IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MISSOURI

In re PATRIOT COAL CORPORATION, *et al.*, Debtors.	**Chapter 11** **Case No. 12-51502-659** **(Jointly Administered)** **Objection Deadline:** **April 16, 2013 at 4:00pm** **(prevailing Central Time)** **Hearing Date:** **April 23, 2013 at 10:00am** **(prevailing Central Time)** **Hearing Location:** **Courtroom 7 North**

MOTION OF AURELIUS CAPITAL MANAGEMENT, LP, AND KNIGHTHEAD CAPITAL MANAGEMENT, LLC, FOR ENTRY OF AN ORDER, PURSUANT TO 11 U.S.C. §§ 105(a) AND 1104(a), DIRECTING THE APPOINTMENT OF A CHAPTER 11 TRUSTEE

Aurelius Capital Management, LP (**"Aurelius"**), and Knighthead Capital Management, LLC (**"Knighthead"**), solely on behalf of certain funds and accounts that they manage or advise and that hold a substantial amount of certain Patriot Coal Corporation ("**Patriot**") notes (collectively, the "**Noteholders**"),[1] as creditors and parties in interest in the above-captioned jointly-administered Chapter 11 cases, hereby submit this motion (the "**Motion**") for an order

[1] The notes are the 3.25% Convertible Senior Notes due 2013 (the "**3.25% Notes**") and the 8.25% Senior Notes due 2018 (the "**8.25% Notes**") (collectively, the "**Notes**"). Entities managed by Aurelius or Knighthead are, collectively, the beneficial owners of a majority of the 8.25% Notes. Entities managed by Aurelius alone are also the beneficial owners of a substantial amount of the 3.25% Notes. None of the Noteholders have any fiduciary duties to any party in interest in this case, nor is any Noteholder an insider of Patriot or any of its subsidiaries or affiliates.

directing the appointment of a Chapter 11 trustee to control the estates of those Debtors (the "**Non-Obligor Debtors**") that are not signatories to collective-bargaining or retiree-healthcare agreements with the United Mine Workers of America (the "**UMWA**").[2] In support thereof, the Noteholders respectfully state as follows:

PRELIMINARY STATEMENT

1. These jointly-administered cases were filed nearly nine months ago, in July 2012. Since then, the cases have focused almost exclusively on a dispute between the Debtors here and the UMWA over obligations that some Debtors have to current and retired union members. That dispute came to a head two weeks ago, when the Debtors filed a motion to abrogate collective bargaining agreements with the UMWA, modify obligations to union retirees, and implement replacement proposals of their own that the UMWA has thus far rejected.

2. Lost in the acrimony between the Debtors and the UMWA, however, is a single, undisputable fact: Of the ninety-nine Debtors in this jointly administered action, only ***thirteen*** actually have obligations to the UMWA or union retirees (the "**Obligor Debtors**"). Patriot and its other eighty-five Debtor subsidiaries (collectively, the "**Non-Obligor Debtors**") have no such obligations, nor do they guarantee union liabilities held by anyone else.[3] To be sure, the Non-Obligor Debtors *do* have obligations to other, *non-union* creditors—foremost amongst them, the Noteholders here.

3. It is axiomatic that each of the Debtors here, separately, owes fiduciary duties solely to its own creditors. As described more fully below, however, the Debtors' recent proposals to the UMWA are built on a plan to satisfy union liabilities with the assets of the *Non-*

[2] The Non-Obligor Debtors are listed in Exhibit A to the Motion.

[3] Indeed, at least one of the Non-Obligor Debtors—Patriot itself—actually holds pre- and post-petition intercompany claims against the Obligor Debtors.

Obligor Debtors, which have no obligations to the UMWA. Worse, the plans do so without providing the Non-Obligor Debtors any value in return. The proposals are a clear breach of the fiduciary duties owed to the Non-Obligor Debtors—breaches that will severely prejudice their creditors, such as the Noteholders, which bargained for and received obligations from Patriot and guarantees from the remaining Non-Obligor Debtors that the UMWA did not.

4. Compounding the problem, rather than moving expeditiously to take the Non-Obligor Debtors out of bankruptcy, the debtors-in-possession have spent *nine months* negotiating with the UMWA about these illegal proposals, which are based on the faulty premise that the Non-Obligor Debtors actually owe union benefits. The proposals could never be the basis for a confirmable plan of reorganization. In the meantime, the Debtors move inexorably towards liquidation—a fate the Non-Union Debtors need not meet. Having no obligations to the UMWA, the Non-Obligor Debtors (including Patriot itself) should be able to emerge from bankruptcy expeditiously. Their failure to have done so already is solely a function of the company's inability and unwillingness to meet its fiduciary duties—and presages that the company will give short-shrift to the due process of interested parties in the plan process as well.

5. Only by appointing a trustee can the Court ensure that the estates of the Non-Obligor Debtors are managed as the law requires—in the best interests of their own actual creditors. Indeed, under black letter law the appointment of a trustee is required when a company is unable to fulfill its duties to creditors. That requirement is all the more urgent here, where the debtors-in-possession are actively *harming* the creditor interests of eighty six of its Debtors (*i.e.*, the Non-Obligor Debtors) for the benefit of creditor interests in just thirteen of the Debtors (*i.e.*, the Obligor Debtors). Only a trustee can set true the course and do so before liquidation. One should be appointed promptly.

