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)** **Hearing Date:** **March 18, 2013 at 1:00 p.m.** **(prevailing Central Time)** **Hearing Location:** **Courtroom 7 North** **Re: ECF No. 2819, 3088, 3142, 3143**

DEBTORS' OMNIBUS REPLY TO OBJECTIONS TO ENTRY OF AN ORDER APPROVING DEBTORS' COMPENSATION PLANS

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Patriot Coal Corporation and its subsidiaries that are debtors and debtors in possession in these proceedings (collectively, "**Patriot**" or the "**Debtors**") respectfully submit this reply (the "**Reply**") to the United Mine Workers' (the "**Union**") Objection to Debtors' Motion for an Order Approving and Authorizing Bonus Plans for Certain Employees [ECF No. 3142] (the "**Union Objection**") and the Objection of the United Mine Workers of America 1974 Pension Trust and the United Mine Workers of America 1993 Benefit Plan (together, the "**Funds**") to the Debtors' Motion for Authority to Implement Compensation Plans [ECF No. 3143] (the "**Funds Objection**" and, together with the Union Objection, the "**Objections**"), and respectfully represent as follows:

PRELIMINARY STATEMENT

Despite demanding reams of discovery and a lengthy extension of time, the Union and the Funds (together, the "**Objectors**") are unable to reasonably dispute any of the following:

- All chapter 11 incentive plans as well as retention plans that do not include "insiders" are subject only to business judgment scrutiny.
- The Debtors are suffering unprecedented attrition levels, including the loss of additional key employees since the Debtors' Motion for Authority to Implement the Compensation Plans (the "**Motion**") was filed.
- With improving market prospects and with many plan participants (the "**Proposed Plan Participants**") having transferrable skills (as the Funds' own expert concedes), attrition can only be expected to increase should the proposed incentive plan (the "**AIP**") and the proposed critical employee retention plan (the "**CERP**," and together with the AIP, the "**Proposed Plans**") not be approved. This is particularly true given that attrition has likely been temporarily slowed in anticipation of these Proposed Plans being approved by the Court.
- The Debtors' six executives managers have voluntarily removed themselves from participation in either Proposed Plan.
- The total maximum combined cost of the Proposed Plans is extremely modest—just 0.36% of revenues.

- AIP payouts are far from assured due to the aggressive performance metrics. Indeed, the Debtors are on pace to miss multiple key metrics.

- Pursuant to a settlement with the United States Trustee (the "**U.S. Trustee**"), anyone who was even arguably an insider under the applicable case law was removed from the CERP and, accordingly, the U.S. Trustee did not object to the Motion.

- The Proposed Plans are consistent with—albeit less generous than—established prepetition practices at Patriot.

- Even if every dollar is earned under the Proposed Plans, covered employees will still be undercompensated relative to market.

- The Proposed Plans—including the AIP performance metrics—were developed in close consultation with the Committee of Unsecured Creditors (the "**UCC**" or "**Committee**"), including its legal and financial advisors, and enjoy the Committee's support.

Despite these facts, the Objectors ask this Court to deny the Motion and risk critical damage to these chapter 11 estates based on inapplicable legal standards and unsupported assertions.

For example, the Objectors contend that the Proposed Plans contain insiders based solely on the formal job titles of certain individuals. But well-established law makes clear that formal job titles are irrelevant to the "insider" inquiry; rather, courts must look beyond title to determine whether an individual truly has sufficient influence and control to be considered an insider. Similarly, the Objectors assert that the plainly incentive-based AIP is not truly incentivizing because the performance metrics contained therein are essentially "lay-ups" that are nearly guaranteed to be satisfied. However, this argument is utterly divorced from reality, as the Committee and its professionals carefully vetted these metrics and as evidenced by the fact that the Debtors are currently on pace to <u>miss</u> multiple key performance metrics. In yet another example, the Objectors contend that the Debtors are not facing a serious attrition problem. Once again, this contention missed the mark in the face of uncontroverted evidence that the Debtors are in fact suffering from historically high attrition rates of key individuals.

Perhaps most telling, in support of its Objection, the Funds proffer a single witness, Mr. David Juza, who has absolutely no expertise, experience or even rudimentary knowledge regarding chapter 11 retention or incentive plans. (The Union proffered no witness.) And as will be noted throughout this Reply, the bulk of Mr. Juza's declaration and deposition testimony does not support—and often directly and definitively contradicts—the Objectors' assertions and arguments.

At bottom, the Objectors' attacks have very little, if anything, to do with the merits of these modest Proposed Plans. Indeed, if these Proposed Plans were in any way objectionable in cost, scope, or structure, the Court would have heard so loud and clear from the U.S. Trustee, the Committee, the DIP Lenders, and other parties in interest. Instead, the Objectors have launched their double-barreled attack—at a combined cost to the Debtors and the Objectors perhaps equaling the maximum total cost of the Proposed Plans themselves—in a thinly-veiled attempt to pre-litigate section 1113 and 1114. But this Motion must rise or fall on its own merits and the Proposed Plans should be promptly approved because they comport with the Debtors' sound business judgment, which is the applicable legal standard. Any further delay in implementing these Proposed Plans will likely result in the further and accelerated exodus of critical employees, causing irreparable harm to the Debtors and placing the entire reorganization at risk.

ARGUMENT

I. The Proposed Plans are Subject to Review Under the Business Judgment Standard

As set forth in the Debtors' Motion: (i) retention and incentive plans that fall within section 503(c)(3) of the Bankruptcy Code are reviewed under the familiar business judgment standard; (ii) the heightened showing in section 503(c)(1) is required only if and when a debtor proposes a retention plan for "insiders"; and (iii) all of the Debtors' insiders have been excluded

from the Proposed Plans, so section 503(c)(1) has no application to this Motion. Mot. ¶ 38; *see also In re Velo Holdings Inc.*, 472 B.R. 201, 212 (Bankr. S.D.N.Y. 2012); *In re Residential Capital, LLC*, 478 B.R. 154, 171 (Bankr. S.D.N.Y. 2012); *In re Borders Grp.*, 453 B.R. 459, 473-74 (Bankr. S.D.N.Y. 2011). Despite this black-letter law and the clear facts, the Objectors urge this Court to find that the Proposed Plans must satisfy the additional requirements of section 503(c)(1), erroneously arguing that (i) the Proposed Plans contain "insiders" and (ii) although the AIP was designed and operates as an incentive plan, the AIP is actually a stealth retention plan. Neither argument withstands scrutiny and this Court should review the Proposed Plans under the business judgment standard in accordance with the clear weight of authority.

A. The Proposed Plans Do Not Include Insiders

Section 503(c)(1) of the Bankruptcy Code is inapplicable because the Proposed Plan Participants are not "insiders" as that term is defined in section 101(31)(B) of the Code. Although the Proposed Plan Participants are critical to the Debtors' restructuring efforts, they are mid-ranking employees who lack control or authority over the Debtors, which is the cornerstone of "insider" status.

1. Applicable Legal Standards

Section 101(31)(B) provides, in relevant part, that an "insider" of a corporate debtor "includes": "(i) a director of the debtor; (ii) an officer of the debtor; [or] (iii) a person in control of the debtor . . . ." 101 U.S.C. § 101(31)(B); *see also Stalnaker v. Gratton (In re Rosen Auto Leasing)*, 346 B.R. 798, 804 (B.A.P. 8th Cir. 2006). The list is "illustrative, not exclusive." *In re Rosen*, 346 B.R. at 804.

