UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

In re:	)	Case No. 12-51502-659
	)	
PATRIOT COAL CORPORATION, et al.,	)	Jointly Administered under
	)	Chapter 11
Debtors.	)	
	)	Related to: Docket No. 2819
	)	
	)	Hearing Date and Time:
	)	March 18, 2013 at 1:00 p.m. (CDT)

THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS' STATEMENT IN SUPPORT OF THE APPROVAL OF THE DEBTORS' COMPENSATION PLANS

The Official Committee of Unsecured Creditors (the "**Committee**"), representing all creditors of each of the 99 separate Debtors[1], by and through its undersigned counsel, supports the Debtors' motion to approve an annual incentive plan ("**AIP**") and critical employee retention plan ("**CERP**", collectively, the "**Management Compensation Plans**") [Docket No. 2819] and respectfully states as follows:

PRELIMINARY STATEMENT

1. Management compensation, a serious issue in any chapter 11 case, is especially sensitive in these cases because the Debtors seek economic concessions from workers and retirees, including those represented by the United Mineworkers of America ("**UMWA**"). When the Debtors presented their initial management compensation plan proposals, the

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[1] Each Debtor filed a separate petition. The 99 cases have been administratively consolidated for the purpose of maintaining one docket, but the Debtors have not been substantively consolidated and each has filed its own separate schedule of assets and liabilities and statement of financial affairs. The 98 Debtors other than Patriot Coal Corporation are identified in Exhibit 1 of the Declaration of Mark N. Schroeder (Docket No. 4). The employer tax identification numbers and addresses for each of the Debtors are set forth in the Debtors' chapter 11 petitions.

Committee (which includes the UMWA as a member[2]) told the Debtors that the Committee would not support them.

2. This initial resistance was due, in part, to the concern that such plans could adversely affect the Debtors' pursuit of concessions from workers and retirees through negotiation or litigation. Specifically, sections 1113(b)(1)(A) and 1114(f)(1)(A)[3] require that any proposal to modify the UMWA's collective bargaining agreement and/or retiree medical benefits "assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably." *Id.*

3. After intense negotiations spanning two months, including four written submissions from the Debtors, four telephonic and in-person meetings between Debtors and Committee professionals and two meetings between the Debtors' senior management and Committee principals, the Committee negotiated major changes (detailed below), including a 44% cut in cost and a structural change to ensure that retiree sacrifices would not increase management compensation. The Committee understands that the UMWA and UMWA 1974 Plan remain firmly opposed to the Management Compensation Plans; nevertheless, based on the changes to the plans and the presentations made by the Debtors, the Committee concluded that:

- the Management Compensation Plans would ***not*** preclude the Court from granting relief under Sections 1113(b)(1)(A) and 1114(f)(1)(A); and
- The CERP and AIP are each justified by the facts and circumstances of these cases under Section 503(c)(3).

Accordingly, the Committee supports approval of the Management Compensation Plans because the plans are in the best interests of creditors and the estates.

[2] In addition to the UMWA, the Committee's members include: (i) Wilmington Trust Company, as Indenture Trustee; (ii) U.S. Bank National Association, as Indenture Trustee; (iii) the United Mine Workers of America 1974 Pension Plan and Trust (the "UMWA 1974 Plan"); (iv) Gulf Coast Capital Partners, LLC; and (v) American Electric Power.

[3] Unless otherwise indicated, all statutory cites are to the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*

THE HISTORY OF NEGOTIATIONS

4. On November 29, 2012, the Debtors presented their first proposed management compensation plans to Committee counsel for transmission to the Committee.

5. On December 4, 2012, Committee counsel and the Committee's financial advisor, Mesirow Financial Consulting LLC, met with Debtors' management, counsel and investment banker, to discuss the proposed management compensation plans (among other things) in preparation for the Debtors' presentation the next day, December 5th, to the full Committee at an in-person meeting.

6. Following the December 5, 2012 meeting, the Committee debated the initial management compensation proposals. The Committee authorized counsel to (i) tell the Debtors that no Committee member supported the management compensation proposals in their original form and (ii) urge the Debtors to adopt a different approach.

7. In response to the Committee's concerns, on January 25, 2013, the Debtors transmitted their second proposal to Committee professionals. At a telephonic meeting on January 28th, Committee professionals transmitted to the Debtors' professionals their questions and issues relating to the second proposal.