PROCEDURAL HISTORY

6. On July 9, 2012, Patriot and ninety-eight of its direct or indirect subsidiaries (collectively, the "**Debtors**") commenced voluntary cases under Chapter 11 of the Bankruptcy Code. 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. For administrative purposes only, the Debtors' cases are being jointly administered pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure and the Joint Administration Order entered on July 10, 2012. *See* Dkt. 30.

7. On November 27, 2012, the United States Bankruptcy Court for the Southern District of New York (the "**SDNY Bankruptcy Court**") issued a memorandum decision transferring venue of the Debtors' jointly-administered Chapter 11 cases and associated adversary proceedings (the "**Cases**") to the United States Bankruptcy Court for the Eastern District of Missouri. On December 19, 2012, the SDNY Bankruptcy Court entered an order transferring the Cases, effective as of that date. *See* Dkt. 1789.

8. On March 14, 2013, Patriot moved for an order, pursuant to 11 U.S.C. §§ 1113(c) and 1114(g), that: (1) authorizes the Obligor Debtors to reject collective bargaining agreements they have with the UMWA; (2) authorizes the Obligor Debtors to terminate retiree benefits for certain of their current retirees; and (3) implements the terms of two proposals (the "**Termination Motion**"). As explained more fully below, those proposals call for the Non-Obligor Debtors to assume a new, substantial liability that currently is owed only by the Obligor Debtors. *See* Dkts. 3214, 3219.

JURISDICTION

9. This Court has subject matter jurisdiction over this matter pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and may be heard and determined by the Bankruptcy Court. Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

10. The statutory predicates for the relief requested herein are Sections 105(a), 1104(a)(1) and 1104(a)(2) of the Bankruptcy Code.

BACKGROUND

A. The Obligor Debtors And The Non-Obligor Debtors

11. Patriot owns and operates coal mines in the Appalachia and Illinois Basin coal regions. *See* Declaration of Mark N. Schroeder ("**Schroeder Decl**.") (Dkt. 4) ¶ 6. It does so through direct and indirect subsidiaries, most of which are Debtors here. *Id.* ¶ 16. Each of these subsidiaries is a legally distinct entity with its own books and records. Some are organized as corporations, others as limited liability companies. Many, though not all, are incorporated in Delaware.[4]

12. As relevant here, Patriot's ninety-eight Debtor subsidiaries can be categorized according to whether they employ or have legacy relationships with union labor. Only thirteen subsidiary Debtors do (*i.e.*, the Obligor Debtors). The remaining eighty five, and Patriot itself, do not (*i.e.*, the Non-Obligor Debtors). *See, e.g.*, Schroeder Decl. ¶ 15.

13. As explained more fully below, this Motion seeks appointment of a trustee to control the estates of the Non-Obligor Debtors only. The Motion does not seek appointment of a

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[4] A list of Patriot's subsidiaries, as well as the location and form of their incorporation can be found at http://www.sec.gov/Archives/edgar/data/1376812/000137681213000006/pcx_ex211x20121231.htm.

trustee to control the estates of the thirteen Obligor Debtors, nor does the Motion seek any other relief as to those Debtors.

B. <u>The Differing Liabilities Of The Obligor Debtors And The Non-Obligor Debtors</u>

1. The Union Debt

14. Of critical importance here, the liabilities of the Obligor Debtors and the Non-Obligor Debtors differ in a significant way: *only* the Obligor Debtors, and *not* the Non-Obligor Debtors, are liable for the salary, pension, and health-care benefits owed to union employees and retirees (the "**Union Debt**"). That is, as unsecured creditors, union employees and retirees possess claims only against the estates of the Obligor Debtors. Union employees and retirees possess no claims against the estates of Patriot or the other Non-Obligor Debtors, nor do union employees or retirees have any other rights to the assets of the Non-Obligor Debtors.[5] This distinction is undisputed. Indeed, the Schedule of Financial Affairs for every single debtor takes care to identify which subsidiaries have potential liabilities to union members and retirees (and, by implication, which do not).[6]

15. The Obligor Debtors are now struggling under the weight of the Union Debt that they owe (but that the Non-Obligor Debtors do not). *See* Schroeder Decl. ¶¶ 33-38. The Debtors allege that the portion of the Union Debt attributable to "unionized retiree healthcare liabilities"

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[5] The sole exceptions may be Patriot's obligations under both a 1974 agreement with the UMWA concerning pensions and the Coal Act. Should Patriot withdraw from the UMWA pension fund—as it states it would like to do, but has not yet (*see* Dkt. 3219 at 47)—certain obligations will become due immediately. *See* 29 U.S.C. § 1399. Those obligations may run to all of Patriot's subsidiaries, including the Non-Obligor Debtors. Upon withdrawal from the fund, however, Patriot would have the option of satisfying its withdrawal obligations through an annual annuity payment well within Patriot's means. *See id*. § 1399(c)(1)(C)(i). Patriot has expressed no intent to impair its Coal Act claims and plans to pay these going forward.

[6] *See* <u>http://www.patriotcaseinfo.com/sofa.php</u>. Those Schedules also list nine Non-Obligor Debtors with limited, non-union related legacy healthcare obligations.

alone already exceeds $1 billion. *See* Declaration of Paul P. Huffard ("**Huffard Decl**.") (Dkt. 3224) ¶ 68 (emphasis added). Sizable *additional* amounts are also owed on account of the 1974 UMWA pension fund (Schroeder Decl. ¶ 36), the Coal Act (*id*. ¶ 37), and "the future entitlement of currently active employees to healthcare when they retire" (Huffard Decl. ¶ 68 n.28).