The Bankruptcy Code does not define "director," "officer," or "person in control." In the absence of legislative guidance, courts have crafted a functional inquiry to determine insider

status. *See In re Longview Aluminum, L.L.C.*, 657 F.3d 507, 509 (7th Cir. 2011) ("The insider analysis is a case-by-case analysis based on the totality of the circumstances. . . ."); *accord In re Global Aviation Holdings*, 478 B.R. 142, 148 (Bankr. E.D.N.Y. 2012) (observing that the insider analysis turns on the "degree of involvement in the debtor's affairs"); *In re Velo Holdings*, 472 B.R. at 208 (same); *In re Borders,* 453 B.R. at 469 (same).

Consistent with this functional approach, it is well-settled that "the label an employer chooses to attach to a position is not dispositive for purposes of insider analysis." *In re Global Aviation*, 478 B.R. at 148; *see also In re Borders*, 453 B.R. at 468 ("An individual's title, by itself, is insufficient to establish that an individual is a director or officer."). Accordingly, a "director" under section 101(31)(B) is not a mid-ranking employee who happens to bear the title of "Director," but is an individual who serves on the board of directors of a corporation. *See, e.g.*, *Rupp v. United Security Bank (In re Kunz)*, 489 F.3d 1072, 1077 (10th Cir. 2007); *In re Global Aviation*, 478 B.R. at 147-48; *In re Borders*, 453 B.R. at 468. Similarly, an "officer" under section 101(31)(B) is not a mid-ranking employee with a lofty title, but is an individual who has been "elected or appointed by the board of directors to manage the daily operations of a corporation, such as the CEO, president, secretary, or treasurer." *In re Borders*, 453 B.R. at 468 (emphasis added); *accord In re Global Aviation*, 478 B.R. at 148; *see also id.* at 150 (observing that an insider is a person with "the authority to make company-wide or strategic decisions"). Accordingly, "insider" status has been conferred on individuals who participate in corporate governance, *see id.* at 148, or "occupy a high position within the corporation making [him or her] active in setting overall corporate policy or performing other important executive duties . . . ," *see NMI Sys. v. Pillard (In re NMI Sys., Inc.)*, 179 B.R. 357, 369-70 (Bankr. D.D.C. 1995) (declining to confer insider status on a vice president who was not a "member of the inner circle

making the company's critical financial decisions"). Courts have concluded that an "insider" is a person who has the authority to "set[] corporate policy," *see In re Global Aviation*, 478 B.R. at 149, or "unqualifiably dictate corporate policy and the disposition of corporate assets," *see In re Borders*, 453 B.R. at 459 (citation omitted). Typically, an "insider" attends board meetings or reports to the board in the ordinary course. *See In re Global Aviation*, 478 B.R. at 148-49.

Thus, regardless of title, "Vice Presidents," "Directors," and "Managers" who function outside of the inner executive circle are routinely held to lack insider status. *See In re Global Aviation*, 478 B.R. at 148 ("[T]itles such as 'vice president' are not determinative."); *In re Borders*, 453 B.R. at 469 (declining to confer insider status on "director-level employees," including a "Corporate Secretary," because "[c]ompanies often give employees the title 'director' or 'director-level' but do not give them decision-making authority akin to an executive"); *In re Public Access Technology.com, Inc.*, 307 B.R. 500, 506 (E.D. Va. 2004) (holding that mere title of "Executive Vice President" was insufficient to find that the employee was an officer where "there [were] no affidavits, articles of incorporation, corporate minutes, resolutions, or any documents showing that this title [made] [the employee] an officer of the corporation"). Pursuant to the functional approach, courts understand and acknowledge that it is customary for corporations to offer numerous mid-ranking, non-insider employees a title such as "Vice President" for marketing or morale. *See In re NMI Sys.*, 179 B.R. at 370 (noting that the "mere title of 'vice president' is insufficient to make an individual an officer" and declining to confer insider status on a vice president who was "accorded the title for the purposes of marketing and as the boss of the unit he managed").

2. None of the Proposed Plan Participants is an Insider

Ignoring the relevant case law, the Objectors argue that the Proposed Plans contain thirty-five to forty insiders. *See* Union Obj. at 8-9, 18; Funds Obj. ¶ 24. Indeed, taking a rigid approach that is antithetical to the prevailing functional analysis, the Objectors have simply selected any Proposed Plan Participant with any sort of title—such as "Senior Vice President," "Vice President," "General Manager," "Operational Manager," or "Manager"—and have labeled him or her an "insider," without regard to that employee's duties and responsibilities or level in the corporate hierarchy. In reality, however, all of the Proposed Plan Participants share the following characteristics:

- None is a member of the inner circle making the Debtors' critical financial and operational decisions.
- None has the authority to make company-wide or strategic decisions.
- None exercises sufficient authority over the Debtors to dictate corporate policy and the disposition of corporate assets.
- None reports to the Board of Directors in the ordinary course.
- None reports to the CEO.[1]
- None attends Board meetings.[2]
- None was elected by the Board as an officer to manage the company.

Therefore, no Proposed Plan Participant in either the CERP or the AIP is an insider under the applicable legal standards. And consistent with their status as non-insider, mid-ranking

[1] *See* Hatfield Dep. Tr. at 18:9-10 ("There are no participants in the program that are direct reports to [Mr. Hatfield], the CEO. That group voluntarily stepped out of the program and waived any participation.").

[2] The sole exception is the Corporate Secretary, who does so only in a note-taking capacity. *See* Hatfield Dep. Tr. at 61:25–62:6 (stating that Corporate Secretary was present at Board meetings "specifically [for] taking the minutes"); *In re Borders*, 453 B.R. at 470 n.4 (finding that "the Corporate Secretary is not an insider because the position is purely ministerial (i.e., taking the minutes of board of directors' meetings and maintaining corporate records).").

employees, they earn significantly less than the six excluded executive managers. *See In re Global Aviation*, 478 B.R. at 148-49 (declining to confer insider status on employees who earned less than the senior executives earned).

Undeterred, the Objectors ask this Court to ignore the weight of authority in favor of *Foothills*, a single, non-binding, out-of-district, outlier case holding that a "vice president" is presumptively an officer. *See* Union Obj. at 9; Funds Obj. ¶ 25 (citing *In re Foothills Texas, Inc.*, 408 B.R. 573 (Bankr. D. Del. 2009)). But even *Foothills* does not require this Court to find that the Proposed Plan Participants are insiders. First, as mentioned, *Foothills* is an outlier that contradicts established and persuasive precedent. *See infra* I.A.1 (citing *In re Global Aviation Holdings Inc.*, 478 B.R. 142 (Bankr. E.D.N.Y. 2012); *In re Borders Group*, 453 B.R. 459 (Bankr. S.D.N.Y. 2012); and *In re Velo Holdings*, 472 B.R. 201 (Bankr. S.D.N.Y. 2012)). Second, *Foothills* is factually distinguishable. Unlike the Debtors' corporate structure, the company at issue in *Foothills* had only ten employees in total, including the President, CEO, and CFO. *See* 408 B.R. at 575. Thus, it was not a stretch to presume that two vice presidents working in such a small business were insiders. This stands in stark contrast to Patriot, which has over 4,000 employees (excluding full-time consultants). Third, even if the Court elects to follow *Foothills*, the Debtors have conclusively rebutted the presumption of insider-status by showing that the Senior Vice Presidents and Vice Presidents in the Proposed Plans do not participate in the Debtors' management.

