**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)** **Hearing Date:** **April 23, 2013 at 10:00am** **(prevailing Central Time)** **Hearing Location:** **Courtroom 7 North**

NOTEHOLDERS' OBJECTION TO DEBTORS' SECOND MOTION FOR AN ORDER EXTENDING DEBTORS' EXCLUSIVE PERIODS WITHIN WHICH TO FILE A PLAN OF REORGANIZATION AND SOLICIT VOTES THEREON

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, file this Objection to the Debtors' Second Motion For An Order Extending Debtors' Exclusive Periods Within Which To File A Plan Of Reorganization

[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 has 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.

And Solicit Votes Thereon (the "**Second Exclusivity Motion**") (Dkt. 3498). In support thereof they state as follows:

PRELIMINARY STATEMENT

1. When the Debtors first moved to extend their exclusivity periods in October 2012, they justified the request on the ground that these bankruptcy cases "have been pending for only a few short months," and that additional time was needed to "develop a plan of reorganization that maximizes creditor recoveries." Dkt. 1398 at 11 (capitalization omitted).

2. Nearly 180 days have passed since the Debtors made those statements and an extension was granted. And nearly 300 days have passed since these cases were commenced. Yet, no reorganization plan has been filed. No outline of a plan has been circulated—at least not to the Noteholders' knowledge, and certainly not to the Noteholders. And until just recently, the Debtors have shown little interest in engaging the Noteholders in restructuring efforts, even though the input and support of the Noteholders, which collectively are the largest creditors of most of the ninety-nine Debtors in these cases, are essential to reorganizing successfully.

3. Meanwhile, the Debtors lurch towards liquidation. By their own account, they may default on their post-petition financing facility as soon as this July—barely more than 60 days from now. And without access to that essential source of funding, the Debtors acknowledge that liquidation may soon follow.

4. Despite this urgent situation, the Debtors have made little headway toward crafting a viable reorganization plan. They have made *no effort* to bring out of bankruptcy the eighty-six Debtors, including Patriot, that have no union-related liability (the "**Non-Obligor Debtors**"), even though these Debtors have substantial value and could (and should) have emerged from bankruptcy already. Instead, the Debtors have focused their efforts on the thirteen Debtors that do have union-related liability (the "**Obligor Debtors**"). But while those efforts

have consumed the bulk of the Debtors' time, they have failed to produce a consensual result and have led only to a motion, under Sections 1113 and 1114 of the Bankruptcy Code (the "**Termination Motion**"),[2] that cannot possibly lead to a confirmable plan because the motion is based on a plainly unlawful proposal: To force the Non-Obligor Debtors to use their assets to satisfy union-related debts that they do not owe, without providing them any value in return.

5. These are exactly the circumstances in which a court should *not* allow the status quo to continue. The Debtors have given no reason to think they will produce a plan within the next 120 days, let alone a confirmable one. By declining to extend the Debtors' exclusivity period for a second time, the Court would allow more voices to participate in the plan formation process, would compel parties to be more realistic in their expectations, and would (in the Noteholders' respectful view) markedly improve the chances of reaching a confirmable plan and avoiding liquidation, which no party wants.

6. For these reasons, the Court should deny the Second Exclusivity Motion.

ARGUMENT

7. Section 1121 of the Bankruptcy Code expressly limits the time in which a debtor has the exclusive right to file a plan of reorganization and solicit acceptances thereof to 120 and 180 days, respectively. 11 U.S.C. §§ 1121(b), (c). Congress imposed these time limits for good reason: To "acknowledg[e] that creditors, whose money is invested in the enterprise no less than the debtor's, have a right to a say in the future of that enterprise," and "to limit the delay that makes creditors the hostages of Chapter 11 debtors." *In re Timbers of Inwood Forest Associates, Ltd.*, 808 F.2d 363, 372 (5th Cir. 1987) *aff'd sub nom. United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988). Thus, a court may not extend a debtor's

[2] *See* Debtors' Motion To Reject Collective Bargaining Agreements And To Modify Retiree Benefits Pursuant To 11 U.S.C. §§ 1113, 1114 Of The Bankruptcy Code (Dkt. 3214).

exclusivity periods unless the debtor can show there is "cause" to do so. 11 U.S.C. § 1121(d); *In re Sw. Oil Co. of Jourdanton, Inc.*, 84 B.R. 448, 450-51 (Bankr. W.D. Tex. 1987) (debtor bears burden of proof). And, in light of the significant prejudice that such extensions can cause creditors and others, requests for extensions are "serious matter[s]" that "should be granted neither routinely nor cavalierly." *Matter of All Seasons Indus., Inc.*, 121 B.R. 1002, 1004 (Bankr. N.D. Ind. 1990) (internal quotation marks omitted); *In re Sw. Oil Co. of Jourdanton, Inc.*, 84 B.R. at 450 (same).