2. The Noteholders' Debt

16. The non-guaranteed obligations at the Obligor Debtors can be distinguished from obligations Patriot has to *other* groups of creditors—among them, the Noteholders. Some of these obligations exist at Patriot alone, while others were made by Patriot and guaranteed by all or substantially all of its subsidiaries. *See* Schroeder Decl. ¶ 19 ("Patriot Coal has issued two series of unsecured notes: (a) $250 million in 8.25% senior unsecured notes due 2018, *which are guaranteed by substantially all of the Debtor subsidiaries of Patriot Coal* and (b) $200 million in 3.25% unsecured convertible notes due 2013.") (emphasis added). Indeed, by virtue of the guarantees given in the 8.25% Notes, their holders—including the Noteholders here—are the Non-Obligor Debtors' single largest group of creditors.[7]

C. <u>The Debtors' Attempt To Satisfy The Union Debt With The Assets Of The Non-Obligor Debtors</u>

17. On March 14, 2013, the Debtors filed their Termination Motion. As relevant here, the Termination Motion asks the Court to implement a proposal that would terminate the Union Debt owed by the Obligor Debtors (but *not* the Non-Obligor Debtors) and, in its stead, transition responsibility for union retirees' healthcare benefits into a Voluntary Employee Beneficiary Association trust ("**VEBA**"). *See* Dkt. 3219 at 5. That VEBA would, in turn, be

[7] *See* http://www.patriotcaseinfo.com/sofa.php (schedule of liabilities for all Debtors). Though the 3.25% Notes are not guaranteed by Patriot's Debtor subsidiaries, they—and the creditors who hold them—nonetheless benefit from substantial intercompany receivables due from Patriot's many subsidiaries.

funded almost entirely by (1) "a substantial unsecured claim" and (2) "profit-sharing." *See id.* at 52-53.[8]

18. Of critical importance—and as explained more fully below—under the Debtors' proposal, the VEBA would be funded not only by the Obligor Debtors, but *also* by the Non-Obligor Debtors (including Patriot), *i.e.*, Debtors that presently hold no liability for union retirees' healthcare, or for any other part of the Union Debt. Thus, the proposal would cause the Non-Obligor Debtors to incur an entirely new liability. While the amount of this new liability sought to be imposed on the Non-Obligor Debtors has not been quantified, the Debtors' estimate that the face amount of the union retirees' healthcare benefits is approximately $1 billion. *See* Huffard Decl. ¶ 68.

1. The VEBA Will Be Funded Through A "Substantial Unsecured Claim" That Runs Against The Non-Obligor Debtors

19. As explained in a declaration accompanying the Termination Motion, "[a] significant funding source for the VEBA will be an unsecured claim against ***the Debtors' estate***." Huffard Decl. ¶ 67. As the same declaration makes clear in an earlier footnote, its use of the word "Debtors" refers to *all* of the Debtors here, and not just the "Obligor Companies" "that are signatories to collective bargaining agreements" with the UMWA. *Id.* ¶¶ 1-2 & n.1.[9]

20. This is not a drafting error. In order to value the unsecured claim that the Debtors have proposed to the UMWA, its advisors used as a market comparator the trading prices of

[8] Patriot also plans to fund the VEBA with a $15 million lump-sum cash payment on July 1, 2013. *See* Dkt. 3219 at 52. As compared to the other two funding mechanisms described herein, however, this single lump-sum payment is but a small percentage of the total funding envisioned for the VEBA.

[9] Put differently, if the Debtors intended to fund the VEBA with an unsecured claim against only the estates of the Obligor Debtors, their proposal would be that "[a] significant funding source for the VEBA will be an unsecured claim against ***the Obligor Companies' estate***." But that is not what they propose to do.

Patriot's 3.25% and 8.25% Notes—those owned by the Noteholders here. *See id.* ¶ 69 (noting that "the financial markets have reflected trading in other unsecured claims of the Company," which "have been quoted at market prices ranging from approximately 13% to 49% of face value"). As explained earlier, both those Notes are obligations of Patriot, and the 8.25% Notes "are guaranteed by substantially all of the Debtor subsidiaries of Patriot Coal." Schroeder Decl. ¶ 19. In light of those characteristics, using the Notes to value the VEBA's unsecured claim makes no sense if that claim is to run only against the Obligor Debtors (as should be the case). In contrast, valuing the VEBA claim against the Notes makes perfect sense if—as the Debtors say is the case—they intend to have the claim run against *all* of them, Obligor and Non-Obligor alike.

2. The Proposed "Profit-Sharing" Siphons Assets From The Non-Obligor Debtors

21. The Termination Motion attempts to misappropriate the assets of the Non-Obligor Debtors to satisfy the Union Debt in another way. In addition to the "unsecured claim" just described, the Debtors also propose to fund the VEBA by "contribut[ing] to [it] an amount equal to 15 percent of net income earned by Patriot above $75 million in 2014 and 2015 and an amount equal to 15 percent of net income earned by Patriot above $150 million in 2016 and subsequent years." Dkt. 3219 at 53. As the Debtors explain it, "[t]his profit-sharing component will allow the UMWA to share in any upside should Patriot's financial performance improve in years to come." *Ibid*. But to the extent Patriot's future profitability comes from Non-Obligor Debtors—which are currently much more profitable than Patriot's Obligor-Debtor subsidiaries[10]—this proposal would simply further siphon value from those Non-Obligor Debtors (which have no obligations to the UMWA) to the Obligor Debtors (which do).

