. D. Del. Jan. 12, 2006), Hr'g Tr. at 86-87 (concluding that the standard under section 503(c)(3) of the Bankruptcy Code was "quite frankly nothing more than a reiteration of the standard under [section] 363 . . . the business judgment of the debtor"); *In re Mesa Air Grp.*, No. 10-10018, 2010 WL 3810899, at *4 (Bankr. S.D.N.Y. Sept. 24, 2010) (incentive payments were "'justified by the facts and circumstances of the case' under section 503(c)(3) as they were within the 'sound business judgment' of the Debtors"); *cf. In re Trilogy*, Case No. 09-42219, 2010 Bankr. LEXIS 5636, at *3-4 (Bankr. W.D. Mo. Aug. 31, 2010) (DRD) ("The court should approve a use, sale or lease of property under Bankruptcy Code Section 363(b) if the debtor has established some articulated business justification for the proposed transaction."); *see also In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007) (holding that a judge determining a section 363(b) application must find from the evidence presented before him a good business reason to grant such application); *In re Channel One Comm.*, 117 B.R 493, 496 (Bankr. E.D. Mo. 1990) (same); *Walter v. Bank* (*In re Walter*), 83 B.R. 14, 16 (B.A.P. 9th Cir. 1988) ("there must be some articulated business justification for using, selling, or leasing the property outside the ordinary course of business" (citing *In re Continental Air Lines, Inc.* 780 F.2d 1223, 1226 (5th Cir. 1986))).

39. "Under the 'business judgment' rule, the management of a corporation's affairs is placed in the hands of its board of directors and officers, and the Court should interfere with their decisions only if it is made clear that those decisions are, *inter alia*,

clearly erroneous, made arbitrarily, are in breach of the officers' and directors' fiduciary duty to the corporation, are made on the basis of inadequate information or study, are made in bad faith, or are in violation of the Bankruptcy Code." *In re Farmland Indus. Inc.*, 294 B.R. 855, 881 (Bankr. W.D. Mo. 2003) (approving an amendment to the Debtors' post-petition financing credit agreement as an exercise of sound and reasonable business judgment); *In re Food Barn Stores, Inc.*, 107 F.3d 558, 567 n.16 (8th Cir. 1997) ("[w]here the [debtor's] request is not manifestly unreasonable or made in bad faith, the court should normally grant approval 'as long as the proposed action appears to enhance the debtor's estate'" (citing *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1309 (5th Cir. 1985))); *In re Farmland Indus. Inc.*, 294 B.R. 903, 913 (Bankr. W.D. Mo. 2003) (approving the rejection of employment agreements and noting that "[u]nder the business judgment standard, the question is whether the [proposed action] is in the Debtors' best economic interests, based on the Debtors' best business judgment in those circumstances" (citations omitted)).

40. Here, the Proposed Compensation Plans easily satisfy the business judgment test as they are demonstrably in the best interests of the Debtors' estates. Courts in this district and elsewhere have routinely approved similar programs under similar circumstances. *See, e.g.*, *In re Falcon Prods, Inc.*, Case No. 05-41108-399 (BSS) (Bankr. E.D. Mo. June 2, 2005) (approving a retention package for non-insider employees); *In re Interstate Bakeries Corp.*, Case No. 04-45814 (JWV) (Bankr. W.D. Mo. Feb. 17, 2005) (approving retention program, with an incentive component, covering 494 non-union employees); *In re Lightsquared Inc.*, Case No. 12-12080

(SCC) (Bankr. S.D.N.Y. Oct. 23, 2012) (approving key employee incentive plan with incentive targets tied to regulatory objectives, budget compliance and emergence from chapter 11); *In re Residential Capital*, Case No. 12-12020 (MG) (Bankr. S.D.N.Y. Oct. 18, 2012) (approving retention program for 174 non-insider employees); *In re Velo Holdings, Inc.*, Case No. 12-11384 (MG) (Bankr. S.D.N.Y. June 6, 2012) (approving key employee incentive plan with incentive targets tied to financial performance and sales of the debtors' business units); *In re Buffets Restaurants Holdings, Inc.*, Case No. 12-10237 (MFW) (Bankr. D. Del. Mar. 15, 2012) (approving incentive program based on financial and operational milestones); *In re Borders Grp., Inc.*, Case No. 11-10614 (MG) (Bankr. S.D.N.Y. Apr. 22, 2011) (approving incentive plan based on achievement of certain financial performance metrics in addition to timely confirmation of a plan of reorganization or court-approved asset sale); *In re The Great Atlantic & Pacific Tea Co.*, No. 10-24549 (RDD) (Bankr. S.D.N.Y. May 2, 2011) (approving incentive plan based on financial performance); *In re Nortel Networks Inc.*, Case No. 09-10138 (KG) (Bankr. D. Del. Mar. 5, 2009) (authorizing incentive and retention plans covering 972 employees); *cf. In re US Fidelis, Inc.*, Case No. 10-41902-705 (CER) (Bankr. E.D. Mo. June 16, 2010) (approving $16,000 in incentive payments to four employees); *In re BMC Indus., Inc.*, Case No. 04-43515 (RJK) (Bankr. D. Minn. July 12, 2004) (approving the assumption and continuation of retention and incentive programs).

1. <u>The 2013 AIP is in the Best Interests of the Debtors' Estates</u>

41. The Debtors carefully designed the 2013 AIP to balance the Debtors' need to properly incent the 2013 AIP Participants through appropriate, market-

competitive compensation with the need to ensure that the Debtors' estates receive enhanced value in exchange. All parties in interest will benefit if the Debtors are able to achieve their earnings, liquidity, safety, and environmental performance objectives. (Hatfield Decl. ¶ 20.) Approval of the 2013 AIP is a necessary step towards achieving those goals; indeed, payments under the 2013 AIP are made only upon the achievement of performance metrics. The program will both beget and reward success by motivating the 2013 AIP Participant to work towards attaining financial and operational targets that are critical to the Debtors' viability and success. (Hatfield Decl. ¶¶ 20, 28-30.)

42. Moreover, the payment amounts under the 2013 AIP are reasonable. Based on a review of compensation programs for chapter 11 debtors of comparable revenue and workforce size, Towers concluded that the 2013 AIP is consistent with (or below) industry standards. Indeed, the total program cost of the 2013 AIP ($1.7 million) and the cost per participant ($7,526) are among the lowest of the chapter 11 incentive plans identified by Towers. (*See* Bubnovich Decl. ¶¶ 15-16, 19.)

43. Even with implementation of the Proposed Compensation Plans, Towers' analysis showed that the 2013 AIP Participants would remain significantly undercompensated, with total compensation opportunities for this group of key employees 17% below the market median for similar positions. Absent the relief requested herein, the 2013 AIP Participants will be underpaid by 27% as compared to the market[15] and by 22% compared to their own historical compensation[16] – at a time

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[15] As adjusted for announced 2.5% across-the-board salary reduction, effective March 1, 2013.

when their performance has never been more important. (Bubnovich Decl. ¶18; Hatfield Decl. ¶ 33.)

