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' REPLY IN SUPPORT OF 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

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 Reply in support of their 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 (the "**Trustee Motion**") (Dkt. 3423). In support thereof they state as follows:

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[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.

PRELIMINARY STATEMENT

1. The Debtors Objection[2] to the Trustee Motion makes many assertions, but like the dog that did not bark, the objection is most telling for what it does not say.

2. First, the Debtors do not deny that each of the ninety-nine Debtors in these cases is a distinct legal entity that owes fiduciary duties to its own creditors. *See, e.g.*, Debtors Objection ¶ 30 ("each Debtor is a distinct legal entity"); Declaration of Mark N. Schroeder (Dkt. 4) ¶ 48 (Debtors have requested "only administrative, and not substantive, consolidation of the estates"); *see also In re Innkeepers USA Trust*, 442 B.R. 227, 235 (Bankr. S.D.N.Y. 2010) ("In a bankruptcy case, it is 'Bankruptcy 101' that a debtor and its board of directors owe fiduciary duties to the debtor's creditors to maximize the value of the estate, *and each of the estates in a multi-debtor case*." (emphasis added)).

3. Second, the Debtors do not deny that only a small fraction of the ninety-nine Debtors have union-related liability (the "**Obligor Debtors**"), while the vast majority do not (the "**Non-Obligor Debtors**"). Indeed, the only discrepancy between the Debtors and Noteholders on this point is that the Debtors believe there are only ten Obligor Debtors, *i.e.*, three *fewer* Obligor Debtors than the Noteholders contend. *See* Debtors Objection ¶ 1 n.3. For purposes of this motion, we assume *arguendo* that the correct number is ten, but whether the number is ten or thirteen does not affect the analysis in any way.

4. Third and most important, the Debtors do not deny—or at least do not seriously deny—that the operative proposal underlying their motion under Sections 1113 and 1114 (the

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[2] *See* Debtors' Objection To The 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 ("**Debtors Objection**") (Dkt. 3675).

"**Termination Motion**")[3] siphons assets from the Non-Obligor Debtors to pay union-related debts that the Non-Obligor Debtors do not owe, thereby severely injuring their creditors, including the Noteholders.

5. In short, the Debtors essentially concede *every premise* of our argument for why a disinterested trustee must be appointed to control the estates of the Non-Obligor Debtors: Because those Debtors, far from safeguarding the interests of their creditors as the law requires, are actively *harming* them. Indeed, the Debtors shockingly suggest that such diversion of value is appropriate. Debtors Objection ¶¶ 36-39.

6. Yet, the Debtors caricature the Trustee Motion as "baseless" (¶ 2) and "simply preposterous" (¶ 20)—while also faulting us for "rel[ying] solely on rhetoric" (¶ 2)—and impugning our motives for filing the motion (¶ 1).

7. With respect, the Debtors' contentions are meritless. Most of the Debtors' objections are to arguments we do not make. For example, the Debtors insist that this case does not involve fraud, yet we do not claim it does. The Debtors clamor that the existence of interdebtor disputes is not itself cause for the appointment of a trustee, but we do not say it is.

8. While the Debtors battle these strawmen, they all but ignore the argument we *do* make: That the Non-Obligor Debtors have unquestionably breached the fiduciary duties they owe to their creditors, and that *this* harm requires the immediate appointment of a disinterested trustee who can discharge those duties faithfully. Indeed, the Debtors' only (and unavailing) response to this argument is nestled in the final four paragraphs of their objection.

[3] 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).

9. The Debtors, along with the other parties that oppose the Trustee Motion, instead focus on the practical consequences of appointing a chapter 11 trustee, including its effect on the unified operation of the Debtors and on the availability of post-petition financing.

10. These are clearly important questions, and ones the Noteholders take very seriously. But while the other parties are right to ask these questions, the parties are wrong in their answers. Their error stems from a basic misimpression of what a trustee would, and would not, do. To be clear, a trustee would ***not*** alter the direction of Patriot's business or interfere with its daily management. Instead, the trustee's sole concern would be to oversee the reorganization of the Non-Obligor Debtors for which the trustee is appointed. The trustee's singular focus would be to maximize the value of their estates for the benefit of their creditors while respecting corporate separateness, as the law requires. Thus, the appointment of a trustee would cause no operational crisis, and the Patriot enterprise would continue to function as it now does. For similar reasons, the Noteholders are confident that a trustee could work with post-petition lenders to ensure that financing remains available. After all, the DIP Lenders have loaned money against the value of the Debtors, and the trustee would work tirelessly to *maximize* that value—and not, as the debtors-in-possession of the Non-Obligor Debtors have done, to reduce it.

11. For these reasons, the Court should grant the Trustee Motion.

ARGUMENT

12. We respond below to each of the arguments made against the Trustee Motion. We begin by addressing two threshold contentions—that the Non-Obligor Debtors are in fact liable for union-related debt, and that the Debtors' recent modification of their proposal under Sections 1113 and 1114 affects the merits of the Trustee Motion. Both contentions are wrong.

I. The Non-Obligor Debtors Are Not Liable For Union-Related Debt

13. The United Mine Workers of America ("**UMWA**"), alone, asserts in passing that both the Obligor Debtors *and the Non-Obligor Debtors* are liable for union-related debt. UMWA Objection ¶ 3.[4] The UMWA cites no evidence for this assertion, and it is demonstrably false. The Schedule of Financial Affairs for each of the ninety-nine Debtors expressly states which Debtors are liable for union-related debt. The Obligor Debtors are liable; the Non-Obligor Debtors are not. *See* http://patriotcaseinformation.com/sofa.php.