[10] *See* Declaration of Seth Schwartz (Dkt. 3225) at ¶ 5 (bullet 2), ¶ 52.

3. The Non-Obligor Companies Receive **Nothing** *In Return For Their New VEBA-Related Liabilities*

22. Of critical importance, the Termination Motion does not call for the Non-Obligor Debtors to receive ***anything*** in return for incurring these new VEBA-related liabilities. By using the assets of the Non-Obligor Debtors to satisfy liabilities to the UMWA that are currently held solely by the Obligor Debtors—without providing the Non-Obligor Debtors value in return—the Termination Motion severely compromises the interests of the Noteholders. Right now, the Noteholders are one of the few creditors that can secure a recovery from Patriot and, in the case of the 8.25% Notes, the other eighty-five Non-Obligor Debtors. The Debtors' proposal would effectively make the Noteholders *pari passu* with new VEBA-related liabilities that dwarf the Noteholders' $250 million interest in the 8.25% Notes and $200 million interest in the 3.25% Notes. The result will leave the Noteholders with, at best, a fraction of what they could recover absent the VEBA proposal. That is not what the respective parties bargained for or received from Patriot: The Noteholders have guarantees from the Non-Obligor Debtors; the UMWA does not.

D. Patriot's Delays Are Threatening The Viability Of The Non-Obligor Debtors

23. It is undisputed that the vast majority of the liabilities at issue in these Cases are concentrated at the Obligor Debtors. *See* Schroeder Decl ¶ 33. Patriot has nevertheless made no effort whatsoever to try and take the Non-Obligor Debtors—which are unencumbered by the Union Debt—out of bankruptcy. Its reasons are now clear: Patriot wants to use the Non-Obligor Debtors to fund claims that exist only at the Obligor Debtors.

24. As troubling as this is, the point may soon become moot: Patriot is moving so slowly through bankruptcy that the entire company will soon need to be liquidated if drastic action is not taken.

25. Patriot's primary source of cash since commencement of these bankruptcy cases has been a DIP facility. *See* PCX Form 10-K for fiscal year 2012 (attached as Exhibit B) at 9. The DIP Facility contains a number of financial covenants applicable to Patriot and its subsidiaries, including requirements relating to minimum consolidated EBITDA, maximum capital expenditures, and minimum liquidity. *Id*. at 34. A breach of those covenants would "give the DIP lenders the right to terminate their lending commitments," to "declare all loans, all interest thereon and all other obligations under the DIP Facilities due and payable," and to "exercise other remedies available to them." *Id*. at 33-34.

26. Under these circumstances, a responsible steward of the company would have moved quickly to take any Debtors that it could out of bankruptcy. But Patriot dallied. As the Debtors concede in their Termination Motion, they did not even make an opening offer to the UMWA until November 2012—fully four months after these voluntary Cases were filed. *See* Dkt. 3219 at 2 n.3. It then took the Debtors *another* four months just to file their Termination Motion. That motion is unlikely to be resolved until at least a year after these voluntary Cases were first filed. As troubling as these delays would be in any Chapter 11 bankruptcy, they are all the more outrageous here because the Termination Motion—and all nine months' worth of negotiations that preceded it—have nothing to do with Non-Obligor Debtors in the first place *because they have no obligations to the UMWA*. Indeed, because the negotiations were based on this faulty premise, they would have been a reckless delay *even if* agreement had been reached with UMWA because that agreement could never have resulted in a confirmable plan.

27. In the meantime, Patriot has been hemorrhaging cash. When compared to monthly averages in the second half of 2012, its average revenue for the first two months of 2013

decreased by $40 million—a staggering 27% decline.[11] At the same time, Patriot has reduced its average monthly operating costs by only $18 million (a 13% decline). The combined effect changed operating margins from 4.2% in the second half of 2012 to -14.6% in the first two months of 2013. This gap between revenues and expenses is all but eliminating Patriot's liquidity.

28. Patriot denies none of this. Indeed, it openly admits that because of its deteriorating financial condition "there is a substantial likelihood that [it] may not comply with the [DIP lenders'] minimum consolidated EBITDA financial covenant beginning in the third quarter of 2013." Exhibit B at 34. And if that happens, Patriot also does not deny that it "may not have sufficient cash availability to meet [its] operating needs or satisfy [its] obligations as they become due, in which instance [it] could be required . . . to convert the Bankruptcy Case into a liquidation under Chapter 7 of the Bankruptcy Code." *Ibid.*

29. This outcome can be avoided—at least with respect to the Non-Obligor Debtors—if Patriot would move quickly to take them out of Bankruptcy. But it is clear Patriot has no intention of doing so, because taking the Non-Obligor Debtors out of bankruptcy would undermine the proposals in the Termination Motion and make clear that the past nine months of negotiations with the UMWA were built on a faulty premise. Only the prompt appointment of a trustee can reverse this course of (in)action and save the Non-Obligor Debtors from liquidation.