The Objectors' additional argument that certain Proposed Plan Participants are insiders because they assisted in the development of the program is equally unpersuasive. In *In re CEP Holdings, LLC*—upon which the Union relies—the court looked to whether "the potential plan recipient had <u>significant input</u> into the negotiation of the plan (including the amount of additional

compensation the employee would receive under the plan)." 2006 WL 3422665, Nos. 06-51847, 06-51848 (Bankr. N.D. Ohio Nov. 28, 2006) (emphasis added). Here, no Proposed Plan Participant had "significant input" into the negotiation or development of the Proposed Plans.

Finally, in a last effort to portray mid-level employees such as "vice presidents and [the] chief information officer" as "insiders," the Union selectively quotes and misconstrues Patriot's Bylaws. *See* Union Obj. at 9. Unfortunately for the Union, simply reading the entire relevant section of the Bylaws quickly dispatches this argument. Section 3.2 of the Bylaws states, in relevant part:

> The principal officers of the Corporation shall consist of a Chief Executive Officer, a President, one or more Vice Presidents, a Secretary, a Treasurer and such other additional officers with such titles (including, without limitation, a Chief Operating Officer and a Chief Financial Officer) as the Board of Directors shall from time to time determine, all of whom shall be elected by and shall serve at the pleasure of the Board of Directors.

See Form of Amended & Restated By-Laws of Patriot Coal Corporation § 3.2 (emphasis added).[3] Section 3.2 further provides that the Board may elect, or the CEO or the President may appoint, "other officers." *See id.* Not one of the CERP Participants—including the Vice Presidents and the Chief Information Officer—was elected by the Board or appointed by the CEO or the President. Therefore, none of the CERP Participants is either a "principal officer" or an "other officer" under the Bylaws.[4]

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[3] http://www.sec.gov/Archives/edgar/data/1376812/000095013707015969/c19546exv3w2.htm.

[4] The Objectors' argument that certain Proposed Plan Participants are "insiders" because they have been designated as "Authorized Officers" in the Written Consents filed in connection with the bankruptcy petitions is even less persuasive. *See* Union Obj. at 16. First, an "Authorized Officer" in a Written Consent is a technical term, limited to the context of filing a bankruptcy petition and performing administrative, bankruptcy-related tasks. It beggars credulity to argue that any person designated as an "Authorized Officer" in a Written Consent is automatically an insider under section 101(31)(B), and the Objectors are unable to offer a single authority for such an outlandish proposition. Second, an "Authorized Officer" of a *subsidiary*, as opposed to the parent company, is even further removed from insider status. Subsidiary personnel are not members of the Debtors' inner executive circle.

3. The Settlement with the U.S. Trustee Removes Any Insider Doubt

As detailed above, none of the Proposed Plan Participants is a member of Patriot's inner circle, dictates company-wide policy or strategy, reports to the Board or CEO in the ordinary course, attends Board meetings, or was elected by the Board for the purpose of managing the company. Nevertheless, in discussions with the Debtors, the counsel to the U.S. Trustee stated the position that because seven Proposed Plan Participants had been elected by the Board, they are insiders. While the Debtors do not believe that this fact alone is dispositive of the insider question (and in fact continue to believe these individuals are not insiders),[5] the Debtors agreed to remove these seven employees from the CERP.[6] Accordingly, the U.S. Trustee is now in agreement that no insiders of the Debtors are included in the CERP and that section 503(c)(1) is therefore inapplicable. *See* Notice Regarding Debtors' Motion for Authority to Implement Compensation Plans [ECF No. 3088].

B. The AIP is Primarily Incentive-Based

As explained, neither the CERP nor the AIP includes any insiders. Still, even if the AIP did contain insiders, the AIP would be subject to business judgment review under section 503(c)(3) because section 503(c)(1) does not apply to plans that are primarily incentive-based.

[5] First, despite their board-election, five of the seven employees are not "principal officers" under the Patriot Bylaws. They are "other officers"—which is a mid-ranking designation created by the Debtors for marketing and promotional purposes. Second, a "principal officer" or an "other officer" under the Bylaws is not necessarily an "officer" under section 101(31)(B). Although the seven employees were elected by the Board, they were not elected by the Board to manage the company. *See In re Borders*, 453 B.R. at 468; *accord In re Global Aviation*, 478 B.R. at 148.

[6] The removed individuals have the following titles: Senior Vice President, Operations; Vice President, Safety; Vice President, Associate General Counsel & Corporate Secretary; Vice President, Operations; Vice President & Treasurer; Vice President, Investor Relations; Assistant Secretary & Senior Counsel.

1. Applicable Legal Standards

Section 503(c)(1) "applies to those employee retention provisions that are essentially 'pay to stay' key employee retention programs." *In re Dana Corp.*, 358 B.R. 567, 571 (Bankr. S.D.N.Y. 2006) ("*Dana II*"). "When a plan is designed to motivate employees to achieve specific performance goals, it is primarily incentivizing and thus not subject to section 503(c)(1)." *In re Residential Capital, LLC*, 478 B.R. 154, 171 (Bankr. S.D.N.Y. 2012). Thus, a plan that is primarily incentive-based—even a plan that contains insiders—is subject to the familiar business judgment standard. *In re Velo Holdings*, 472 B.R. at 209-11; *see also In re Residential Capital*, 478 B.R. at 157, 170-71; *In re Borders*, 453 B.R. at 471, 473-74.[7]

Moreover, a valid incentive plan may contain some retentive effect and still remain subject to the business judgment standard; the plan need only be primarily incentive-based in order to qualify for business judgment review. *In re Residential Capital*, 478 B.R. at 171 (observing that a valid incentive plan must be "primarily incentivizing and not primarily retentive"); *In re Borders*, 453 B.R. at 471 ("Although a purported KEIP may contain some retentive effect, that does not mean that the plan, overall, is retentive rather than incentivizing in nature." (internal quotation marks omitted) (citation omitted)); *see also In re Velo Holdings*, 472 B.R. at 209 (same); *Dana II*, 358 B.R. at 785 ("[I]ncentivizing plans with some components that arguably have a retentive effect do not necessarily violate section 503(c)."); *In re Dana Corp.*,

[7] The Union's reliance on *In re Borders* for the proposition that an incentive plan is subject to heightened scrutiny if it includes insiders is misplaced. *See* Union Obj. at 18. In fact, the court in *In re Borders* expressly applied the business judgment standard in evaluating an incentive program that provided compensation opportunities to insiders. Not one of the remaining cases on which the Union purports to base its argument for "heightened scrutiny" even involved evaluation of an incentive program. *See* Union Obj. at 17-18 (citing *In re Pilgrim's Pride Corp.*, 401 B.R. 229, 232-33 (Bankr. N.D. Tex. 2009) (considering non-compete agreements); *In re Regensteiner Printing Co.*, 122 B.R. 323, 325 (N.D. Ill. 1990) (considering retention payment agreements under section 503(b)); *Pepper v. Litton*, 308 U.S. 295 (1939) (considering claim disallowance, and pre-dating the enactment of the Bankruptcy Code of 1978 by forty years)).