44. For these reasons, the 2013 AIP is a valid exercise of the Debtors' business judgment and approval of the program is in the best interests of the Debtors, their estates, and all parties in interest in these chapter 11 cases.

2. The CERP is in the Best Interests of the Debtors' Estates

45. Implementation of the CERP is a similarly valid exercise of the Debtors' business judgment as it is specifically designed to (a) prevent attrition of essential employees during the course of these chapter 11 cases and (b) align the CERP Participants' interests with those of the Debtors' stakeholders. (*See* Hatfield Decl. ¶¶14-18, 35.)

46. The CERP Participants were specifically selected as those with (a) the skills most critical to a successful reorganization and most difficult to replace; (b) critical knowledge and experience in matters central to the reorganization; and (c) a strong performance record. (Hatfield Decl. ¶ 35, Bubnovich Decl. ¶ 21.) As further described in the declaration of Mr. Bubnovich, the CERP is reasonable in light of the size of the Debtors' business, the CERP Participants' below-market compensation, and the comparability of program costs and terms to other chapter 11 retention plans. (Bubnovich Decl. ¶¶ 24-28.)

47. Absent implementation of the CERP, the Debtors fear that many of the CERP Participants (who currently earn nearly one-fourth less, on average, than their

[16] Based on average decline in compensation for 2013 AIP Participants employed by Patriot since January 2010, from 2010-2011 to 2012-2013, as adjusted for increased annual health care premiums and announced 2.5% across-the-board salary reduction.

2010-2011 compensation levels)[17] would seek alternative career opportunities, and thereby impede the Debtors' ability to execute on critical business and restructuring initiatives. (Hatfield Decl. ¶ 35.) As noted above, there has already been a very substantial exodus since the Petition Date. For the good of all stakeholders, it must be stopped. The Debtors cannot afford to lose any more of their most talented and valuable employees, who each possess unique and vital institutional knowledge that is critical to executing day-to-day business operations during this crucial time. If the CERP Participants were to resign, the value and benefits of these employees' experience would be lost, causing the Debtors to incur significant costs in recruiting and training qualified replacements (assuming such qualified replacements could in fact be expeditiously recruited). (Hatfield Decl. ¶ 35.)

48. For the foregoing reasons, the Debtors' implementation of the CERP is an exercise of their sound business judgment that is in the best interests of the Debtors, their estates, employees, and stakeholders, and should be approved.

C. **The Court Has Inherent Authority under Section 105 to Approve the Proposed Compensation Plans**

49. Under section 105(a) of the Bankruptcy Code, the Court has expansive equitable powers to fashion any order or decree that is in the interest of preserving or protecting the value of the Debtors' assets. *See, e.g.*, *Carlson v. United States* (*In re Carlson*), 126 F.3d 915, 920 (7th Cir. 1997) ("Section 105(a) gives the bankruptcy court the authority to issue any order necessary to carry out the provisions of the

[17] Based on comparison of 2010/2011 compensation to 2012/2013 compensation for CERP Participants employed by Patriot since January 2010, as adjusted for increased annual health care premiums and an announced 2.5% across-the-board salary reduction.

Bankruptcy Code."); *In re Chinichian*, 784 F.2d 1440, 1443 (9th Cir. 1986) ("Section 105 sets out the power of the 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, however, is that equitable principles govern . . ."); *Steinberg v. Esposito*, 33 B.R. 812, 813 (Bankr. N.D. Ill. 1983) (The "bankruptcy court is vested with great latitude to protect the assets of the debtor's estate, including the use of equitable remedies . . ..."). Recognizing the importance of adequately compensating a Debtors' employees, courts in this jurisdiction have approved compensation plans pursuant to 105(a). *See, e.g.*, *In re Falcon Prods., Inc.*, Case No. 05-41108-399 (BSS) (Bankr. E.D. Mo. June 2, 2005); *In re Interstate Bakeries Corp.*, Case No. 04-45814 (JWV) (Bankr. W.D. Mo. Feb. 17, 2005).

50. For all the reasons stated herein, implementation of the Proposed Compensation Plans is essential to retaining and motivating the Debtors' key employees, without whom the Debtors' restructuring efforts would be severely compromised.

Request for Waiver of Stay

51. In addition, by this Motion, the Debtors seek a waiver of any stay of the effectiveness of the order approving this Motion. Pursuant to Bankruptcy Rule 6004(h), "[a]n order authorizing the use, sale, or lease of property other than cash collateral is stayed until the expiration of 14 days after entry of the order, unless the court orders otherwise." For the reasons set forth above, the Debtors require immediate implementation of the Proposed Compensation Plans for the benefit of all

parties in interest. Accordingly, the Debtors submit that ample cause exists to justify a waiver of the 14-day stay imposed by Bankruptcy Rule 6004(h), to the extent that it applies.

Notice

52. Consistent with the Order Granting Debtors' Motion for an Order Establishing Certain Notice, Case Management and Administrative Procedures entered on October 18, 2012 [ECF No. 1386] (as may be amended, the "**Case Management Order**"), the Debtors will serve notice of this Motion on (a) the Core Parties and (b) the Non-ECF Service Parties (as those terms are defined in the Case Management Order). All parties who have requested electronic notice of filings in these cases through the Court's ECF system will automatically receive notice of this motion through the ECF system no later than the day after its filing with the Court. A copy of this Motion and any order approving it will also be made available on the Debtors' Case Information Website (located at *www.patriotcaseinfo.com*). A copy of the Proposed Order will be provided to the Core Parties, and will be available at *www.patriotcaseinfo.com/orders.php* (the "**Patriot Orders Website**"). The Proposed Order may be modified or withdrawn at any time without further notice. If any significant modifications are made to the Proposed Order, an amended Proposed Order will be made available on the Patriot Orders Website, and no further notice will be provided. In light of the relief requested, the Debtors submit that no further notice is necessary. Pursuant to paragraph 22 of the Case Management Order, if no objections are timely filed and served in accordance therewith, the relief requested herein may be entered without a hearing

No Previous Request

53. No previous request for the relief sought herein has been made by the Debtors to this or any other court.

WHEREFORE, the Debtors respectfully request that the Court grant the relief requested herein and such other and further relief as is just and proper.