ARGUMENT

30. Appointment of a disinterested trustee to control the estates of the Non-Obligor Debtors is urgently needed to protect the estates' creditors, of whom the Noteholders are the largest. The Non-Obligor Debtors possess substantial value and stand an excellent chance of

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[11] The numbers in this paragraph are drawn from Patriot's consolidated "Monthly Operating Reports."

reorganizing. But that is possible only if they are controlled by a trustee who holds their best interests at heart. The current debtors-in-possession of the Non-Obligor Debtors do not. They have made clear that they will not hesitate to sacrifice the welfare of their creditors—to whom they owe fiduciary duties—for the benefit of the Obligor Debtors' creditors—to whom they do not. Indeed, no better example could be imagined than the Termination Motion, which seeks to encumber the Non-Obligor Debtors with up to a *billion dollars* of Obligor debt for *nothing* in return. And, time is of the essence: As Patriot itself acknowledges, its only source of funding is set to expire, and it faces a substantial prospect of liquidation.

31. While Chapter 11 debtors presumptively remain in possession of their estates, courts do not hesitate to replace them with a disinterested trustee when doing so works "to preserve the integrity of the bankruptcy process and to insure that the interests of creditors are served." *In re Celeritas Techs., LLC*, 446 B.R. 514, 518 (Bankr. D. Kan. 2011). The appointment of a trustee "represents a potentially important protection that courts should not lightly disregard or encumber with overly protective attitudes towards debtors-in-possession." *In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518, 525 (Bankr. E.D.N.Y. 1989).

32. The determination whether to appoint a trustee is governed by Section 1104(a), which provides that, at any time after the commencement of a Chapter 11 case but before confirmation of a plan, a bankruptcy court "shall" order the appointment of a trustee:

> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C.A. § 1104(a). The movant has the burden of showing only by a "preponderance of the evidence" that appointment of a trustee is warranted under Section 1104(a). *In re Keeley & Grabanski Land P'ship*, 455 B.R. 153, 163 (B.A.P. 8th Cir. 2011). Because the two subsections of Section 1104(a) are written in the disjunctive, a court "shall" order appointment of a trustee if the movant can satisfy either subsection. *See* 11 U.S.C. § 1104(a); *In re Lowenschuss*, 171 F.3d 673, 685 (9th Cir. 1999). Here, both are satisfied.

A. <u>Cause Exists Under Section 1104(a)(1) To Appoint A Trustee Because The Debtors-In-Possession Are Intentionally Harming The Interests Of The Non-Obligor Debtors</u>

33. It is elemental that a debtor-in-possession "has the same fiduciary duties as a trustee appointed by a court." *In re V. Savino Oil*, 99 B.R. at 524. "As a *de jure* trustee, the debtor-in-possession holds its powers in trust for the benefit of creditors." *Id.* at 524-25 (collecting cases). The debtor-in-possession owes creditors "the highest duties of care and loyalty," *In re Nartron Corp.*, 330 B.R. 573, 593 (Bankr. W.D. Mich. 2005), and must "protect and conserve property in its possession for the benefit of creditors," *In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 474 (3d Cir. 1998) (quotation marks omitted). Indeed, "[t]he willingness of Congress to leave a debtor-in-possession [in control of the estate] is premised on an expectation that current management can be depended upon to carry out the fiduciary responsibilities of a trustee." *In re V. Savino Oil*, 99 B.R. at 526. "And if the debtor-in-possession defaults in this respect, Section 1104(a)(1) commands that the stewardship of the reorganization effort must be turned over to an independent trustee." *Ibid.*

34. Here, the debtor-in-possession of each Non-Obligor Debtor owes fiduciary duties to that debtor's creditors.[12] Yet not only are the debtors-in-possession *not* advancing their creditors' interests, they are actively *harming* them.

35. The most salient difference among the Debtors is that the Obligor Debtors face an immense liability owing to their union obligations—about $1 billion, or half the estimated liability of the entire Patriot enterprise—that the Non-Obligor Debtors do not carry. Largely for this reason, while both the Obligor Debtors and the Non-Obligor Debtors are insolvent, the Non-Obligor Debtors are financially much sounder, and their creditors stand to recover substantial amounts on their claims. It goes without saying that the debtors-in-possession of the Non-Obligor Debtors cannot intentionally *harm* their own creditors for the benefit of the creditors of the Obligor Debtors (or anyone else). To do so would flagrantly violate the duties owed to the Non-Obligor Debtors' creditors, which creditors depend on their respective debtors-in-possession to "protect and conserve property in its possession for the[ir] benefit." *In re Marvel Entm't Group*, 140 F.3d at 474 (quotation marks omitted).

36. Yet that is exactly what the debtors-in-possession of the Non-Obligor Debtors have done, and without even a hint of compunction. The Debtors' Termination Motion proposes that the Court terminate the billion-dollar Union Debt of the Obligor Debtors; create a new liability owned by the VEBA; fund the VEBA with a $1 billion face value claim that runs against the assets of not only the Obligor Debtors, but also the *Non-Obligor Debtors*; and divert the Non-Obligor Debtors' future profits to fund the VEBA, as well. And what will the Non-Obligor

[12] While the Debtors' Chapter 11 cases are being administered jointly under Bankruptcy Rule 1015(b), that is purely for administrative convenience. Each Debtor—Obligor and Non-Obligor alike—is a separate and distinct entity, whose creditors are separately owed fiduciary duties.

Debtors receive in return for incurring this entirely new, billion-dollar liability? *Nothing*. Literally, nothing.