8. On February 1, the Debtors presented a third proposal for management compensation to Committee professionals, which provided additional supporting data and diligence for the Committee's review. On February 4, in preparation for the Debtors' telephonic meeting with the full Committee the next day, Committee professionals met telephonically with the Debtors' senior management and professionals to discuss concerns relating to the third proposal. At the February 5th meeting, the Debtors presented to the full Committee their fourth

proposal in form substantially identical to the Management Compensation Plans before this Court.

9. The Committee questioned the Debtors about the Management Compensation Plans, first in a session attended by all members and second in a session dealing only with Sections 1113 and 1114, which the UMWA and UMWA 1974 Plan did not attend. The UMWA and UMWA 1974 Plan rejoined the Committee for final debate and vote, and the Committee voted to support the Management Compensation Plans.

THE NEGOTIATED CHANGES

10. The Committee's two months of negotiations with the Debtors and their advisors over four different management compensation proposals resulted in major changes which may be summarized as follows:

- ***A 44% reduction in maximum cost***. The Debtors' initial plans offered 281 people the chance to earn compensation totaling a maximum of $12.3 million; the final plans offer 274 people the chance to earn a maximum of $6.9 million. At this level, the cost of the plans represents a relatively minimal portion of the Debtors' overall revenues.

- ***Managers are taking cuts elsewhere***. The Debtors responded to the Committee's concerns by demonstrating that total management compensation was in fact noticeably decreasing after giving effect to cuts in other areas, including salary, termination of supplemental 401(k) plan contributions, increased out-of-pocket healthcare costs and termination of retiree medical benefit plans for managers.

- ***Retiree sacrifices will not increase managers' pay***. The original AIP financial targets were based on the loan agreement's minimum ***E***arnings ***B***efore ***I***nterest, ***T***axes, ***D***epreciation and ***A***mortization, or "EBITDA". EBITDA, however, is calculated ***after*** deduction of retiree expenses relating to pension and other post-retirement medical benefits.[4] If retiree expenses go down, EBITDA goes up. In other words, cutting pensions and retiree benefits would have raised EBITDA and made it easier to earn such compensation. This is no longer true. In response to concerns raised by the Committee, the

[4] There are two basic categories of expenses related to retirees: (1) pension and (2) "***O***ther ***P***ost-***E***mployment ***B***enefits," or "OPEB," which principally includes retiree medical benefits.

Debtors based their final AIP targets on "EBITDA***P***", or Earnings Before Interest, Taxes, Depreciation, Amortization and ***P***ost-Retirement Medical Benefits – which means that targets will be met, or not met, independent of any sacrifices made by or required of retirees.

- ***Committee Notice and Review***. Use of an EBITDAP metric is an innovative approach to compensation plans of this type. Because of the novelty of the metric, the Committee requested, and the Debtors have agreed, to provide the Committee with the computation of EBITDAP and liquidity targets five days prior to any payment under the AIP triggered by meeting those targets (the "**EBITDAP Notice Provision**").

- ***Timing of payments under the CERP extended.*** The original proposal provided final payments (50% of the total award) to participants upon the Debtors' emergence from bankruptcy. The final CERP makes final payments on the latter of (1) 90 days following emergence or (2) March 31, 2014, thereby increasing the retention period of the program.

FACTS AND CIRCUMSTANCES JUSTIFY THE PLANS UNDER SECTION 503(c)(3)

11. The Management Compensation Plans are similar, but not identical, to plans adopted prior to the commencement of these cases;[5] therefore, it is not clear whether they qualify as "ordinary course". Whether they are or not, however, the Committee submits that the Management Compensation Plans pass muster under Section 503(c)(3).

12. Several decisions from other courts have purported to apply the "business judgment" test to determine whether to approve both compensation plans under sections 363 and 503(c)(3). However, certain of these decisions actually apply a more detailed business judgment analysis – analyzing several factors (as outlined below) that are not generally required under the standard business judgment test – to determine whether a compensation plan is "justified by the facts and circumstances of the case". *See In re Pilgrim's Pride Corp.*, 401 B.R. 229, 236 (Bankr. N.D. Tex. 2009); *In re Dana Corp.*, 358 B.R. 567, 576-77 (Bankr. S.D.N.Y. 2006). Regardless of what standard applies, the Committee believes it makes no difference to this motion. The

[5] The Management Compensation Plans refer to consummation of a chapter 11 plan as a benchmark for an incentive payment; pre-bankruptcy plans, of course, had no comparable benchmark.