351 B.R. 96, 103 (Bankr. S.D.N.Y. 2006) ("*Dana I*") (same); *In re Global Home Prods., LLC*, 369 B.R. 778, 786 (Bankr. D. Del. 2007) ("The entire analysis changes if a bonus plan is not primarily motivated to retain personnel or is not in the nature of severance."); *In re Nelson Nutraceutical, Inc.*, 369 B.R. 787, 802 (Bankr. D. Del. 2007) (interpreting section 503(c)(1) to apply to "a transfer made to an insider of the debtor for the *primary* purpose of inducing such person to remain with the debtor's business" (internal quotation marks and alterations omitted)).

2. <u>The AIP is Incentive-Based and Therefore Subject to Review Under the Business Judgment Standard</u>

The AIP is primarily, if not exclusively, incentivizing. Payments under the AIP are 100% conditioned on Proposed Plan Participants achieving specified performance goals. These performance goals, in turn, are carefully designed to motivate employees to achieve important financial, safety, and environmental results, which are critical to the Debtors' successful restructuring. Hatfield Decl. ¶ 30; Bubnovich Decl. ¶ 10. Sixty percent of the total incentive compensation is based on financial metrics, which require meeting challenging liquidity and modified-EBITDA (referred to as "**EBITDAP**") objectives in the Debtors' five-year business plan, with each objective weighted at 30%. Fifteen percent of the total incentive compensation is conditioned on the company meeting these additional goals in the Debtors' five-year business plan: (i) safety incidence, (ii) Mine Safety Health Administration and ("**MSHA**") compliance, and (iii) environmental incidence metrics. The remaining 25% of the total incentive compensation is based on the attainment of qualitative individual objectives pertaining to strategic areas that are important to the Debtors' business. Hatfield Decl. ¶¶ 28-30, 32; Bubnovich Decl. ¶¶ 10-11.

The performance-based structure of the AIP contrasts sharply with the structure of incentive programs that have been deemed retentive in nature. In *Residential Capital*, for

example, the bankruptcy court found that the plan was not primarily incentivizing because it "allow[ed] for nearly two thirds of the [awards] to vest upon the closing of two section 363 asset sales that were negotiated before the commencement of the[] [chapter 11] cases" and did "not impose any additional financial metrics or hurdles in order for those [awards] to vest." 478 B.R. at 172. As the court explained: "[T]riggering bonus awards solely on the basis of a sale transaction, confirming a reorganization plan or exiting bankruptcy are not sufficient" to avoid section 503(c)(1), because if the "vesting of an award only require[s] the eligible recipients to remain with the debtors until the effective date," then "such an award cannot be fairly characterized as primarily incentivizing." *Id.* at 172-73. Likewise, in *Dana I*, the court found that a purported incentive bonus was a retention bonus because it "include[d] an amount payable to the [e]xecutives upon the [d]ebtors' emergence from chapter 11, regardless of the outcome of these cases." 351 B.R. at 102 ("Without tying this portion of the bonus to anything other than staying with the company until the [e]ffective Date, this [c]ourt cannot categorize a bonus of this size and form as an incentive bonus."). The court thus concluded: "Using a familiar fowl analogy, this compensation scheme walks, talks and is a retention bonus." *Id.*; *see also In re Hawker Beechcraft, Inc.*, 479 B.R. 308, 317 (Bankr. S.D.N.Y. 2012) (rejecting incentive plan because the recipients would "earn a bonus under either of two transactions one of which is bound to occur").

To borrow that same analogy, the AIP here walks like, talks like, and is an incentive plan. The payments are tied to the achievement of performance-based goals, and the payments do not vest solely upon a closing, sale, or transaction that is bound to occur regardless of performance. *See In re Mesa Air Grp., Inc.*, No. 10-10018, 2010 WL 3810899, at *4 (Bankr. S.D.N.Y. Sept.

24, 2010) (finding that incentive plan was not retentive because it was "tied to certain performance goals," such as "maintenance of flight schedules" and "efficient return of aircraft").

Moreover, the AIP is not only laden with specific performance measures, but it also "encourages [employees] to increase their pre-bankruptcy job responsibilities to achieve the bonus requirements and financial targets." *See In re Velo Holdings*, 472 B.R. at 210 (holding that an incentive plan is not retentive if the plan requires potential recipients "to do more to meet the wide-scale goals outlined in the KEIP as they must address concerns and issues that are unique to the bankruptcy proceeding"). The Debtors' financial and liquidity concerns cannot be overstated and, as a result, the AIP conditions a full 60% of the total incentive compensation on achieving specific EBITDAP and liquidity targets. These financial metrics were deliberately weighted more heavily than they were in the Prepetition AIP in order to reflect the Debtors' business judgment that financial metrics are of comparatively greater significance during restructuring. Hatfield Decl. ¶ 30; Bubnovich Decl. ¶ 10 (stating that the financial metrics are "weighted most heavily to reflect their centrality to a successful reorganization"). The liquidity component did not even appear in the Prepetition AIP:

> [I]t was also thought that our lenders in particular, and the UCC, would want a heavy focus on the financial performance given the severe nature of our position through the course of 2013. So our feeling was that this was an appropriate allocation given that we helped the ongoing restructuring process and substantial liquidity and financial challenges. . . . In prior plans, there would not have been a liquidity component, and the safety and compliance would have both been slightly higher . . . [and] the individual would also be slightly higher.[8]

Hatfield Dep. Tr. at 75:6-21. Therefore, the Proposed AIP is not retentive, as it specifically motivates the Participants to ramp up their efforts and tackle bankruptcy-related problems.

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[8] *See also* Bubnovich Decl. ¶ 10 (stating that weighting of individual performance component at 25% "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").

The Objectors do not dispute that the AIP is designed as an incentive plan; instead, they argue that it is not truly an incentive plan because the performance-targets are essentially "lay-ups."[9] *See Dana II*, 358 B.R. at 583. That assertion, in addition to being completely unfounded and an unwarranted attack on the Debtors' good-faith business judgment, is demonstrably false. Indeed, the AIP is primarily incentivizing and is not retentive because surmounting the AIP's performance-based hurdles will prove difficult. *See id.* at 583 (finding that an LTIP was not a disguised KERP in part because the "benchmarks for the LTIP are difficult targets to reach and are clearly not 'lay-ups'"); *In re Borders*, 453 B.R. at 472 (finding that incentive plan was not a disguised retention plan in part because "meeting the[] goals will no doubt be challenging and therefore incentivizing").

First and foremost, the independent due diligence performed by the Committee and its professionals, and the Committee's continued support for the Proposed Plans, undermines any argument that the AIP is not a true incentive plan because it sets targets that are too easy to reach.

Second, the financial metrics are aggressive, particularly in light of the ongoing depression in the coal markets. Hatfield Decl. ¶ 28; Bubnovich Decl. ¶ 11. As Mr. Hatfied testified to in his deposition, the "financial forecast was sufficiently aggressive in light of a deteriorating market" that has seen coal prices fall and revenue drop precipitously since Patriot's filing and even since preparation of its financial forecasts. *See* Hatfield Dep. Tr. at 74:11-23.[10]

[9] The Objectors' additional argument that the AIP is not incentivizing to non-management personnel because those lower-level employees cannot impact the Debtors' financial metrics is easily refuted by their own purported expert, Mr. Juza. *See* Union Obj. at 17. As Mr. Juza testified, even lower level participants in the AIP "have some impact" on EBITDA and liquidity. *See* Juza Dep. Tr. at 123:19–124:11.