Dated: February 12, 2013
New York, New York

Respectfully submitted,

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SCHEDULE 1
(Debtor Entities)

1. Affinity Mining Company
2. Apogee Coal Company, LLC
3. Appalachia Mine Services, LLC
4. Beaver Dam Coal Company, LLC
5. Big Eagle, LLC
6. Big Eagle Rail, LLC
7. Black Stallion Coal Company, LLC
8. Black Walnut Coal Company
9. Bluegrass Mine Services, LLC
10. Brook Trout Coal, LLC
11. Catenary Coal Company, LLC
12. Central States Coal Reserves of Kentucky, LLC
13. Charles Coal Company, LLC
14. Cleaton Coal Company
15. Coal Clean LLC
16. Coal Properties, LLC
17. Coal Reserve Holding Limited Liability Company No. 2
18. Colony Bay Coal Company
19. Cook Mountain Coal Company, LLC
20. Corydon Resources LLC
21. Coventry Mining Services, LLC
22. Coyote Coal Company LLC
23. Cub Branch Coal Company LLC
24. Dakota LLC
25. Day LLC
26. Dixon Mining Company, LLC
27. Dodge Hill Holding JV, LLC
28. Dodge Hill Mining Company, LLC
29. Dodge Hill of Kentucky, LLC
30. EACC Camps, Inc.
31. Eastern Associated Coal, LLC
32. Eastern Coal Company, LLC
33. Eastern Royalty, LLC
34. Emerald Processing, L.L.C.
35. Gateway Eagle Coal Company, LLC
36. Grand Eagle Mining, LLC
37. Heritage Coal Company LLC
38. Highland Mining Company, LLC
39. Hillside Mining Company
40. Hobet Mining, LLC
41. Indian Hill Company LLC
42. Infinity Coal Sales, LLC
43. Interior Holdings, LLC
44. IO Coal LLC
45. Jarrell's Branch Coal Company
46. Jupiter Holdings LLC
47. Kanawha Eagle Coal, LLC
48. Kanawha River Ventures I, LLC
49. Kanawha River Ventures II, LLC
50. Kanawha River Ventures III, LLC
51. KE Ventures, LLC
52. Little Creek LLC
53. Logan Fork Coal Company
54. Magnum Coal Company LLC
55. Magnum Coal Sales LLC
56. Martinka Coal Company, LLC
57. Midland Trail Energy LLC
58. Midwest Coal Resources II, LLC
59. Mountain View Coal Company, LLC
60. New Trout Coal Holdings II, LLC
61. Newtown Energy, Inc.
62. North Page Coal Corp.
63. Ohio County Coal Company, LLC
64. Panther LLC
65. Patriot Beaver Dam Holdings, LLC
66. Patriot Coal Company, L.P.
67. Patriot Coal Corporation
68. Patriot Coal Sales LLC
69. Patriot Coal Services LLC
70. Patriot Leasing Company LLC
71. Patriot Midwest Holdings, LLC
72. Patriot Reserve Holdings, LLC
73. Patriot Trading LLC
74. PCX Enterprises, Inc.
75. Pine Ridge Coal Company, LLC
76. Pond Creek Land Resources, LLC
77. Pond Fork Processing LLC
78. Remington Holdings LLC
79. Remington II LLC
80. Remington LLC
81. Rivers Edge Mining, Inc.
82. Robin Land Company, LLC
83. Sentry Mining, LLC
84. Snowberry Land Company
85. Speed Mining LLC
86. Sterling Smokeless Coal Company, LLC
87. TC Sales Company, LLC
88. The Presidents Energy Company LLC
89. Thunderhill Coal LLC
90. Trout Coal Holdings, LLC
91. Union County Coal Co., LLC
92. Viper LLC
93. Weatherby Processing LLC
94. Wildcat Energy LLC
95. Wildcat, LLC
96. Will Scarlet Properties LLC
97. Winchester LLC
98. Winifrede Dock Limited Liability Company
99. Yankeetown Dock, LLC

EXHIBIT A

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

In re: PATRIOT COAL CORPORATION, *et al.*, Debtors.	Chapter 11 Case No. 12-51502-659 (Jointly Administered)

DECLARATION OF BENNETT K. HATFIELD IN SUPPORT OF THE DEBTORS' MOTION FOR AN ORDER PURSUANT TO SECTIONS 105(a), 363 AND 503 OF THE BANKRUPTCY CODE AUTHORIZING IMPLEMENTATION OF COMPENSATION PLANS

I, Bennett K. Hatfield, hereby declare that the following is true to the best of my knowledge, information, and belief:

1. I serve as the President and Chief Executive Officer of Patriot Coal Corporation ("**Patriot Coal**"), one of the above-captioned debtors and debtors in possession in these proceedings (collectively, the "**Debtors**" or "**Patriot**"), which has its principal office at 12312 Olive Boulevard, St. Louis, Missouri. Previously, I served as President and Chief Operating Officer for Patriot Coal. I am intimately familiar with the Debtors' day-to-day operations, business affairs, financial performance, and restructuring efforts.

2. I participated in the development of the Debtors' proposed 2013 incentive plan (the "**2013 AIP**"), a program that would provide cash incentive payments to critical non-insider employees based on the achievement of specified financial, operational, and individual goals, as well as the proposed retention plan for critical employees (the "**CERP**" and, together with the 2013 AIP, the "**Proposed Compensation Plans**"), a program that would provide cash retention payments to certain employees that the Debtors have

determined are essential to a successful reorganization. I am duly authorized to make and submit this declaration (this "**Declaration**") on behalf of the Debtors in support of the Debtors' Motion for Authority to Implement Compensation Plans (the "**Motion**").[1]

3. Except as otherwise indicated, all statements in this Declaration are based upon: my personal knowledge; information supplied or verified by personnel in departments within the Debtors' various business units; my review of the Debtors' books and records as well as other relevant documents; my discussions with other members of the Debtors' management team; information supplied by the Debtors' consultants; or my opinion based upon experience, expertise, and knowledge of the Debtors' operations, financial condition, and history. In making statements based on my review of the Debtors' books and records, relevant documents, and other information prepared or collected by the Debtors' employees or consultants, I have relied upon these employees and consultants to accurately record, prepare, collect, and/or verify any such documentation or information. I am not a participant in the Proposed Compensation Plans nor am I eligible to receive payments under the Proposed Compensation Plans. In addition, I am not being compensated for this testimony other than through payments made to me in the ordinary course of business in my position as President and Chief Executive Officer of Patriot Coal.

4. If I were called to testify as a witness in this matter, I would testify competently to the facts set forth herein.

5. I believe that the approximately 225 non-insider employees selected by management for participation in the 2013 AIP (the "**2013 AIP Participants**") will play an indispensable role in the performance of the Debtors' businesses over the next few months and beyond, which will drive the overall outcome of these chapter 11 cases. I also believe

[1] Each capitalized term used but not defined herein shall have the meaning set forth in the Motion.

that the retention of the approximately 119 non-insider employees selected for participation in the CERP is vital to the Debtors' business and reorganization efforts.

6. I played a pivotal role in formulating and negotiating the terms of the Proposed Compensation Plans. I believe that the development of effective incentive and retention plans is essential to maintain and improve the Debtors' financial and operational performance and to achieve a restructuring that maximizes value for all stakeholders.

7. Accordingly, I believe that the Debtors have an immediate need to (a) implement the 2013 AIP to provide incentive opportunities that will enable the Debtors to achieve their near-term business and restructuring goals and (b) implement the CERP to retain the Debtors' most critical employees by compensating them at levels more commensurate with (but still lower than) their historical compensation and industry practices. In my estimation, failure to implement these plans would jeopardize the Debtors' prospects of a successful reorganization and would create additional costs in hiring and training new employees and risk undermining mine safety and efficiency.