8. In determining whether cause exists to extend exclusivity, courts consider various factors, including whether the debtor has made progress toward reorganization and in its negotiations with creditors. *In re Adelphia Communications Corp.*, 352 B.R. 578, 587 (Bankr. S.D.N.Y. 2006); *see also Matter of All Seasons Indus., Inc.*, 121 B.R. at 1006 (creditors' "loss of confidence" in debtor's management favors denying extension of exclusivity); *In re Hoffinger Indus., Inc.*, 292 B.R. 639, 643-44 (B.A.P. 8th Cir. 2003). Courts also consider whether there has been a "deterioration of the debtor's cash position" during the bankruptcy case. *In re Sw. Oil Co. of Jourdanton, Inc.*, 84 B.R. at 453; *In re Ravenna Indus., Inc.*, 20 B.R. 886, 890 (Bankr. N.D. Ohio 1982) (same). And, a "primary consideration" is whether extending exclusivity (or, not extending it) "would facilitate moving the case forward"—a "practical call" that can "override a mere toting up of the [other] factors." *In re Dow Corning Corp.*, 208 B.R. 661, 670 (Bankr. E.D. Mich. 1997).

9. Here, these considerations all point strongly against extending exclusivity. The Debtors have not made meaningful progress toward reorganization, in large part because they have disregarded the rights and interests of their creditors; the Debtors' financial state is dire;

and allowing other parties in interest, including the Noteholders, to propose reorganization plans is the most promising way to advance the progress of these cases and avoid liquidation.

I. The Debtors Have Made No Meaningful Progress Toward Reorganization

A. The Non-Obligor Debtors

10. The most salient difference among the Debtors is that the Obligor Debtors face an immense liability owing to their union obligations—about $1 billion by their estimate—that the Non-Obligor Debtors do not carry. Thus, while both the Obligor Debtors and the Non-Obligor Debtors are distressed, the Non-Obligor Debtors are financially much sounder. In addition, the liabilities of the Non-Obligor Debtors are fairly straightforward, as they consist chiefly of the Notes. In light of these characteristics, the Non-Obligor Debtors could (and should) have emerged from bankruptcy already. Doing so would not have impaired the ongoing operation of the Patriot enterprise, and it would have avoided the enormous administrative expense that has continued to accrue. *See, e.g.*, PCX Form 10-K for fiscal year 2012 at F-10, Dkt. 2905 at 11, and Dkt. 3351 at 11 (Debtors have accrued advisor fees of $46 million since petition date).

11. The Debtors, of course, have opted to keep all eighty-six Non-Obligor Debtors in bankruptcy. The Debtors have provided no target date for their emergence or even any milestones they hope to achieve. Nor have the Debtors provided any explanation—let alone justification—for this value-destructive strategy. The result is that the Non-Obligor Debtors, though possessing substantial value, languish in bankruptcy indefinitely while their creditors remain unable to act on account of the exclusivity period.

B. The Obligor Debtors

12. The Debtors have instead focused their attention on addressing the large union debt owed by the Obligor Debtors, but their process has lacked any urgency. Although the

Debtors retained their financial advisors two months *before* filing their petitions in July 2012 (*see* Declaration of Paul P. Huffard (Dkt. 3224) ¶ 8), they did not make their opening offer to the United Mine Workers of America (the "**UMWA**") until four months *after* the petition date, in November 2012. The Debtors then took another four months before filing their Termination Motion. The result is that by the time the motion is likely to be resolved, nearly a year will have passed since these cases were commenced.

13. But more troubling than the Debtors' sluggishness has been the substance of their approach. The Section 1114 proposal underlying the Termination Motion cannot possibly lead to a confirmable plan because it is fundamentally unlawful. At bottom, the proposal would force the Non-Obligor Debtors to use their assets to pay union-related debts that they do not owe, while providing them no value (at all) in return. Up until last week, the proposal accomplished this primarily by granting a brand new, *$1 billion* face value unsecured claim against the Non-Obligor Debtors (as well as against the Obligor Debtors). That proposal blatantly violates basic principles of corporate separateness, and the Termination Motion cites no legal authority whatsoever in its defense.