37. It is difficult to conceive a starker example of how the debtors-in-possession of the Non-Obligor Debtors could fail to serve the "highest duties of care and loyalty" (*In re Nartron*, 330 B.R. at 593) than by intentionally stripping value from the very estates they are legally obligated to protect. Such misconduct constitutes cause under Section 1104(a)(1) according to any of the formulations courts have adopted:

- The debtors-in-possession have breached their fiduciary duties to the creditors of the Non-Obligor Debtors; [13]
- The debtors-in-possession have intentionally impaired the assets of the Non-Obligor Debtors for the benefit of other debtors' creditors;[14]
- By seeking to reduce dramatically the value of the Non-Obligor Debtors, the debtors-in-possession have grossly mismanaged their estates;[15] and,

[13] *See In re Russell*, 60 B.R. 42, 45 (Bankr. W.D. Ark. 1985) (collecting cases and stating: "A trustee will be appointed when the debtor-in-possession is incapable of performing his fiduciary duties."); *see also Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 355 (1985) (same); *In re Marvel Entm't Group*, 140 F.3d at 474 (same); *In re Celeritas Techs.*, 446 B.R. at 520 (same); *In re Nartron Corp.*, 330 B.R. at 593; *In re V. Savino Oil*, 99 B.R. at 526 (same); *In re Ford*, 36 B.R. 501, 504 (Bankr. W.D. Ky. 1983).

[14] *See In re Veblen W. Dairy LLP*, 434 B.R. 550, 554 (Bankr. D.S.D. 2010) (ordering appointment of trustee for cause where debtor-in-possession used debtor's assets to pay down a debt owed by another related entity, suggesting an "inten[t] to benefit insiders and the several affiliated entities, rather than Debtor's creditors"); *In re Keeley*, 455 B.R. at 163 (cause can be established by debtor-in-possession's "lack [of evenhandedness] in dealings with insiders and affiliated entities in relation to other creditors" or by "self-dealing or squandering of estate assets" (internal quotation marks omitted)); *see also In re Oklahoma Ref. Co.*, 838 F.2d 1133, 1136 (10th Cir. 1988) (collecting cases and stating: "There are many cases holding that a history of transactions with companies affiliated with the debtor company is sufficient cause for the appointment of a trustee where the best interests of the creditors require.").

[15] *In re Main Line Motors, Inc.*, 9 B.R. 782, 784-85 (Bankr. E.D. Pa. 1981) (appointing trustee due to gross mismanagement where the debtor-in-possession transferred more than $300,000 out of the debtor corporation without receiving value in return); *In re Intercat, Inc.*, 247 B.R. 911, 923 (Bankr. S.D. Ga. 2000) (similar).

- As evidenced by the filing of this Motion and the massive debt the debtors-in-possession seek to thrust upon the Non-Obligor Debtors (without providing any value in return), the misconduct of the debtors-in-possession is material.[16]

38. That the reason the debtors-in-possession of the Non-Obligor Debtors insist on injuring their own creditors is (purportedly) to benefit the Obligor Debtors scarcely mitigates their misconduct. Quite the opposite, this conflict of interest just further *proves* that the debtors-in-possession are incapable, unwilling, or both, of acting as fiduciaries of their own creditors. That itself is cause to order the appointment of a trustee.[17] *See also, e.g., In re Marvel Entm't Group*, 140 F.3d at 472 (finding "significant" that Section 1104(a)(1) does not enumerate an exclusive list of circumstances amounting to cause, but rather gives courts "discretionary authority [that] is consistent with a 'policy of flexibility' permeating the Bankruptcy Code's overall aim of protecting creditors while giving debtors a second chance").

39. For all these reasons, there is cause for the Court to order the appointment of a disinterested trustee. And, "'[i]f cause is found, the appointment of a trustee is mandatory.'" *In re Keeley*, 455 B.R. at 163 (quoting *In re Veblen*, 434 B.R. at 553).

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[16] *See In re Keeley*, 455 B.R. at 163 ("'materiality of any misconduct'" is relevant to determining whether cause exists) (quoting *In re Veblen*, 434 B.R. at 553).

[17] *See In re Keeley*, 455 B.R. at 163 (bankruptcy court should consider "'whether any conflicts of interest on the part of the debtor-in-possession are interfering with its ability to fulfill its fiduciary duties'" (quoting *In re Veblen*, 434 B.R. at 553)); *see also In re William H. Vaughan & Co.*, 40 B.R. 524, 526 (Bankr. E.D. Pa. 1984) (appointing trustee because "[w]e cannot reasonably expect the debtor in possession, which is controlled by Vaughan, to subject to rigorous scrutiny the dealings between the two"); *In re Marvel Entm't Group*, 140 F.3d at 472-73 (similar); *In re Humphreys Pest Control Franchises, Inc.*, 40 B.R. 174, 176-77 (Bankr. E.D. Pa. 1984) (similar); *In re Concord Coal Corp.*, 11 B.R. 552, 554 (Bankr. S.D.W. Va. 1981) (similar).

B. <u>Appointment Of A Trustee Under Section 1104(a)(2) Is In The Interest Of The Non-Obligor Debtors And Their Creditors</u>

40. Appointment of a disinterested trustee to control the estates of the Non-Obligor Debtors is independently warranted by Section 1104(a)(2), which provides that a bankruptcy court "shall" order the appointment of a trustee "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." 11 U.S.C. § 1104(a)(2). "A Bankruptcy Court has particularly wide discretion to appoint a trustee under the flexible standard of [Section 1104(a)(2)], even when no cause exists under [Section] 1104(a)(1)." *In re Keeley*, 455 B.R. at 165; *In re Marvel Entm't Group*, 140 F.3d at 474 (same); *In re Bellevue Place Associates*, 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994) (same).