Current Compensation and Retention Status

8. Historically, the Proposed Plan Participants were compensated through salaries, cash incentives, and equity awards, but at present they are only being compensated through base salary. The Debtors' prepetition incentive and retention programs, and the current status of those programs, are summarized as follows:

- Long Term Equity Incentive Plan (the "**LTIP**"): The LTIP was an equity incentive plan under which participants were eligible to receive equity-based awards (e.g., restricted or deferred stock units and stock options), the value of which was tied to the price of a share of Patriot common stock. *LTIP participants have lost millions of dollars in previous equity grants that, as a result of the Debtors' bankruptcy, are valueless. Further, the Debtors have discontinued the LTIP such that (i) no additional awards will be granted and (ii) only time-vested restricted stock awards (which are of de minimis value) will be delivered upon the scheduled vesting, distribution, or exercise dates of outstanding awards.*

- Annual Incentive Plan (the "**Prepetition AIP**"): The Prepetition AIP was an annual cash incentive plan developed to motivate participants to achieve specified performance objectives. Participants were eligible to receive annual cash bonuses under the plan, if earned, in target amounts ranging from 5% to 60%, and maximum amounts ranging from 7.5% to 90%, of their base salaries. The Prepetition AIP was in effect, with minor modifications from year to year, since 2008. *No incentive payments were paid pursuant to the 2012 Prepetition AIP, despite the fact that participants earned approximately $3 million under the 2012 program.*

- Retention Programs (the "**Prepetition Retention Programs**"): The Debtors maintained two separate Prepetition Retention Programs. An initial retention program was adopted in 2009 to retain personnel essential to productivity and profitability at individual mines. A second retention program was adopted in June 2012 to target additional employees with critical skills. Participants in the Prepetition Retention Programs were eligible to receive cash retention payments in amounts ranging from 15% to 60% of their base salaries, subject to their continued employment through specified dates. *No retention payments payable after the Petition Date have been paid.*

9. In addition to decreased cash and equity-based compensation resulting from post-filing suspension of incentive and retention plans, the Proposed Plan Participants have faced a reduction in benefits, including the loss of significant retirement savings invested in Patriot stock through Patriot's 401(k) and employee stock purchase plans and personal accounts as well as an average approximately $3,000 annual increase in out-of-pocket healthcare costs. The Proposed Plan Participants will continue to experience compensation reductions as a result of (i) an announced 2.5% across-the-board salary cut, effective March 1, 2013, (ii) reduced hourly wage rates for certain non-union job classifications, and (iii) additional rollbacks in benefit programs.

10. For example, the Debtors have announced that they will seek several benefit reductions for non-union salaried employees, including terminating eight traditional retiree health plans, eliminating the Medical Premium Reimbursement Program, and eliminating life insurance coverage for active employees upon retirement. Certain of the Proposed Plan Participants will also be affected by reductions in holiday, personal, and vacation time and

the elimination of legacy deferred vacation balances and legacy retirement programs. Some employees also used personal cash savings to pay taxes on equity awards that vested prior to the filing of these chapter 11 cases but will no longer be delivered, resulting in significant personal losses. For employees who have been with Patriot over the past three years, the loss of these incentive and retention opportunities has resulted in a 20% decrease in average compensation from 2010-2011 to 2012-2013.[2]

11. Many of the Proposed Plan Participants have therefore lost a significant portion of their historical compensation packages. Because demand outstrips supply for employees with specialized mining skills or highly transferrable management, administrative, or legal skills, the risk of attrition from this key talent pool is high. The loss of a handful of additional key employees could quickly cascade into broad-based departures across the Debtors' businesses, unraveling their restructuring from the inside.

Need for Proposed Compensation Plans

12. The Proposed Plan Participants have worked tirelessly since the Debtors' chapter 11 filing in order to stabilize operations and lay the necessary groundwork for a successful reorganization. Despite experiencing significant reductions in wages and benefits, the Proposed Plan Participants have been called upon to perform critical responsibilities in an increasingly challenging environment, including in many instances shouldering responsibilities that are "above and beyond" their historical day-to-day duties as a result of bankruptcy-related tasks and a shrinking workforce.

13. For example, in connection with reporting obligations to postpetition lenders, the Creditors' Committee, the U.S. Trustee, and other constituents, many Plan Participants, across various areas of the Debtors' businesses, have been asked to assume frequent and

[2] As adjusted for increased annual health care premiums and an announced across the board reduction in salaries of 2.5%, effective March 1, 2013.

detailed data collection and analysis responsibilities. Some Proposed Plan Participants have also been called upon to (i) prepare business plans, cash flow projections, and related budgets required under the DIP credit facility; (ii) gather and coordinate the dissemination of due diligence information; (iii) participate in the analysis of thousands of leases and executory contracts to identify those that are beneficial to the Debtors' estates and reject those that are not; and (iv) address a multitude of creditor, supplier, and customer inquiries.

14. Thus, it is not surprising that, since the Petition Date, the Debtors have lost over 25 key employees through voluntary departures, including the Vice President of Kentucky Operations, the Vice President Controller, the Vice President of Human Resources, the Vice President of Sales, and the Vice President of Financial Planning & Analysis. Indeed, Patriot is currently experiencing historically unprecedented levels of attrition among corporate employees, who possess skill sets that are easily transferable to other industries. The effects of this accelerating attrition have resulted an 11% reduction in Patriot's corporate headcount since 2011. Quite simply, other companies, including Patriot's competitors, are able to offer compensation packages as generous as the prepetition packages historically offered to the Proposed Plan Participants, while offering greater job stability.[3]

15. The impact of the Debtors' bankruptcy proceedings on employee morale, and the accompanying uncertainty regarding job stability, cannot be overstated. An overwhelming majority of departing employees, including mine foremen, managers, engineers, accountants, and attorneys, have expressly cited the lack of stability at Patriot as a reason for their resignations. At least nine departing employees have accepted positions of either lower pay or rank in exchange for greater job security. Indeed, the Debtors even lost

[3] For example, the compensation package for a General Manager with a base salary of $180,000 historically included a 40% bonus opportunity and a 40% LTIP opportunity, resulting in a total annual compensation of $324,000. Whereas the Debtors currently offer base salary only, other mining companies continue to offer cash and equity incentive opportunities while also providing greater job security.

one critical employee – an engineer – who, citing job uncertainty, accepted a lower-level position with a competitor despite the Debtors' offer of a promotion that included a $20,000 pay increase. Similarly, a number of departing employees have accepted positions at companies in less convenient locations, in some cases even relocating to other states. Some former employees explained that the Debtors' failure to make expected retention or incentive payments or offer opportunities for future retention or incentive compensation was an important factor in their decision to leave the company.

16. Meanwhile, those Proposed Plan Participants who have chosen to remain with the Debtors must often expend additional effort to compensate for the loss of each critical employee that resigns. Thus, many Proposed Plan Participants are working longer hours than contemplated by the normal terms of their employment while suffering significant reductions in compensation and benefits, with no assurances that these circumstances will be mitigated any time soon. For these reasons, I believe that the Debtors are at significant risk of losing many Proposed Plan Participants.