14. Perhaps realizing that the proposal could not lead to a confirmable plan, last week the Debtors abruptly dropped it. But what they replaced it with is just as problematic, and just as unlawful: A per-ton royalty on all coal produced by not just the Obligor Debtors, but also by the Non-Obligor Debtors. Like the prior proposal, this one also tramples upon fundamental notions of corporate separateness by forcing the Non-Obligor Debtors to use their assets to pay debts that they do not owe. And, the proposed royalty exists in perpetuity and thus literally has no limit. *See* Debtors' Fifth Section 1114 Proposal (Apr. 10, 2013), available at http://patriotcaseinformation.com/pdflib/Fifth%20section%201114%20proposal.pdf ("The

Royalty Contributions would not be capped and continue in perpetuity . . . ."). In addition, the new proposal grants the UMWA a large equity share (35 percent) in the reorganized company—without providing any derivation of that figure—which could severely prejudice the interests of the Noteholders in the event that they, too, receive equity. And, the proposal retains from prior proposals a profit-sharing scheme that, like the new royalties, inevitably would siphon value from the Non-Obligor Debtors to pay union obligations they do not owe.[3]

15. In short, the Debtors have squandered nearly 300 days of bankruptcy by pursuing a proposal that—even if it *had* gained the support of the UMWA, which it did not—would still have led nowhere because it could not have led to a confirmable plan of reorganization. What is more, when the Noteholders naturally expressed their intent to oppose the Termination Motion, the Debtors sought to exclude them from the upcoming proceedings, and even sought to deny them their right to submit a written objection—efforts this Court rejected. The Noteholders respectfully submit that, had the Debtors solicited their input earlier (or at all), much time and expense could have been saved.[4]

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[3] The Noteholders explain these deficiencies in greater detail in their objection to the Termination Motion, but the unlawfulness of the Debtors' proposal is evident from even this summary description. *See* Noteholders' Objection To Motion To Reject Collective Bargaining Agreements And To Modify Retiree Benefits Pursuant To 11 U.S.C. §§ 1113 and 1114 (Dkt. 3608).

[4] The Debtors' insistence on pursuing a proposal that diverts value from the Non-Obligor Debtors in order to pay a debt that those Debtors do not owe not only fails to advance the reorganization process, but is also a clear breach of the fiduciary duty owed to the Non-Obligor Debtors' creditors, including the Noteholders. Because the debtors-in-possession of the Non-Obligor Debtors have thus actively sought to harm the interests of their own creditors, the Noteholders have moved for the appointment of a Chapter 11 trustee to control their estates. *See* Motion For Entry Of An Order, Pursuant To 11 U.S.C. §§ 105(a) And 1104(a), Directing The Appointment Of A Chapter 11 Trustee (Dkt. 3423). While those debtors-in-possession are no longer fit to manage their estates, at minimum they should not be *rewarded* with an extension of time in which to be the exclusive plan proponent.

II. The Debtors' Financial Condition Is Dire

16. While the Debtors have not made meaningful progress toward reorganization or in their negotiations with creditors, their financial condition has worsened dramatically, to a point that can fairly be called a crisis. Right now all that separates the Debtors from liquidation is the funding they receive through their post-petition financing facility. *See* PCX Form 10-K for fiscal year 2012 at 9. But that 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.

17. These provisions will soon be triggered, because 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 27 percent decline). At the same time, Patriot has reduced its average monthly operating costs by only $18 million (a 13 percent decline). The result is that operating margins have plummeted from 4.2 percent in the second half of 2012 to -14.6 percent in the first two months of 2013. Faced with the grim reality of these figures, Patriot has candidly acknowledged that it is on track to default on its DIP Facility as soon as this July. *Id.* at 34. And if that happens, Patriot does not deny that it may have no choice but to liquidate. *Ibid.*

III. Denying An Extension Of Exclusivity Would Move The Cases Forward

18. In light of the Debtors' lack of progress and desperate financial condition, the last thing the estates need is a continuation of the status quo, much less a continuation for 120 days

that would bring the Debtors well past the time they expect to default on the DIP Facility, and to the verge of the expiration of the DIP Facility in October 2013. In contrast, ending exclusivity would allow more, and diverse, voices to join the bargaining table. Not only might other parties in interest, including the Noteholders, have promising ideas for how to restructure the Debtors and avoid liquidation, but the mere presence of competing viewpoints will force parties to be more realistic in their expectations, which itself is salutary to the bargaining process. And, allowing the Noteholders to propose a plan makes particular sense here in light of the fact that, as the largest creditors of most of the Debtors, their support is critical to achieving a successful reorganization.