[10] While the Funds' expert, Mr. Juza, based his opinion that the financial metrics do not provide meaningful incentives on the fact that they are consistent with Patriot's financial forecasts, he testified that (i) he has (….continued)

There is no greater indication of the financial metrics' robustness than the fact that Patriot is on track to miss its EBITDAP target. *Cf. Dana II*, 358 B.R. at 583 (finding that LTIP was not retentive where the debtors' pro forma EBITDAR was $210 million and the financial target was $250 million). The Union's allegation to the contrary is factually incorrect. *See* Union Obj. at 17. Furthermore, the choice of EBITDAP over EBITDA as a financial metric makes the target more difficult to achieve, not less, because any cost savings achieved through cuts to pension and other post-retiree medical benefits cannot influence the EBITDAP calculation. *See* Hatfield Decl. ¶ 28.[11]

Third, the operational metrics are similarly aggressive, which is evidenced by the fact that the payout thresholds for safety incidence, MSHA compliance, and environmental incidence are more aggressive than in the preceding three years, and that Patriot is on track to miss the safety incidence rate by approximately 80%.[12] Nevertheless, the Funds contend that the safety incidence target is not sufficiently incentivizing because it is slightly lower than achieved rates for 2011. *See* Funds Obj. at 12. That argument is unpersuasive. First, the year that the Funds conveniently use as a comparator was an exceptional year for the company's safety incidence

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(continued….)

no basis to know whether such forecasts are aggressive and (ii) that companies are best positioned to determine their own performance metric targets. Juza Dep. Tr. at 177:3-17, 84:13-25.

[11] *See also* Hatfield Dep. Tr. at 41:21–42:5 ("There was a consensus in the discussion that it would be best to avoid having a plan design that might . . . influence management in some respects with how we bargained in the 1113, 1114 process. Key point being that they did not want to incentivize anything other than fair and open marketing and exchange of proposals in the 1113/1114 process. We wanted to remove that from factoring into the incentive program.").

[12] *See* 2010 Schedule 14A Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, at 23 (Apr. 1, 2010), http://www.sec.gov/Archives/edgar/data/1376812/000095012310031397/c56892ddef14a.htm; 2011 Schedule 14A Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, at 24 (Apr. 1, 2011), http://www.sec.gov/Archives/edgar/data/1376812/000095012311031890/c63736def14a.htm; 2012 Schedule 14A Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, at 26 (Mar. 30, 2012), http://www.sec.gov/Archives/edgar/data/1376812/000119312512143555/d316417ddef14a.htm.

rate. *See* 2012 Schedule 14A Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, at 26 (Mar. 30, 2012). To suggest that setting a performance objective that is slightly lower than a banner year is not incentivizing defies logic. Second, the Funds ignore the fact that those prior year rates were achieved during a time when Debtors had their Prepetition AIP, which also included safety, MSHA compliance, and environmental incentives. Thus, as the Funds' own purported expert confirmed, the prior year performance rates demonstrate the importance and effectiveness of an incentive program for operational metrics. *See* Juza Dep. Tr. at 121:7-14 (observing that 2011 performance in compliance, environmental, and safety performance may have been attributable to annual incentive program).

Finally, the Objectors attack the individual metrics component of the AIP. The individual goals provide management with discretion to reward employees who have excelled in their contribution to the achievement of the company's financial and operational objectives pursuant to pre-determined, individualized metrics. During an employee's performance review, the supervisor of that employee sets three to five goals, in writing. *See* Hatfield Dep. Tr. at 49:17-25. Supervisors are instructed to make the goals "specific and measurable" and to set a numeric target, if possible. *See* Hatfield Dep. Tr. at 50:4-9. It is neither realistic nor required, as the Objections imply, for the company to have to identify each and every one of those individual goals in advance.[13] Contrary to the Objectors' assertions, the individual component of the incentive payout is incentivizing and is consistent with Patriot's longstanding practice. *See* Union Obj. at 17; Funds Obj. ¶ 12.[14]

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[13] In fact, an incentive program developed by the Funds' own purported expert failed to detail the differentiated individual goals of participants. *See* Juza Dep. Tr. at 43:8-18.

[14] The Objectors' remaining theories for why the AIP is not an incentive program are easily dismissed. First, the fact that the AIP is not payable until 30-60 days after it is earned—in part to allow the Debtors' to finalize its books for the preceding performance period—does not transform the AIP into a primarily retentive program.
(….continued)

II. The Proposed Plans Satisfy the Business Judgment Standard

The Debtors have met their burden of demonstrating that the Proposed Plans are in the best interests of the Debtors' estates and should be approved under sections 363(b) and 503(c)(3) as within the Debtors' sound business judgment.

Under well-established law, a debtor satisfies the business judgment standard when its proposed action "is in the [d]ebtors' best economic interests, based on the [d]ebtors' best business judgment in those circumstances." *In re Farmland Indus. Inc.*, 294 B.R. 903, 913 (Bankr. W.D. Mo. 2003); *see also In re Food Barn Stores, Inc.*, 107 F.3d 558, 567 n.16 (8th Cir. 1997) ("Where 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.'" (citations omitted)). While not binding authority on this Court, in the context of analyzing incentive and retention plans, some courts have looked to the factors set forth in *Dana II* to determine whether the business judgment standard has been met. Those factors are:

> (1) whether the plan is calculated to achieve the desired performance;
>
> (2) whether the cost of the plan is reasonable in the context of a debtor's assets, liabilities and earning potential;
>
> (3) whether the scope of the plan is fair and reasonable or discriminates unfairly among employees;
>
> (4) whether the plan is consistent with industry standards;
>
> (5) whether the debtor performed due diligence in investigating the need for the plan; and
>
> (6) whether the debtor received independent counsel in performing due diligence, creating, and authorizing the plan.

In re Dana Corp., 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006) ("*Dana II*").

(continued….)

Second, the fact that the AIP opportunity has been increased for the seven Proposed Plan Participants who were recently removed from the CERP will only strengthen those Participants' incentives to achieve the AIP performance metrics.

Notwithstanding the protestations of the Objectors—who would turn the business judgment standard on its head and engage in a multi-day, massively expensive litigation that is a referendum on every management decision—the evidence presented to date, and that will be presented at the hearing, clearly demonstrates that the Proposed Plans easily satisfy the business judgment standard and each *Dana II* factor.[15]

A. **The Proposed Plans Reflect a Valid Exercise of the Debtors' Business Judgment**

There is no reasonable dispute that:

- the Debtors are operating under incredibly difficult conditions, while simultaneously experiencing historically high attrition rates at a time when a successful reorganization is dependent on maximizing contributions from all employees;
- the Proposed Plan Participants have suffered drastic cuts in compensation and benefits while simultaneously being asked to work longer hours and shoulder greater responsibilities—all in the face of increased job uncertainty;
- retaining and appropriately incentivizing the Proposed Plan Participants is vital to a successful reorganization, the achievement of which would obviously benefit all stakeholders; and
- the $6.9 million cost of the Proposed Plans is modest in light of the value of the ongoing contributions of these employees and the risk of losing their critical skills and institutional knowledge. Hatfield Decl. ¶ 38.