17. Maximizing value for the Debtors' estates will largely depend on Patriot's ability to minimize the loss of additional critical people. Indeed, the further loss of critical employees could mean the difference between a mine operating profitably or incurring substantial financial losses or facing safety issues. It is safe to assume that most, if not all, of the Proposed Plan Participants have remained with the Debtors during these challenging times with the expectation that the dramatic reduction in compensation they experienced in 2012 would be mitigated going forward by the implementation of chapter 11 incentive and retention plans. Recently, several managers and foremen have expressed that they are considering positions with local competitors in response to not having received expected payments under the 2012 retention plans. It is my judgment that without the Proposed

Compensation Plans, the Debtors are at risk of losing an unacceptable number of the Proposed Plan Participants to competing employers able to offer market compensation and/or job security that a company in chapter 11 cannot match. Moreover, even as to the employees who would decide to stay, the demoralizing effect of working more for less, and the impact that would have on overall operating results, cannot be overstated.

18. I believe there is an urgent need to act now to appropriately align the interests of the Debtors, the Plan Participants, and the Debtors' stakeholders.

Development of the Proposed Compensation Plans

19. The Debtors, with oversight from the Debtors' compensation committee of the board of directors (the "**Compensation Committee**"), and their advisors carefully considered compensation programs that would effectively incentivize non-insider employees in a manner tailored to the Debtors' changed circumstances as well as market practice. Various iterations of the programs were discussed at several meetings of the Compensation Committee, which I attended, along with the Senior Vice President of Law and Administration, the Vice President of Human Resources and other members of management.

20. A benchmarking analysis performed by Towers Watson ("**Towers**") demonstrated that the current compensation for most Proposed Plan Participants is materially below the market median for their positions. The Debtors, in consultation with Towers, designed the 2013 AIP to compensate key employees at levels more commensurate with (though most often still below) the market. The 2013 AIP is structured to (a) motivate eligible employees (the "**2013 AIP Participants**") to achieve critical financial and operating goals key to achieving the Debtors' business plan that would benefit all stakeholders and position the post-emergence company for long-term viability, and (b) be as consistent as

possible with market practice and the Debtors' prepetition compensation program (albeit materially less generous).

21. Similarly, the Debtors modeled the CERP to (a) retain critical employees essential to the Debtors' ability to meet business objectives that would allow for a successful emergence from chapter 11; (b) achieve an appropriate balance of retaining employees critical to the reorganization efforts while protecting creditor interests; and (c) be consistent with market practice. To encourage eligible employees (the "**CERP Participants**") to remain with the company during this challenging and uncertain period, the timing of CERP payouts is aligned with the anticipated progress of the restructuring process.

22. The Proposed Compensation Plans are largely a continuation in structure of the Debtors' prepetition incentive and retention practices, but have been substantially reduced in cost and tailored to reflect the business realities of the restructuring process. In fact, the maximum combined cost of the 2013 AIP and CERP would be more than $1 million less than the actual cost of the 2011 Prepetition AIP alone, and more than $2 million less than the 2010 Prepetition AIP alone.[4] Moreover, in an important act of leadership, the six members of the Debtors' executive management team, which sets corporate policy, have asked to be – and are – excluded from participation in the Proposed Compensation Plans.

23. The Proposed Compensation Plans are the result of a lengthy, iterative, process among the Debtors, their advisors, the Compensation Committee, and the Creditors' Committee. On December 5, 2012, the Debtors and their advisors presented initial drafts of chapter 11 incentive and retention plans at a meeting of the Creditors' Committee. Close consultation and negotiations followed this presentation. The Creditors' Committee's professionals reviewed drafts of the Proposed Compensation Plans, reviewed the Debtor's

[4] Based on actual incentive compensation payments in 2010 and 2011.

rationales and analyses and offered numerous comments and modifications. The Debtors have attempted to accommodate the Creditors' Committee's reactions, reshaping earlier forms of the plans into what is now presented to the Court. Final versions of the Proposed Compensation Plans were presented to the Creditors' Committee at its February 5, 2013 meeting and, as a result of this process, the Creditors' Committee supports the approval of the Proposed Compensation Plans as a reasonable exercise of the Debtors' business judgment.

24. I believe the Creditors' Committee's support for the approval of the Proposed Compensation Plans underscores that the Proposed Compensation Plans will offer considerable benefits for the Debtors' estates, appropriately motivate and focus the Proposed Plan Participants, and help to ensure the ongoing viability of the Debtors' businesses.

Description of the 2013 AIP

A. Eligibility

25. The 2013 AIP continues, on a modified and substantially reduced basis, the Debtors' Prepetition AIP for approximately 225 employees who are best positioned to help maximize the Debtors' financial and operational performance for the benefit of all stakeholders. The 2013 AIP Participants comprise approximately 5% of the Debtors' workforce, including critical salaried employees in operations management, finance, human resources, legal, engineering, and sales. The 2013 AIP Participants are the same employees who would have been eligible to participate in the Debtors' Prepetition AIP with a notable exception – the six members of the executive management team which sets corporate policy and dictates the disposition of corporate assets participated in the Prepetition AIP, but voluntarily declined to be considered for participation in the Proposed Compensation Plans. These individuals consist of the Chief Executive Officer, Chief Financial Officer, Chief

Marketing Officer, Executive Vice President for Operations, Senior Vice President for Global Strategy & Corporate Development and Senior Vice President of Law and Administration.

B. Terms

26. The 2013 AIP is based on the Debtors' long-standing Prepetition AIP, but has been reduced in cost and modified to focus the 2013 AIP Participants on performance targets that are critical to a successful reorganization. The Debtors relied on Towers' expertise in setting compensation opportunities at or below market levels. Based on Towers' analysis, the Debtors understand that even if the Proposed Compensation Plans are implemented, nearly all 2013 AIP Participants for whom benchmarking data was available would continue to be compensated at below-market rates.

27. The 2013 AIP consists of two six-month performance periods (January 1, 2013 to June 30, 2013 and July 1, 2013 to December 31, 2013). The cost for each six-month period would total at most $875,000 for all 225 participants, and would be paid 30 to 60 days following the end of each performance period. The average cost per 2013 AIP Participant would be only $7,526.

28. The two most significant performance metrics under the 2013 AIP are liquidity and a modified measure of EBITDA[5] (adjusted to add back retiree health care and multi-employer pension plan cash spending, referred to as "EBITDAP"). This modification to EBITDA was made in order to maintain a balanced focus on decision-making with regard to the Debtors' 1113/1114 process. Payouts on account of these metrics require meeting the liquidity and EBITDAP objectives in the Debtors' five-year business plan, with each one weighted at 30% in calculating total incentive

[5] As defined in the DIP credit agreements.

compensation. The EBITDAP and liquidity metrics are net of 2013 AIP costs and are particularly aggressive in light of the ongoing depression in the coal markets.

29. Three additional objective metrics under the 2013 AIP include: (a) safety incidence rate, (b) environmental incidence rate, and (c) Mine Safety and Health Administration ("**MSHA**") compliance rate, with each such metric weighted at 5% in determining total incentive compensation. As with the financial metrics, payouts on account of these environmental and safety metrics require achieving the corresponding targets in the Debtors' five-year plan, which are critical to the Debtors' operational success.