19. Moreover, denying the Debtors a (second) extension of their exclusivity periods "does not sound a death knell for [a] debtor's reorganization. Denying such a motion only affords creditors their right to file the plan; there is no negative effect upon the debtor's co-existing right to file its plan." *Matter of All Seasons Indus., Inc.*, 121 B.R. at 1005 (internal quotation marks omitted); *see also In re Sw. Oil Co. of Jourdanton, Inc.*, 84 B.R. at 454 (same). "The debtor remains free to take as long as it wishes or feels appropriate to develop and propose its own plan. The risk is, of course, that while it is developing its plan, another party in interest will file a plan. However, that is as Congress intended." *Matter of All Seasons*, 121 B.R. at 1005 (internal quotation marks omitted).

20. In short, as the Debtors themselves recognize in their Second Exclusivity Motion, "[t]he principal goal of chapter 11 is the successful reorganization of debtors *in order to increase the pool of assets available to creditors*." Second Exclusivity Motion ¶ 13 (emphasis added). The Debtors have now had nearly 300 days in which to be the exclusive plan proponent. That time has been marked by slow negotiations with the UMWA, an unlawful (and hence futile)

proposal in the Termination Motion, and an effort to exclude criticism or even review of that proposal. If Patriot and its subsidiaries are to "increase the pool of assets available to creditors" and avoid liquidation, then it is time to allow those creditors (and others) the opportunity to propose their plans, and solutions, to these cases.

IV. The Debtors' Arguments In Favor Of Extending Exclusivity Are Meritless

21. The Debtors' Second Exclusivity Motion addresses none of the points above, even though they all lean strongly against extending exclusivity. Instead, the Debtor's motion is largely a refrain of their first motion, even though some 180 days have passed since that motion was filed, virtually no progress has been made in that time, and the Debtors' financial condition has substantially worsened.

22. Moreover, the Debtors offer no assurance that they will be able to propose a suitable plan if they are granted an exclusivity extension, and no specific reason to think that exclusivity is necessary—or even helpful—to those efforts. Rather, the Second Exclusivity Motion rests largely on vague assertions about prior progress that lack the basic detail needed for the Debtors to prove that "cause" exists for an extension. *See, e.g.*, Second Exclusivity Motion ¶ 22 ("there can be no doubt that the Debtors have made significant progress toward proposing a plan of reorganization"); ¶ 26 ("the Debtors have had significant, productive negotiations with a wide variety of creditors"). Further, while the Debtors rightly note (at ¶ 24) that one factor courts consider in deciding whether to extend exclusivity is whether "a debtor has sufficient liquidity to pay its postpetition debts as they come due," it is difficult to see how this factor favors the Debtors in light of their *concession that they are about to default on their essential source of post-petition financing*.

23. The Debtors' main argument in support of extending exclusivity is that they cannot yet formulate a plan of reorganization because "there are several matters that must be resolved," principally the "restructuring of their labor and retiree liabilities." Second Exclusivity Motion ¶¶ 19, 23. But the Debtors do not even attempt to explain why addressing these liabilities, which are owed by the thirteen Obligor Debtors alone, requires keeping in bankruptcy the *eighty-six* Non-Obligor Debtors that have no such liabilities and that possess substantial value.

24. Nor is there reason to think that extending exclusivity will advance the reorganization of the Obligor Debtors. To the contrary, nine months of negotiations between the Debtors and the UMWA give little hope for consensual resolution of any dispute. Management's desultory commencement of the process (waiting months before making its opening proposal) and its constantly shifting—yet consistently unlawful—proposals (the Debtors have just made their fourth proposal under Section 1113 and their fifth under Section 1114) have not produced consensus, but only the hotly-contested Termination Motion. The UMWA has responded by denouncing the Debtors' "radical" proposals and suggesting that the miners will have little choice but to "withhold their labor." Dkt. 3610 at 1. It is hard to see how this process makes the various constituencies of the Debtors more likely to reach agreement. Yet the Debtors ask for another four months to continue along the same unproductive path they have followed for the last nine.

25. The Debtors' remaining arguments do not justify further delaying the statutory right of the Noteholders and other parties in interest to file reorganization plans, but merely show that the Debtors have not been inactive, which no party claims they have been. But when 300

days have passed without meaningful progress and the Debtors stand on the brink of liquidation, much more than mere activity is required to justify another 120 days of the status quo.

CONCLUSION

For all these reasons, the Court should deny the Second Exclusivity Motion.

Dated: April 16, 2013

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing *Noteholders' Objection To Debtors' Second Motion For An Order Extending Debtors' Exclusive Periods Within Which To File A Plan Of Reorganization And Solicit Votes Thereon* was filed on April 16, 2013 using the Court's CM/ECF system, which sent a copy to all parties receiving electronic notices in this case.

/s/ Alan D. Strasser
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