41. Section 1104(a)(2) requires a bankruptcy court "to exercise its broad equity powers." *In re Russell*, 60 B.R. at 45. Among the factors guiding the court's discretion are: "(1) the trustworthiness of the debtor; (2) the debtor's past and present performance and prospects for the debtor's reorganization; (3) confidence, or lack thereof, of the business community and creditors in present management; and (4) the benefits derived by appointment of a trustee, balanced against the costs of appointment." *In re Keeley*, 455 B.R. at 164-65.

42. Here, the intentional subversion of the interests of the Non-Obligor Debtors and their creditors by their own fiduciaries requires appointment of a trustee under Section 1104(a)(2), just as it also establishes cause for appointment of a trustee under Section 1104(a)(1). *See In re Celeritas Techs.*, 446 B.R. at 520 ("As with the analysis of cause under § 1104(a)(1), the debtor's ability to fulfill its duty of care to protect the assets, its duty of loyalty, and its duty of impartiality is at the base [of evaluating whether a trustee is needed under § 1104(a)(2) to control the debtor's estate]."). To put it mildly, the conduct of the debtors-in-possession have rendered them untrustworthy stewards of the interests of the Non-Obligor Debtors, and the

Noteholders hold no confidence whatsoever in their commitment or ability to protect the Noteholders' rights. *See In re Keeley*, 455 B.R. at 164-65. And in light of the substantial size of the Noteholders' claims, which constitute the majority of the unsecured debt owed by the Non-Obligor Debtors, the Noteholders' ability to work constructively with a disinterested trustee is essential to the successful reorganization of the Non-Obligor Debtors. *See ibid.*

43. Finally, for several reasons, the cost-benefit analysis weighs decidedly in favor of ordering the appointment of a trustee to control the Non-Obligor Debtors' estates. *See ibid.* *First* and most important, the circumstances are urgent. As Patriot itself acknowledges, its sole source of funding will soon expire, and without needed cash to operate its business, the Non-Obligor Debtors will careen into liquidation. That result is senseless. Though financially distressed, the Non-Obligor Debtors are fundamentally sound, and there is no reason they should suffer the value-destructive result of a liquidation. But if the Non-Obligor Debtors are to have any chance to reorganize successfully, they must be superintended by a trustee that is not *actively working against them*. *See In re Burival*, No. BK07-42271 *et al.*, 2009 WL 511134, at *2 (Bankr. D. Neb. Feb. 26, 2009) (ordering appointment of trustee where "[t]ime is of the essence"); *In re Concord Coal Corp.*, 11 B.R. at 555 (similar).

44. *Second*, the relief this Motion requests is measured. It does not request the appointment of a trustee to control the estates of all the Debtors, but only the estates of the Non-Obligor Debtors. The relief is thus tailored to the facts justifying it: The gross failure of the debtors-in-possession of the Non-Obligor Debtors to act as fiduciaries for their creditors.

45. *Third*, appointing a trustee to control the estates of the Non-Obligor Debtors will not disrupt the bankruptcy case. The Noteholders are confident they can find a trustee who possesses industry knowledge and is disinterested. *See* 11 U.S.C. § 1104(b)(1) (creditors entitled

to elect trustee after court orders appointment of trustee). In addition, Patriot's incumbent management is itself newly appointed, with the CEO having taken on that role just five months ago and the CFO six months ago. *See* Exhibit B at 30-32. *See also In re Marvel Entm't Group*, 140 F.3d at 471 (appointing trustee where court was "not confronted with a debtor who possesses extensive familiarity with the company's operations").

46. *Fourth*, appointing a trustee is cost-effective. The entire purpose of the appointment is to *maximize* the value of the Non-Obligor Debtors by ousting debtors-in-possession that seek to *reduce* their value for the benefit of other entities. *See In re Sharon Steel Corp.*, 86 B.R. 455, 466 (Bankr. W.D. Pa. 1988) ("In a case of this magnitude, the cost of having a trustee in place is insignificant when compared with the other costs of administration and when compared with the enormous benefit to be achieved by the establishment of trust and confidence in . . . management."). And of course, if the Court were to order the appointment of a trustee, then the Debtors would remain as debtors-in-possession of far fewer estates, and therefore incur (one would hope) far fewer expenses. *See* Dkt. 3351 (showing fees of $12.6 million paid to counsel for the Debtors since commencement of the Cases and through February 2013).

47. *Fifth*, there is nothing anomalous in having a disinterested trustee control the estates of the Non-Obligor Debtors, while the Obligor Debtors continue to operate as debtors-in-possession. To the contrary, for example, Bankruptcy Rule 2009(d) expressly requires the bankruptcy court to "order the selection of separate trustees for estates being jointly administered" upon a showing that "the different estates will be prejudiced by conflicts of interest of a common trustee." Fed. R. Bankr. P. 2009(d).

48. *Last*, though certainly not least, appointment of a disinterested trustee is equitable. *See In re Russell*, 60 B.R. at 45. It is fundamentally unfair for the Noteholders to have to sit back

and watch as the debtors-in-possession of the Non-Obligor Debtors—their purported fiduciaries—intentionally and without even the courtesy of notice to the Noteholders strip the Non-Obligor Debtors of value for the benefit of other creditors. Putting an (immediate) end to that scenario is exactly the purpose of Section 1104(a)(2).