30. The remaining 25% of incentive compensation opportunities under the 2013 AIP is based on the attainment of qualitative individual objectives pertaining to strategic areas important to the Debtors' businesses. This metric is weighted less heavily than under the Prepetition AIP to reflect the Debtors' business judgment that objective financial and operational metrics are of comparatively greater significance during restructuring. I believe that the performance metrics establish ambitious operating goals that will beget and reward success by motivating the 2013 AIP Participants to help the Debtors' achieve viability and success.

31. The amounts payable under the 2013 AIP generally range from 1.25% to 15% of the participant's annual base salary.[6] Compensation under the 2013 AIP would be capped at the threshold payouts for meeting the objectives in the Debtors' five-year plan – a significant departure from the prepetition practice of awarding incentive compensation in amounts of up to 300% of threshold for exceeding business plan objectives. For the seventy 2013 AIP Participants who are also CERP Participants, compensation opportunities under the 2013 AIP would be 83% less than their maximum prepetition incentive opportunities. For

[6] One recent hire has been added to the 2013 AIP with a potential incentive compensation of 20% of base salary.

most other 2013 AIP Participants, the amounts payable would be 67% less than their maximum prepetition opportunities.

32. The following table provides additional information on the performance metrics under the 2013 AIP:

Performance Metrics and Goals **Proposed 2013 AIP**				
Performance Area	**Metric**	**Weight**	**January – June 2013 Threshold**	**July – December 2013 Threshold**
Financial	EBITDAP (as defined in the DIP credit agreements, with EBITDAP adding back retiree health care and multi-employer pension plan cash spending) under five-year plan	30%	$75.1M	$72.4M
	Liquidity (as defined in the DIP credit agreements) under five-year plan	30%	$205.8M	$100.6M
Safety	Debtors' overall safety incidence rate	5%	3.27	3.27
MSHA Compliance	Debtors' overall MSHA incidence compliance rate	5%	0.95	0.95
Environmental	Debtors' overall environmental incidence rate under the Surface Mining Control and Reclamation Act	5%	0.0092	0.0092
Individual	3 - 5 specific qualitative goals per individual, aligned with key strategic areas of importance to the Debtor	25%	TBD	TBD

33. Absent the implementation of the Proposed Compensation Plans, the 2013 AIP Participants will be severely underpaid – by 22% compared to their historical compensation[7] – at a time when their performance has never been more important.

[7] Based on average decline in compensation for 2013 AIP Participants employed by Patriot since January 2010, from 2010-2011 to 2012-2013, as adjusted for increased annual health care premiums and announced 2.5% across-the-board salary reduction.

Description of the CERP

A. Eligibility

34. The Debtors seek approval of the CERP for approximately 119 of the Debtors' non-insider employees who are vital to the Debtors' businesses and reorganization. As with the 2013 AIP, Debtor's executive management team – *i.e.*, the six executives that set corporate policy and dictate the disposition of corporate assets – voluntarily declined to be considered for participation in the CERP.

35. Comprising less than 3% of the Debtors' workforce, in areas such as mine operations and management, finance, human resources, legal, engineering, and sales, the CERP Participants have been carefully identified as the employees who, in the management's assessment, are most critical to the Debtors' businesses, sought-after in the recruiting market and costly to replace. In particular, management selected high-performing employees who possess (a) critical skills and institutional knowledge needed to guide the company through this bankruptcy process as quickly as possible; (b) skills most difficult and costly to replace; and (c) a strong performance record. Defections among the CERP Participants would cause the Debtors to incur significant costs in recruiting and attracting qualified replacements,[8] and there is a genuine risk that qualified replacements could not be found. I believe that each of the CERP Participants is critical to the Debtors' restructuring efforts and that these employees possess important experience, relationships, and familiarity with the Debtors' operations and infrastructure that would be costly, if even possible, to replace. I further believe that many of the CERP Participants (who currently earn nearly one-fourth less, on

[8] For example, replacing an employee earning an annual salary of $60,000 would cost approximately $46,000 in recruiting fees, interviewing time, training, and lost productivity, according to the Debtors' estimates.

average, than their 2010-2011 compensation levels)[9] would seek alternative career opportunities, and thereby impede the Debtors' ability to execute on critical business and restructuring initiatives.

B. Terms

36. The CERP is designed to incentivize the CERP Participants to remain with the Debtors and, like the 2013 AIP, to achieve a successful emergence from chapter 11.

37. The maximum cost of the CERP totals approximately $5.2 million, with payouts made in three cash installments tailored to retain employees over the course of these bankruptcy proceedings. CERP Participants are eligible for retention compensation equaling between 11% and 45% of annual base salary, with the specific award percentage based on the participant's importance to the Debtors and the difficulty of replacing the participant, as determined by the Debtors through the exercise of their business judgment. The first and second installments, each equal to 25% of the award, would be payable as of March 31, 2013 and September 30, 2013, respectively. The aggregate cost of each of the first two installments would total a maximum of approximately $1.3 million.[10] The final installment of up to $2.6 million, or 50% of the award, would not be payable until the later of March 31, 2014 or 90 days after the Debtors' emergence from chapter 11.

Conclusion

38. Based on the analysis and advice provided to me by the Debtors' management and advisors, the input of the Compensation Committee, my own experience on Patriot Coal's board of directors, and my independent business judgment, I believe that the Proposed Compensation Plans are consistent with the Debtors' long-standing practice of

[9] Based on comparison of 2010/2011 compensation to 2012/2013 compensation for CERP Participants employed by Patriot since January 2010, as adjusted for increased annual health care premiums and an announced 2.5% across-the-board salary reduction.

[10] Because any amounts forfeited as a result of employee resignations would not be reallocated to other CERP Participants, these amounts reflect the maximum amounts that would be payable under the CERP.

providing certain critical employees with retention payments, and with incentive-based opportunities that will be earned only if meaningful – and challenging – performance targets are attained. Similarly, I believe that the Proposed Compensation Plans are reasonable and specifically targeted to retaining important employees. Moreover, the Proposed Compensation Plans come at a modest cost that is far outweighed by the ongoing contributions these employees provide and the damage to an enterprise caused by critical employee departures. In sum, unless the Proposed Compensation Plans are approved, the Debtors will continue to suffer from attrition of critical employees and will struggle to meet performance targets that are essential to a successful reorganization.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct to best of my knowledge and belief.

Executed on the 12th day of February, 2013.

/s/ Bennett K. Hatfield
Bennett K. Hatfield
President and Chief Executive
Officer of Patriot Coal Corporation
12312 Olive Boulevard
St. Louis, Missouri 63141

EXHIBIT B

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

In re: **PATRIOT COAL CORPORATION, *et al.*,** **Debtors.**	**Chapter 11** **Case No. 12-51502-659** **(Jointly Administered)**

DECLARATION OF NICK BUBNOVICH IN SUPPORT OF THE DEBTORS' MOTION FOR AUTHORITY TO IMPLEMENT COMPENSATION PLANS

I, Nick Bubnovich, hereby declare and state as follows:

1. I voluntarily and freely make this declaration (the "**Declaration**") in support of the motion (the "**Motion**") of Patriot Coal Corporation and its affiliated debtors and debtors-in-possession (the "**Debtors**" or "**Patriot**") pursuant to Sections 105(a), 363 and 503 of the Bankruptcy Code for an order approving and authorizing a chapter 11 incentive plan (the "**2013 AIP**") and a critical employee retention plan (the "**CERP**" and, together with the 2013 AIP, the "**Proposed Compensation Plans**") in the above-captioned cases.