Committee made its own independent determination that the reduction of the size of the Management Compensation Plans to the relatively minor amount of $6.9 million (and the fact that the plans are less generous than similar pre-bankruptcy compensation plans), when compared to the potential risk to the Debtors and all stakeholders of the loss of key personnel, meet the "facts and circumstances" test of Section 503(c)(3).

13. As stated above, in determining whether a compensation plan is "justified by the facts and circumstances of the case" under Section 503(c)(3), courts consider several factors to determine if the structure of a compensation proposal and the process for its development meet the business judgment test:

> *[a]* Is there a reasonable relationship between the plan proposed and the results to be obtained, *i.e*., will the key employee stay for as long as it takes for the debtor to reorganize or market its assets, or, in the case of a performance incentive, *is the plan calculated to achieve the desired performance?...*
>
> *[b]* Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?
>
> *[c]* Is the scope of the plan fair and reasonable; does it apply to all employees; does it discriminate unfairly?
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> *[d]* Is the plan or proposal consistent with industry standards?
>
> *[e]* What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized; what is available; what is generally applicable in a particular industry?
>
> *[f]* Did the debtor receive independent counsel in performing due diligence and in creating and authorizing the incentive compensation?

In re Dana Corp., 358 B.R. at 576-77 (emphasis in the original); *see also In re Dewey & LeBoeuf LLP*, Case No. 12-12321 (MG), 2012 Bankr. LEXIS 3484, *at *4*; *see also In re Global Home Prods., LLC*, 369 B.R. 778, 786 (Bankr. D. Del. 2007) (evaluating an incentive plan under the business judgment standard of section 363 by applying the Dana factors).

14. Compliance with certain of the *Dana* factors is self-evident. The extension in the time for the payments helped the Management Compensation Plans comply with *Dana factor [a]* ("a reasonable relationship between the plan proposed and the results to be obtained, *i.e.*, will the key employee stay for as long as it takes for the debtor to reorganize?"). The final $6.9 million cost of the plans is clearly "reasonable in the context of the [debtors'] assets, liabilities and earning potential" (*Dana factor [b]*). The broad scope of the plan indicated that it did not discriminate (*Dana factor [c]*). The Debtors have clearly received independent counsel (*Dana factor [f]*).[6]

15. The Committee made its own determination that the Management Compensation Plans were in the best interest of creditors and the estate. The Committee focused in particular on:

- ***Attrition***. The Committee requested and received information from the Debtors comparing management attrition suffered during the chapter 11 cases with management attrition prior to chapter 11.

- ***Historical Compensation***. The Committee's request for compensation expense data going back to 2010 allowed the Committee to compare the two-year period 2012-13 with 2011-12 and 2010-11 for executives employed by the Debtors throughout that four-year period. The Committee's review confirmed that even those executives participating in the proposed Management Compensation Plans are receiving 5-10% lower overall compensation than the average of the prior two-year periods.

- ***The Financial Metrics set forth in the AIP Are Robust***. The Performance Metrics set forth in the AIP are robust. In fact, the Debtors are currently on track to miss payment triggers for the EBITDAP – 30% of the AIP opportunity.

[6] The Debtors' motion offers as proof a "proprietary industry study" comparing the compensation of participants in their proposed Management Compensation Plans with comparable managers in the coal industry. This study was made available to Committee Professionals only after the Committee voted to support the plans, and on a "professional eyes only" basis. It was therefore not considered by the Committee's principals. It does, however, appear to bear out the Debtors' position that their managers are undercompensated and so is relevant to *Dana* factors *[d]* and *[e]* to the extent it bears on the "industry standards" referenced in both factors.

- ***Modest Size of the Programs***. The overall amount of compensation to be paid under the programs, approximately $6.9 million, is not substantial in comparison to the Debtors' total revenues, and that amount is payable to over 274 employees.