Moreover, it is telling that the Proposed Plans have the express support of the Committee, a clear indication that the approval of the Proposed Plans is in the best interests of the Debtors'

[15] It bears noting that the Objectors' claim that the Debtors have provided insufficient information in discovery to support the Proposed Plans is utterly without merit. The Debtors have provided the Objectors with extensive discovery, including the opportunity to depose the Debtors' two declarants: Bennett Hatfield, CEO of Patriot, and Nick Bubnovich of Towers Watson. The produced information included, among other materials: (i) job titles, geographic location of employment, historical compensation data, and proposed compensation opportunities for each Proposed Plan Participant going back three years (where applicable); (ii) supporting data regarding the Debtors' historic and current attrition rates; (iii) underlying survey data utilized by Towers in its benchmarking analysis; (iv) data, projections and assumptions underlying the financial and operational performance metrics; (v) historical AIP, LTIP, CERP, mine-level incentive and mine-level retention documents; (vi) draft iterations of the Proposed Plans; (vii) organization charts; (viii) Board of Directors minute meetings; and (ix) compensation information for the executive management team.

estates.[16] Accordingly, for the reasons set forth above and in the Motion, implementation of the Proposed Plans is a reasonable exercise of the Debtors' business judgment.

B. The Proposed Plans Satisfy the *Dana II* Factors

The fact that the Proposed Plans satisfy each of the instructive, non-exhaustive factors set forth in *Dana II* lends further support that the Proposed Plans should be approved.

Factor 1: There is a Reasonable Relationship Between the Proposed Plans and the Desired Results

The AIP performance metrics are aggressive targets that have been specifically crafted to enable the Debtors to achieve the financial and operational goals set forth in their five-year business plan. *See infra* I.B.2. By linking the AIP Participants' incentive opportunities to these critical performance metrics, the AIP directly encourages AIP Participants to achieve goals that will enable the Debtors to successfully reorganize, and is thus clearly designed to "achieve the desired performance."

Similarly, the CERP was designed to address the important need to retain key employees that are crucial to the success of the Debtors' business and restructuring.[17] Moreover, the Debtors have structured the timing of CERP payments to motivate these critical employees to remain with the Debtors throughout the course of these chapter 11 cases—an undeniably

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[16] The Union disingenuously implies that modifications to the Proposed Plans in connection with resolving the informal objection of the U.S. Trustee and subsequent to the Committee's vote of approval on the Proposed Plans undermines the Committee's support. Pure nonsense. First, we understand that the Committee will be filing a statement in support of the Proposed Plans. Second, the maximum amount of potential payments under the Proposed Plans remains the same: $6.9 million. Finally, the only effect of the change, which moved potential payout dollars from the CERP to the AIP, was to make the Proposed Plans potentially <u>cheaper</u> because more money is subject to meeting challenging performance metrics.

[17] Indeed, courts regularly approve retention plans with the sole stated purpose being that of retaining employees. *See*, *e.g.*, *In re Borders Grp., Inc.*, 453 B.R. 459, 474 (Bankr. S.D.N.Y. 2011) (retention plan "appropriately constructed to retain non-insiders" in place of recruiting and training new employees); *In re Allied Holdings, Inc.*, 337 B.R. 716 (Bankr. N.D. 2005) (approving retention bonuses styled "stay bonuses" for which sole eligibility criteria were continued employment on particular dates).

uncertain and burdensome period. Indeed, half of the CERP awards will not be paid until after the Debtors have emerged from chapter 11. While the Funds object to the payment of any CERP awards before emergence, the Debtors have determined, in their business judgment, that three separate CERP payments is a reasonable and necessary way to provide compensation and certainty to employees during the course of the Debtors' restructuring, in order to ensure their continued employment through emergence.[18] And courts routinely approve retention programs that, as here, provide for staggered payments. *See, e.g.*, *In re Nortel Networks Inc.*, No. 09-10138, 2011 WL 1100983 (Bankr. D. Del. Mar. 5, 2009) (approving retention awards that vested in three six-month periods); *In re Allied Holdings, Inc.*, 337 B.R. 716, 727 (Bankr. N.D. Ga. 2005) (approving retention bonuses to be paid in four installments).

Oddly, the Funds also argue that cash retention payments may be insufficient to retain critical employees, since some departing employees have taken positions with other companies at lower pay or rank. Funds Obj. ¶ 29. This argument is uniquely unimpressive. First, in so arguing, the Funds implicitly concede that the Debtors are at a huge competitive disadvantage when it comes to retaining employees who might be inclined to leave (even for less pay) to an employer not in bankruptcy—a fact that strongly militates in favor of the need for a retention program, not against. Hatfield Decl. ¶ 17. Second, the Funds' argument ignores the reality that employees that have departed have faced uncertainty not only about the Debtors' future, but also about the terms of their compensation—including their likelihood of receiving long-anticipated retention and incentive payments. Indeed, the Debtors' failure to pay retention payments has been a factor in many departing employees' decisions to accept an offer with another employer.

[18] *See* Bubnovich Dep. Tr. at 122:11-18 (explaining that such staggered payments provide more effective "carrots" for the purposes of retaining employees).

Hatfield Decl. ¶ 15. Finally, while it is true that cash awards cannot eliminate the risk of critical employees leaving, it can help minimize that risk, as the Funds own purported expert acknowledges—even for employees with an otherwise predetermined plan to leave. *See* Juza Dep. Tr. at 137:9-13, 104:21–105:3.

Factor 2: The Cost of the Proposed Plans is Reasonable in the Context of the Debtors' Assets, Liabilities, and Earning Potential

The Proposed Plans are largely a continuation of the Debtors' prepetition practices, but have been modified to be significantly lower in cost. The combined cost of the AIP and CERP together is less than a single year of the Debtors' Prepetition AIP alone. Hatfield Decl. ¶ 22. Additionally, the amounts paid out under the Proposed Plans are *de minimis* in light of the total asset value of the Debtors and the period of time over which such payments will be made. A maximum potential cash payout of approximately $6.9 million represents a mere 0.36% of the Debtors' 2012 annual revenues. Moreover, 60% of the AIP is self-funding in that the amounts attributable to financial metrics will not be paid unless the Debtors achieve their aggressive financial targets. Similarly, the aggregate cost of the CERP is significantly less costly than the expense of losing critical employees, which includes not just the costs of recruiting and training replacements, but the less quantifiable costs of losing years of experience and institutional knowledge. Hatfield Decl. ¶ 38; Juza Dep. Tr. at 106:20–110:11.

Indeed, the Union's claim that "each of the departed CERP [P]articipants in the fourth quarter of 2012 and the first quarter of 2013 have already been replaced, in all but one case by employees receiving a lower salary," and that the Debtors have "not articulated any negative consequences derived from replacements," callously understates the disruption and the costs of losing such critical employees. *See* Union Obj. at 26. The loss of each and every one of these employees has come at great cost to the Debtors. As an initial matter, the Union ignores the

tangible cost of locating, recruiting and training new employees. *See, e.g.*, Hatfield Decl. ¶ 35 n.8. Moreover, the Debtors are often unable to fully replace departing critical employees, either because they are unable to locate a suitable replacement, or unable to attract a replacement to come work for an entity in chapter 11. Consequently, many of the alleged "replacements" have been promoted from within whereby the next most qualified person is asked to assume responsibilities that he or she may not be prepared or fully qualified to assume. These internal promotions create a ripple effect throughout the company, either leaving a vacancy in their wake or requiring the Debtors to fill the junior position through outside hires or expensive consultants.

Finally, the Union completely ignores the less tangible, but no less real, costs associated with losing critical, well-respected employees, mentors, supervisors, and managers, with years of experience at Patriot. Such employees cannot simply be "replaced" by a new employee earning a "lower salary" as the Union claims. The Debtors have absorbed all such losses that they can afford to absorb—and in some cases more than they could afford—and the time to stem this rising tide of attrition through implementation of the moderately priced Proposed Plans is long overdue.