2. Except as otherwise indicated, all facts set forth in this Declaration are based upon my personal knowledge, my review of relevant documents, and information provided to me by the Debtors' management and other advisors.

Employment and Qualifications

3. From January 3, 2005 to July 2, 2012, I was a Director at Towers Watson Delaware Inc. ("**Towers**"), which maintains an office at 71 South Wacker Drive, Suite 2600, Chicago, Illinois and in other cities. I retired on July 2, 2012 and, since then, have

been engaged by Towers as an independent contractor to provide services to the firm and certain of its clients, including the Debtors.

4. Towers is a global consulting firm focused on human capital and financial management. Towers specializes in the areas of employee benefits, talent and rewards (including compensation consulting), exchange solutions, and risk and financial services. Towers employs approximately 14,000 associates in 37 countries. The talent and rewards group of 500 associates assists clients in developing and implementing strategies for attracting, retaining, and motivating their employees.

5. I have worked in compensation consulting for nearly 25 years. I advise companies on a variety of compensation and benefit issues, including the design of annual incentive plans, long-term incentive plans, retention plans, and severance programs.

6. Before joining Towers, I was a partner at Deloitte & Touche LLP from 2002 to 2004. I worked in the Human Capital Group at Arthur Andersen LLP from 1987 to 2002, the last ten years as a partner. I have served as a compensation consultant in numerous large and complex restructurings and have frequently provided services to large multinational companies, both in and out of chapter 11. My clients have included Hawker Beechcraft, Delphi Corporation, Bethlehem Steel Co., Delta Air Lines, Inc., Dura Automotive, Federal Mogul Corp., Frontier Airlines, Fibermark, Inc., Hayes Lemmerz International, Inc., NRG Energy, Inc., and Winn-Dixie, Inc., among many others.

7. I have published numerous articles on executive compensation issues, the most recent being "Compensation Apples and Option Pricing Oranges" in *World at Work Journal* (December 2005), and I co-authored three of the seven chapters in the National

Center for Employee Ownership's 2003 book, *Beyond Stock Options*. In addition, I was a member of the Executive Compensation Committee of the American College of Bankruptcy, which in 2007 prepared the "Best Practices Report for Debtor Employee Retention and Incentive Compensation Programs in Light of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005." I have also been a featured speaker on executive compensation for the American Bar Association, ALI-ABA, National Center for Employee Ownership, Executive Enterprise, Inc., Corporate Counsel Center, American Society of Corporate Secretaries (Chicago Chapter), Chicago Compensation Association, National Association of Stock Plan Professionals (Chicago Chapter), and Chicago-Kent College of Law.

8. From January 2008 through the present, Towers has been retained to provide compensation consulting services to the Compensation Committee of the Debtors' Board of Directors (the "**Compensation Committee**"). As the lead consultant for this engagement since its inception, I have consulted with the Debtors and their other advisors regarding Patriot's compensation and incentive plan structures and the development of the Proposed Compensation Plans. I have also gathered relevant market data and analyzed whether the Proposed Compensation Plans are consistent with typical market practices. I am intimately familiar with Patriot's prepetition compensation programs, current compensation structure at Patriot, and the Proposed Compensation Plans.

Overview of the 2013 AIP

9. In designing the 2013 AIP, the Debtors sought to balance the need to motivate and reward participating employees with the constraints of the Debtors' financial circumstances. The 2013 AIP provides incentive compensation opportunities to

approximately 225 salaried employees in key functional roles such as operations management, engineering, accounting, human resources, legal, and sales (the "**2013 AIP Participants**"). The 2013 AIP Participants are substantially the same employees who would have been eligible for compensation opportunities under the Debtors' prepetition annual incentive plan, with one significant exception: the Debtors' six most senior executives, the executive management team, voluntarily requested not to be considered for the Proposed Compensation Plans.

10. Like Patriot's prepetition incentive plan, the 2013 AIP is designed to motivate employees to achieve important financial, safety, and environmental results, which are critical to a successful restructuring. As detailed below, six performance metrics are weighted to determine participating employees' aggregate incentive compensation under the 2013 AIP:

- Liquidity and a modified measure of EBITDA referred to as "EBITDAP"[1] (collectively, the "**Financial Metrics**") are weighted most heavily to reflect their centrality to a successful reorganization. Each Financial Metric is weighted at 30% in calculating 2013 AIP compensation. Similar financial metrics are commonly found in the incentive plans of other chapter 11 debtors.

- Safety incidence rate, environmental incidence rate, and Mine Safety and Health Administration compliance rate (collectively, the "**Operational Metrics**") were metrics under the Debtors' prepetition annual incentive plans and continue to be important measures of success during restructuring. Each Operational Metric is weighted at 5% in calculating 2013 AIP compensation.

- The achievement of qualitative individual goals pertaining to areas of strategic importance to the Debtors' businesses (the "**Individual Performance Metric**") is weighted at 25% in calculating 2013 AIP compensation. This represents a 10% reduction in weighting from Patriot's prepetition incentive plan to reflect the comparatively greater significance of meeting objective Financial Metrics and Operational Metrics during restructuring.

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[1] EBITDAP is calculated based on EBITDA, as defined in the DIP credit agreements, with the addition back of retiree health care and multi-employer pension plan cash spending.

11. Payouts on account of the Financial Metrics and Operational Metrics require achieving the rigorous goals in the Debtors' five-year plan. I understand from Debtors' management and other advisors that the Financial Metrics – which are net of the costs of the 2013 AIP – are particularly aggressive in light of the ongoing depression in the coal markets.

12. Compensation opportunities under the 2013 AIP generally range from 1.25% to 15% of the participant's base salary.[2] For most of the 70 employees participating in both the 2013 AIP and the CERP, 2013 AIP compensation opportunities have been reduced by 83% from their maximum prepetition incentive opportunity levels. For most other 2013 AIP Participants, 2013 AIP compensation opportunities have been reduced by 67% from their maximum prepetition incentive opportunity levels.

13. Unlike Patriot's prepetition incentive plan, which allowed for payouts of up to 300% of threshold compensation levels (i.e., 90% of base salary for some participants), the 2013 AIP provides no "upside" compensation opportunity for performance exceeding the business plan. Capping incentive compensation at threshold levels distinguishes the 2013 AIP from many chapter 11 incentive plans. And whereas many chapter 11 incentive plans allow for partial payments even when business plan targets are missed (a practice consistent with Patriot's prepetition approach), threshold payouts for Financial Metrics and Operational Metrics under the 2013 AIP require achieving business plan targets, making it more difficult for 2013 AIP Participants to earn any incentive compensation at all.

14. As is typical of chapter 11 incentive plans, the 2013 AIP is divided into two separate performance periods of six months each, beginning on January 1, 2013 and

[2] One recent hire has been added to the 2013 AIP with a potential incentive compensation of 20% of base salary.