- ***Senior-Most Executives are Excluded***. Unlike many programs proposed in chapter 11 cases, the Management Compensation Programs do not provide rich rewards to the senior-most executives of the Debtors. In fact, the Debtors' CEO and their other top six executives will receive only their base salaries and will not participate in the Management Compensation Plans at all.

16. Accordingly, the Committee concluded that on a "risk/reward" basis, the proposed Management Compensation Plans made sense – the "risk" of damage to the Debtors from further management departures outweighed the "reward" of saving $6.9 million. The proposed Management Compensation Plans would provide a suitable incentive to participants to remain with the Debtors and to achieve the agreed performance targets, at an aggregate cost to the estates that was acceptable.

17. Finally, the Committee recognized that any program providing for executive compensation could become a legal issue should the Debtors move to modify their collective bargaining agreements and retiree medical benefit plans with the UMWA under Sections 1113 and 1114. As indicated above, the statute requires that any proposal under those sections must assure that all parties are treated "fairly and equitably." The UMWA and the UMWA 1974 Plan object that the Management Compensation Plans are not fair and equitable at a time when the Debtors are demanding sacrifices from UMWA workers and retirees. The Committee understands and respects the position of the UMWA and the UMWA 1974 Pension Plan.

18. However, the Committee concluded that the revised terms of the proposed Management Compensation Plans reflect a reasonable approach that will stem potential management losses. A back-end weighted CERP and an AIP with aggressive financial metrics

diminish the otherwise unacceptable risk of damage to the estate from the loss of managers who are necessary to run the Debtors. The Management Compensation Plans, moreover, call for limited expenditures, structured in a balanced manner to pay compensation to executives at or below historical levels, based on metrics which do not benefit plan participants from cuts in retiree benefits.[7] The plan participants' other benefits are separately being reduced. Accordingly, the Committee takes seriously the UMWA's and UMWA 1974 Plan's objections to any management incentive or bonus program during the Debtors' pursuit of concessions from other workers and retirees. However, the Committee carefully weighed those objections and decided that the Management Compensation Plans, in their final form, did not implicate Section 1113 and 1114 litigation. The Committee decided that the risk of losing additional critical employees posed a greater danger to the estate.

19. Accordingly, the Committee determined that the Management Compensation Plans were justified by the facts and circumstances of the case under Section 503(c)(3).[8]

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[7] If the Debtors were to cut labor expenses through modification of their collective bargaining agreement with the UMWA, those cuts could theoretically increase EBITDAP and thus make management incentive targets easier to reach. However, savings from changes in the collective bargaining agreement are likely to take effect over a substantial period of time. They are not likely to materially affect 2013 EBITDAP or the likelihood or size of the compensation under the proposed Management Compensation Plans.

[8] The UMWA and the UMWA 1974 Plan have objected to the CERP on the grounds that it is explicitly a "retention plan" for "insiders" in violation of Section 503(c)(1). In response to similar concerns of the U.S. Trustee, the Debtors have removed the top seven participants from the CERP and any potential compensation can be earned by these individuals only by achieving their AIP targets. The Debtors have briefed this issue, and the Committee sees no need to add to the debate. The Committee suggests that the relatively low level of payouts to the participants in the CERP demonstrates that, in the context of this particular CERP, the participants are not "in control" and should not be viewed as "insiders". Were the payments to these participants disproportionate, the Committee might take a different view. The Committee's view expressed in this pleading are limited to the Management Compensation Plans in the form presented to the Court. The Committee expressly reserves its right to review and object to any amendment to these Management Compensation Plans or to any other compensation programs proposed in these cases.

CONCLUSION

20. The Committee believes that the Management Compensation Plans' costs have been materially reduced and narrowed to avoid any suggestion that they unfairly favor management or the non-union workforce. All employees are being asked to make significant financial sacrifices in an effort to restructure the Debtors' businesses. The Management Compensation Plans presented to the Court are modest and align the interests of the Debtors, and their employees striving for such compensation, with all creditor constituencies. The Committee supports approval of the proposed Management Compensation Plans as in the best interests of creditors and these estates.

Dated: March 15, 2013

CARMODY MACDONALD P.C.

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CERTIFICATE OF SERVICE

I certify that on March 15, 2013 a copy of the foregoing pleading was served through the Court's CM/ECF system on those parties receiving ECF notices in these proceedings.

/s/ Gregory D. Willard