49. For all these reasons, appointment of a trustee to control the estates of the Non-Obligor Debtors is warranted under Section 1104(a)(2).[18]

C. <u>Urgent Relief Is Warranted</u>

50. That the fiduciaries of the Non-Obligor Debtors have actively worked to harm their own creditors is deeply disturbing enough. But by squandering months of time, their misconduct has launched the Debtors into genuine crisis. The Debtors themselves acknowledge that, in just a few months, they expect to violate the terms of the DIP Facility that provides cash essential to operating their business. Without that cash, liquidation is inevitable.

51. The Noteholders believe that a disinterested, competent trustee would have taken the Non-Obligor Debtors out of bankruptcy months ago. But regardless of whether a trustee would have pursued that or some other path, what is clear beyond doubt is that if the Non-Obligor Debtors are to avoid liquidation, they must be superintended by a disinterested trustee who acts for them—not against them. Because the circumstances are urgent, so too is the need for relief.

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[18] To be clear, the appointment of a trustee under Section 1104(a)(1) or (2) to control the estates of the Non-Obligor Debtors is warranted regardless whether the Court grants the Debtors' Termination Motion. The question under Section 1104(a) is whether the debtors-in-possession are capable of serving as fiduciaries of the creditors of the Non-Obligor Debtors. Plainly they are not, since they have actively sought to injure those creditors. That remains true whether the Court grants the Termination Motion or not.

That said, the Court should deny the Termination Motion for the reasons stated in the Noteholders' forthcoming objection—namely, that the relief the motion seeks is grossly inequitable to the Non-Obligor Debtors and blatantly unlawful.

NOTICE

52. Notice of this Motion has been given to the following parties or, in lieu thereof, to their counsel, if known: (a) the United States Trustee for the Eastern District of Missouri, (b) counsel to the Voluntary Debtors, and (c) all persons filing notices of appearance in this Case electronically through the Court's Electronic Case Filing System. The Noteholders submit that, in light of the nature of the relief requested, no other or further notice need be given.

53. A copy of the proposed order granting the relief requested herein may be found at www.PatriotCaseInfo.com/orders.php.

NO PRIOR REQUEST

54. No prior motion for the relief requested herein has been made to this or any other court.

WHEREFORE, for the reasons detailed herein, the Noteholders respectfully request that the Court enter an order directing the immediate appointment of a Chapter 11 trustee for the Non-Obligor Debtors pursuant to 11 U.S.C. §§ 105(a), 1104(a)(1) and/or 1104(a)(2), and for any other and further relief to which they may be justly entitled.

Dated: March 28, 2013

Respectfully submitted,

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EXHIBIT A

EXHIBIT A: THE NON-OBLIGOR DEBTORS

1) Patriot Coal Corporation
2) Affinity Mining Company
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) Cook Mountain Coal Company, LLC
19) Corydon Resources LLC
20) Coventry Mining Services, LLC
21) Coyote Coal Company LLC
22) Cub Branch Coal Company LLC
23) Day LLC
24) Dixon Mining Company, LLC
25) Dodge Hill Holding JV, LLC
26) Dodge Hill Mining Company, LLC
27) Dodge Hill of Kentucky, LLC
28) EACC Camps, Inc.
29) Eastern Coal Company, LLC
30) Eastern Royalty, LLC
31) Emerald Processing, L.L.C.
32) Grand Eagle Mining, LLC
33) Hillside Mining Company
34) Indian Hill Company LLC
35) Infinity Coal Sales, LLC
36) Interior Holdings, LLC
37) IO Coal LLC
38) Jarrell's Branch Coal Company
39) Jupiter Holdings LLC
40) Kanawha Eagle Coal, LLC
41) Kanawha River Ventures I, LLC
42) Kanawha River Ventures II, LLC
43) Kanawha River Ventures III, LLC
44) KE Ventures, LLC
45) Little Creek LLC
46) Logan Fork Coal Company
47) Magnum Coal Company LLC
48) Magnum Coal Sales LLC
49) Midland Trail Energy LLC
50) Midwest Coal Resources II, LLC
51) New Trout Coal Holdings II, LLC
52) Newtown Energy, Inc.
53) North Page Coal Corp.
54) Ohio County Coal Company, LLC
55) Panther LLC
56) Patriot Beaver Dam Holdings, LLC
57) Patriot Coal Company, L.P.
58) Patriot Coal Sales LLC
59) Patriot Coal Services LLC
60) Patriot Leasing Company LLC
61) Patriot Midwest Holdings, LLC
62) Patriot Reserve Holdings, LLC
63) Patriot Trading LLC
64) PCX Enterprises, Inc.
65) Pond Creek Land Resources, LLC
66) Pond Fork Processing LLC
67) Remington Holdings LLC
68) Remington II LLC
69) Remington LLC
70) Robin Land Company, LLC
71) Sentry Mining, LLC
72) Snowberry Land Company
73) Speed Mining LLC
74) Sterling Smokeless Coal Company, LLC
75) TC Sales Company, LLC
76) The Presidents Energy Company LLC
77) Thunderhill Coal LLC
78) Trout Coal Holdings, LLC
79) Union County Coal Co., LLC
80) Viper LLC
81) Weatherby Processing LLC
82) Wildcat Energy LLC
83) Wildcat, LLC
84) Will Scarlet Properties LLC
85) Winchester LLC
86) Winifrede Dock Limited Liability Company