Factor 3: The Scope of the Proposed Plans is Fair and Reasonable and Does Not Discriminate Unfairly

The Funds repeatedly criticize the Proposed Plans for being "top-heavy," or offering greater incentive and retention opportunities to senior management than to lower-level employees. Funds Obj. ¶ 34, 37. In support of this argument, they offer their own "Exhibit K," which purports to demonstrate, without explanation, that "the ratio of funds under the proposed CERP and AIP targeted for the most senior staff members as compared to the more junior is

substantially unbalanced."[19] *See* Juza Decl. ¶ 28 (attaching Exhibit K). But the Funds' own expert, who created Exhibit K, testified that higher salaried participants may have a disproportionately significant impact on the achievement of performance metrics and that it is appropriate to award them with greater incentive opportunities.[20] The Funds' argument also ignores the reality that the members of the Debtors' executive management team will receive no payout under the Proposed Plans, as each has voluntarily removed himself from participation in either Proposed Plan. *See* Juza Dep. Tr. at 94:20-95:22 (noting that Exhibit K does not take into account exclusion of Debtors' executive management team from the Proposed Plans).

Moreover, the Funds do not cite a single case to support the proposition that offering senior-level employees greater retention and incentive opportunities is grounds for denying a compensation program. Nor can they, for a review of cases interpreting this factor conclusively demonstrates that it weighs heavily in favor of approving the Proposed Plans, as the Proposed Plans are far more egalitarian than many incentive and retention plans that have been approved. *See, e.g.*, *In re EaglePicher Holdings, Inc.*, No. 05-12601, 2005 WL 4030132, *3 (Bankr. S.D. Ohio Aug. 26, 2005) (approving a plan that covered less than four percent of the debtor's workforce and under which the three most senior employees could obtain as much as 28% of the payments made under the plan); *see also In re Global Aviation Holdings Inc.*, 478 B.R. 142, 145-46 (Bankr. E.D.N.Y 2012) (approving retention plan for only five employees); *In re Borders Grp., Inc.*, 453 B.R. 459, 475-76 (Bankr. S.D.N.Y. 2011) (approving incentive plan for fifteen

[19] The Funds seemingly disregard the fact that a number of the lower-level employees on the Proposed Plans are also eligible to receive mine-level incentive compensation, so comparing their award opportunities under the AIP and CERP to that of more senior employees—who do not enjoy mine-level incentive opportunities—does not reflect an apples-to-apples comparison.

[20] Despite suggesting in his Declaration that the Proposed Plans should maintain a "relative ratio of award to salary," *see* Juza Decl. ¶ 28, at his deposition, the Funds' purported expert testified that in his personal experience, he has never focused on maintaining such a ratio when designing retention or incentive programs. *See* Juza Dep. Tr. at 173:12 –174:10.

key executives, with senior management participants receiving a higher percentage of base salary); *cf. In re Lightsquared Inc.*, No. 12-120890 (SCC) (Bankr. S.D.N.Y. Oct. 23, 2012) (approving incentive plan for four insiders); *In re Sbarro, Inc.*, No. 11-11527 (SCC) (Bankr. S.D.N.Y. Sep. 8, 2011) (approving incentive plan for six senior management employees); *In re The Great Atl. & Pac. Tea Co., Inc.*, No. 10-24549 (RDD) (Bankr. S.D.N.Y. May 2, 2011) (approving incentive plan for 146 employees with six senior members of executive management team to receive maximum payment of $3,695,192 representing 42% of total awards).

Here, the Debtors' top six executives, although eligible for participation in the Debtors' prepetition incentive program, voluntarily removed themselves from inclusion in the AIP. The AIP generally covers most corporate employees, and the CERP covers a range of critical corporate and mine-level positions. Hatfield Decl. ¶ 35; Hatfield Dep. Tr. at 22:26-23:1. Similarly, the CERP is available to employees across a wide range of positions, as opposed to just an elite few. *See In re Global Aviation,* 478 B.R. at 152 ("No unfair discrimination exists if the plan is not limited to the most senior executives and is 'broad enough' to include lower ranking employees." (citing *In re Borders*, 453 B.R. at 475)).

Finally, the fact that senior participants receive a higher percentage of payments than more junior participants is of no moment. As confirmed by the Funds' purported expert, *see* Juza Dep. Tr. at 85:19-85:25, 86:21-87:1, it is entirely reasonable and permissible for award opportunities to reflect a reasonable differentiation between the employees' value to the reorganization effort and to preserve prepetition practices. *See In re Global Aviation,* 478 B.R. at 152 ("Discrimination is permitted so long as it is fair because different employees may have different values to the debtor's reorganization effort."); *In re Velo Holdings, Inc.*, 472 B.R. 201, 212 (Bankr. S.D.N.Y. 2012) ("[T]he KEIP does not unfairly discriminate and comports with

industry standards, as it is nearly identical to the bonus plan that the Debtors had in place prepetition."); *In re Borders*, 453 B.R. at 476 (Bankr. S.D.N.Y. 2011) ("Since the Executives are the ones that will effectively guide the Debtors through bankruptcy, it is reasonable that they should receive additional compensation if they are ultimately successful.").

Factor 4: The Proposed Plans are Consistent with Industry Standards

The Proposed Plans comport with industry standards.[21] As set forth in the Motion and in the Bubnovich Declaration, after extensive market research Towers determined that, even if the Proposed Plans are approved, the Proposed Plan Participant compensation would still fall below the market median. *See* Mot. ¶ 34; Bubnovich Decl. ¶ 18.

The Proposed Plan Participants have already suffered deep cuts in compensation and benefits including:

- an across-the-board 2.5% salary reduction for all salaried positions;[22]
- reduced hourly wage rates for several non-union job classifications;
- discontinued long-term equity incentive program, worth approximately $3 million to Proposed Plan Participants in 2011 alone;
- the termination of the Debtors' Supplemental 401(k) plan, worth approximately $350,000 to Proposed Plan Participants;
- an approximately $3,000 yearly increase in healthcare costs;
- the proposed elimination of eight traditional retiree health plans;
- the proposed elimination of life insurance benefits upon retirement;

[21] The Union's argument that the first retention period must begin after court approval, *see* Union Obj. at 25, is undermined by the fact that several courts have approved retention programs with retention periods beginning prior to court approval. *See, e.g.*, *In re WP Steel Venture LLC*, No. 12-11661 (KJC) (Bankr. D. Del. May 20, 2012) (approving a retention program where payments had been earned almost five months prior to court approval of plan); *In re Betsey Johnson LLC*, No. 12-11732 (JPM) (Bankr. S.D.N.Y. June 28, 2012) (approving retention program that began more than a month before court approval).

[22] Effective March 1, 2013.

- no payment of approximately $3 million in earned amounts under 2012 AIP;
- the termination of legacy pension shortfall programs and defined contribution retirement plan payments;
- the elimination of legacy deferred vacation balances worth approximately $1 million;
- the proposed termination of the medical premium reimbursement program and retiree choice accounts worth at least $9 million; and
- the reduction of holiday, personal leave and vacation time.