July 1, 2013. The shortened periods are designed to maintain employee motivation and engagement in the face of difficult working conditions related to the restructuring process. The cost of the 2013 AIP, if fully earned, would be approximately $875,000 for each six month period.

<u>Towers' Review of the Reasonableness of the 2013 AIP</u>

15. In assessing the reasonableness of the 2013 AIP, my team reviewed market practices with respect to the design of chapter 11 incentive plans, based on court approved programs at similarly-situated companies. We identified 23 other chapter 11 incentive plans in Towers' database.[3] As of their bankruptcy filings, the sponsors of these plans had a median $1.84 billion in revenue and 5,450 employees. On that basis, I determined that the plans represented an appropriate comparator group for the Debtors.[4]

16. Our analysis showed that the cost of the 2013 AIP, if fully earned, would rank as the fifth lowest in the aggregate and the second lowest as a percentage of prepetition revenue among 21 comparator plans for which cost information was available. On a per participant basis, the cost of the 2013 AIP, if fully earned, would be the *lowest* among 19 plans for which such data was available.

17. While the 2013 AIP includes more employees (5% of the Debtors' workforce) than most chapter 11 comparators, the breadth of the participant pool is typical by coal industry standards, consistent with the Debtors' historical practices, and in my view, vital to achieving the Debtors' chapter 11 objectives and long-term viability. This conclusion follows in part from a benchmarking analysis that my team undertook to

[3] Towers' database is based primarily on information in the public domain, which is limited due to the fact that chapter 11 compensation programs are frequently approved as part of debtors' first-day motions without extensive disclosure as to their terms. Accordingly, Towers' analysis is based on the best available, but necessarily incomplete, information regarding market comparables.

[4] At filing, the Debtors' had $2.2 billion in trailing 12-month revenue and 4,300 employees.

compare total compensation opportunities for 2013 AIP Participants with those available to employees in similar positions at other companies. To perform this analysis, we gathered data from several sources reflecting pay practices across various industries, including compensation surveys by Towers and Mercer covering a broad cross-section of hundreds of companies each, as well as a proprietary compensation survey focused on the coal industry. In total, we were able to benchmark compensation for 151 out of 225 2013 AIP Participants.

18. Our analysis showed that 2013 AIP Participants are currently substantially undercompensated by market standards, primarily due to the elimination of the Debtors' prepetition incentive and retention programs. Whereas the Debtors' peer firms routinely offer incentive-based cash payments to employees holding responsibilities comparable to those of the 2013 AIP Participants, Patriot employees currently receive only base salary. As a result, 2013 AIP Participants are currently underpaid by 27% as compared to the market.[5] Moreover, even with implementation of the Proposed Compensation Plans, the aggregate compensation opportunity for 2013 AIP Participants will remain on average 17% below the market median.

19. As a result of the foregoing, and based on my experience and the work I have done in this matter, it is my opinion that (i) the design and structure of the 2013 AIP, including performance metrics, eligibility criteria, and payment terms, are consistent with or more conservative than market practices, (ii) the compensation opportunities for 2013 AIP Participants are reasonable in light of the Debtors' circumstances, (iii) the 2013 AIP provides motivation to key employees by aligning their incentives with the Debtors'

[5] As adjusted for announced 2.5% across-the-board salary reduction, effective March 1, 2013.

financial and operating goals and desire to achieve a successful reorganization, and (iv) the 2013 AIP is required to preserve and maximize the value of the Debtors' estates.

Overview of the CERP

20. I was also involved in the development of the CERP, which is designed to help the Debtors retain 119 of their most essential administrative and mine-level employees (the "**CERP Participants**").

21. Patriot management carefully selected as CERP Participants the employees most critical to the Debtors' businesses, whose continuing service is vital to the preservation and maximization of estate value. In making eligibility determinations, management used the following criteria: (a) critical knowledge, skills, and experience in areas central to a successful reorganization; (b) possession of skills most difficult and costly to replace; and (c) a strong performance record. CERP payments range from 11% to 45% of base salary, depending on management's assessment of the employee's necessity to the Debtors' businesses and the difficulty of replacing such employee.

22. Prior to their chapter 11 filings, the Debtors had two employee retention programs. In 2009, during normal market conditions, Patriot adopted a retention program to respond to the intense demand for skilled mine personnel. This program included 65 mine personnel that management deemed essential to productivity and profitability at individual mines. In June 2012, Patriot established a second retention program, which included 64 additional skilled employees in various corporate and operations management functions.

23. Although the structure of the CERP remains similar to the Debtors' prepetition retention programs, there are four significant differences. First, as with the 2013 AIP, six senior executives, comprising the executive management team, have

voluntarily declined to be considered for participation in the CERP. Second, the range of potential retention payments has been reduced by 25%, from a range of 15% to 60% of base salary under the prepetition programs, to just 11% to 45% under the CERP. This modification represents a cost savings of nearly $2 million. Third, the timing of retention payments has been delayed to correlate with the anticipated progress of the Debtors' chapter 11 proceedings. Thus, two initial installments of 25% each are to be earned as of March 31, 2013 and September 30, 2013, respectively, while a final installment of 50% would not be earned until the later of March 31, 2014 or 90 days following the Debtors' emergence from bankruptcy. Finally, any CERP payments forfeited due to a participant's voluntary termination (or involuntary termination for cause) would not be reallocated to other employees.

Towers' Review of the Reasonableness of the CERP

24. Retention programs are commonly implemented by chapter 11 debtors to prevent the attrition of their most critical employees. Based on my analysis, the terms of the CERP are generally comparable to retention programs adopted by other chapter 11 debtors, but lower in cost.

25. On an annualized basis, the aggregate cost of the CERP is less than $3 million, well below the average and close to the median of twelve chapter 11 retention programs in Towers' database. On a per participant basis, the approximately $25,000 annualized cost of the CERP is below both the median and the average of these comparators. Using either metric, the CERP is well within the range of market practice.

26. Debtors' need for the CERP has been highlighted by the departure of more than 25 critically important employees since June 2012. Often, the departure of key employees can lead to a cascade of resignations, which would impede Patriot's ability to

complete a successful reorganization if qualified replacements could not be recruited. At minimum, the Debtors would incur significant costs in recruiting and training qualified replacements.

27. This risk of critical employee departures is of particular concern because the current compensation of CERP Participants is comprised exclusively of base salary and is well below both market levels and their own historical compensation. My team's benchmarking analysis showed that, even taking into account the Proposed Compensation Plans, CERP Participants remain, on average, 25% below market.[6]

28. Based upon my experience and the work I have done in this case, it is my opinion that the overall design and structure of the CERP are generally consistent with market practice and properly align the CERP participants' incentives with the Debtors' restructuring goals and operating success. Therefore, I believe that the CERP is reasonable and appropriate and necessary to retain employees critical to the Debtors' business objectives, including a successful restructuring and the maximization of estate value.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct to best of my knowledge and belief.

Executed the 12th day of February, 2013.

/s/ Nick Bubnovich

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[6] Based on benchmarking analysis of 56 out of approximately 119 CERP Participants.