Implementation of the Proposed Plans, as the Towers analysis demonstrates, falls far short of restoring Proposed Plan Participant compensation to market medians or to pre-bankruptcy levels, but instead only attempts to restore compensation to reasonable levels. The Objectors do not put forth a competing analysis but, rather, through a mix of argument and a purported expert declaration, attempt to undermine the Towers analysis. That attempt falls flat:

- The Objectors cite Towers' reliance on national surveys as opposed to regional surveys as a critical flaw, yet their own purported expert, Mr. Juza, concedes (i) that Patriot's attrition rates are impacted by national trends, *see* Juza Dep. Tr. at 100:19–101:20; (ii) that Towers' survey data included "cities or regions with much higher costs of living and/or cost of labor as well as those lower on those scales," Juza Decl. ¶ 16 (emphasis added); and (iii) that he did not perform a regional survey and therefore has no idea what the results would be, *see* Juza Dep. Tr. at 134:4-15.
- The Objectors cite the inclusion of data from industries outside the coal industry, yet Mr. Juza concedes that many Patriot employees possess skills that are not specific to the coal industry—*see* Juza Dep. Tr. at 93:20–94:11, 140:6–141:9—and Mr. Bubnovich did consider a proprietary coal survey, which showed that the Proposed Plan Participants are even more severely underpaid when just considering the coal industry.
- The Objectors argue that Towers failed to consider every possible reason for attrition when assessing the need for a CERP, such as "existing mortgages, working spouses, children in school and depth of community involvement," Juza Decl. ¶17, but Mr. Juza testified that he has never considered such individual factors in designing a retention program, *see* Juza Dep. Tr. at 30:11-23, 32:14-25; 36:16–37:3—and for good reason, for doing so would be utterly impractical.
- Finally, the Objectors argue that because Towers was unable to conduct a perfect "apples-to-apples" comparison of these Proposed Plans against other chapter 11 plans,

the Debtors have failed the test set forth in *In re Global Aviation*. Nothing could be further from the truth. In fact, the court there approved a retention plan despite the fact that "[n]o evidence was introduced of industry compensation practices other than [the expert's] testimony that [in his opinion] the compensation packages are at the low end of the industry spectrum." *In re Global Aviation*, 478 B.R. at 153.

Accordingly, the only evidence before the Court demonstrates that the Proposed Plans are consistent with, if not below, market standards.

Factor 5 and Factor 6: The Debtors Conducted Adequate Due Diligence and Received Independent Counsel in Creating and Authorizing the Proposed Plans

While substantially similar in form to the Debtors' prepetition retention and incentive programs, the Proposed Plans have been substantially reduced in cost from prepetition levels and specifically tailored to address the Debtors' restructuring goals. The Proposed Plans were ultimately developed by members of the Debtors' executive management team—all of whom have recused themselves from the Proposed Plans—and were approved by an independent Compensation Committee. In doing so, the executive management team considered the Towers analysis as well as advice from their restructuring advisors, Blackstone and Davis Polk.[23] Moreover, the Compensation Committee reviewed multiple iterations of the Proposed Plans and ultimately determined that the Proposed Plans, in the form presented to the Court, are appropriate, reasonable in cost and scope, and reasonably calculated to achieve the Debtors' goals. Hatfield Decl. ¶ 19. The Debtors also received extensive input from the Committee and its professionals, which resulted in (i) substantial modifications to the Proposed Plans and (ii) the Committee's support. Hatfield Decl. ¶ 23. Likewise, after discussions with the U.S. Trustee, the

[23] The Union suggests that the involvement of certain Proposed Plan Participants in the development of the Proposed Plans creates a conflict of interest and that these employees, even if not insiders, should be subject to a higher standard than business judgment. Union Obj. at 3, 10. These employees, however, only served ministerial functions, such as gathering data, assisting with due diligence, and presenting materials to senior management and the Board. Thus, the Debtors' business judgment is the appropriate test to evaluate their inclusion in the Proposed Plans.

Debtors modified the Proposed Plans to eliminate any remaining "insider" concerns. Thus, the Proposed Plans are the product of extensive and careful analysis, as well as collaboration and compromise among various parties.

* * *

In sum, the Proposed Plans are necessary to encourage each of the Proposed Plan Participants to remain with the Debtors and to incentivize its employees to work toward a successful restructuring. Accordingly, the Proposed Plans are "justified by the facts and circumstances" of these chapter 11 cases and should be approved under section 503(c)(3).[24]

III. <u>Now is Not the Time to Litigate 1113/1114</u>

Even a cursory review of the Objectors' pleadings (and their public statements and press releases) make clear that the Objectors are attempting to use this Motion for political purposes in order to pre-litigate the 1113/1114 motion. The Union, in particular, does not even attempt to hide this fact, as it includes a section in its brief analyzing the Proposed Plans against the inapplicable 1113/1114 "fair and equitable" standard. *See* Union Obj. at 26-30. But now is not the time, this Motion is not the vehicle, and "fair and equitable" is not the standard. This Motion must rise and fall on its own merits and based on the Debtors' business judgment.

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[24] Additionally, as set forth in the Motion, the fact that the Proposed Plans are generally consistent with (and less generous than) the Debtors' prepetition practices and could arguably be approved as an ordinary course transaction without court approval, lends additional support for the argument that the Proposed Plans comport with a reasonable exercise of business judgment. While the Union asserts that such programs can never be considered ordinary course transactions, this claim is belied by the fact that chapter 11 incentive and retention payment programs—in some cases far more expensive than the Proposed Plans—are often considered so ordinary course as to be routinely approved pursuant to debtors' first-day wages motions. *See, e.g.*, *In re Northwest Airlines Corp.*, 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.*, 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.*, No. 11-15463 (SHL) (Bankr. S.D.N.Y. Nov. 29, 2011) (approving numerous incentive and severance plans); *In re Frontier Airlines Holdings, Inc.*, No. 08-11298 (RDD) (Bankr. S.D.N.Y Apr. 14, 2008) (approving severance benefits for approximately 5,000 non-union employees).

Nonetheless, the Debtors are not blind to the fact that all Patriot employees have been or will be asked to make significant sacrifices in order to secure Patriot's future—including union employees. But what the Objections have completely ignored is that while union employee benefits have remained the same, and while union wages have increased, Patriot's non-union employees, including the Proposed Plan Participants, have already suffered drastic reductions in compensation and benefits with more to come—and all without any or minimal say in the matter. While the sacrifices that will be asked of the union employees are real and painful, no more is being asked of them than is being asked of non-union employees. Indeed, even assuming implementation of the Proposed Plans and this Court's approval of all proposed reductions in union compensation and benefits, the union employees will remain equally or better situated than non-union employees in many respects. Accordingly, while not the test against which the Proposed Plans should be evaluated, it is without question that they are "fair and equitable" to all employees.

In addition, delaying consideration of the Proposed Plans until after the conclusion of the 1113/1114 process is untenable and potentially disastrous to all stakeholders. As previously detailed, the Debtors are experiencing unprecedented corporate attrition rates. Unable to attract equivalent replacements, the Debtors have been required to demand more from personnel across all areas of the Debtors' businesses, stretching their remaining workforce to its maximum capacity—all during the most critical period in the Debtors' history. Loss of any more critical employees, and the failure to quickly implement a plan to adequately incentivize key employees, could threaten the entire restructuring effort to the extreme detriment of all, including union employees.

CONCLUSION

WHEREFORE, for the foregoing reasons and the reasons stated in the Motion, the Debtors respectfully request that the Court overrule the Objections and promptly grant the relief requested in the Motion.

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Respectfully submitted,

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