14. The only ground the UMWA offers for its contrary assertion is that the UMWA "believes" that union-retiree liabilities "were always historically held at the corporate level prior to the spin-off transactions which led to the creation of Patriot and Magnum, later acquired by Patriot, and were not assigned to specific 'obligor' subsidiaries until the spin-offs." UMWA Objection ¶ 3. But the UMWA cites no evidence in support of this "belie[f]," and the public filings of Patriot's predecessor immediately before the spin-off directly refute it. *See* Peabody Energy Corporation Form 10-K for fiscal year 2006 at F-67 and F-68, available at http://www.sec.gov/Archives/edgar/data/1064728/000095013707003006/c12536e10vk.htm (showing that "Other noncurrent liabilities"—*i.e.*, union-related retiree liabilities—were held almost exclusively by the "Guarantor Subsidiaries" and not by the "Parent Company").

15. The uncontested evidence thus shows that the Obligor Debtors alone are liable for union-related debt. The UMWA provides no basis for its contrary hypothesis, and the Court should disregard it entirely.

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[4] *See* United Mine Workers' Objection To Motion For Appointment Of A Chapter 11 Trustee ("**UMWA Objection**") (Dkt. 3671).

II. The Debtors' Current Proposal Under Sections 1113 And 1114 Only Reinforces The Need For The Urgent Appointment Of A Disinterested Chapter 11 Trustee

16. Equally misplaced is the Debtors' assertion that their revised proposal of April 10, 2013 (the "**Current Proposal**") "cured the alleged deficiency" in their earlier proposal that was operative at the time the Trustee Motion was filed on March 28 (the "**Prior Proposal**"). Debtors Objection at 20 (capitalization omitted). To the contrary, the Current Proposal just confirms the need for the swift appointment of a disinterested trustee to oversee the restructuring of the Non-Obligor Debtors.

17. The Prior Proposal rested on a fundamentally unlawful premise: To force the Non-Obligor Debtors to use their assets to pay union-related debts that they do not owe, while providing them nothing in return. This was accomplished primarily by imposing on all of the Debtors (including the Non-Obligor Debtors) a brand new, $1 billion face value claim (the "**VEBA Claim**") to help fund a Voluntary Employee Beneficiary Association trust ("**VEBA**"), which would pay for union retirees' healthcare.

18. This immense diversion of value from the Non-Obligor Debtors was not just unlawful, but was also a glaring breach of the fiduciary duties the Non-Obligor Debtors owed to their creditors, which creditors would be severely prejudiced by the creation of the new liability. The Noteholders, through the Trustee Motion, therefore sought the appointment of a disinterested trustee who could maximize the value of the Non-Obligor Debtors for the benefit of their creditors, as the law requires.

19. Apparently recognizing that the Prior Proposal was unlawful, the Debtors abandoned it shortly after the Trustee Motion was filed. But what they replaced it with is just as unlawful, because it seeks to achieve through different means the same result as the Prior Proposal: To use the assets of the Non-Obligor Debtors to pay union-related debts that they do

not owe, while providing them no value in return. Instead of funding the VEBA with the VEBA Claim, the Current Proposal would do so by granting the UMWA a 35% equity stake in the reorganized company. Yet the Current Proposal provides no explanation at all—let alone a justification—for why 35% is an appropriate figure. The Debtors do not disclose what assumptions go into that figure, or provide any reason to think that the union-related debt is entitled to a recovery of 35% of the reorganized company.

20. The Current Proposal also would fund the VEBA through a perpetual, per-ton royalty on coal produced by *all of the Debtors, including the Non-Obligor Debtors*, as well as by a profit-sharing scheme where funds are contributed to the VEBA based on profit earned by *all of the Debtors, including the Non-Obligor Debtors*. Nominally, the Current Proposal provides that the Obligor Debtors are responsible for making these payments, but that hardly fixes the proposal's illegality. To start with, the Noteholders are also creditors of the Obligor Debtors, and the Current Proposal does not even attempt to explain why, as Obligor-Debtor creditors, the Noteholders are not also entitled to receive their pro rata share of the royalty and profit-sharing payments. Nor do the Debtors provide the information necessary to determine whether the 35% equity stake is appropriately adjusted to account for the value the VEBA receives from the royalty and profit-sharing payments—the latter of which alone may amount to $300 million, according to the Debtors' CEO.[5]

21. Further, as we explain in our objection to the Termination Motion, the royalty and profit-sharing payments will inevitably require the use of assets of the Non-Obligor Debtors,

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[5] *See* Bennett Hatfield, "Patriot Coal wants to save 4,000 jobs," *Charleston Daily Mail* (Apr. 4, 2013) ("The VEBA trust would receive funding from Patriot through . . . profit-sharing contributions by Patriot of up to $300 million . . . .").

even though the Non-Obligor Debtors have no union-related debt.[6] On this point there can be no doubt, because the Debtors openly acknowledge it. *See* Debtors Objection ¶¶ 36-39. In fact, the Debtors not only concede the point, but they make the outlandish assertion, unsupported by any legal authority, that this diversion of value from the Non-Obligor Debtors—to pay a debt they do not owe and to the severe prejudice of their own creditors—is somehow "consistent with the Debtors' fiduciary duties." *Id.* at 22 (capitalization omitted).[7]

22. The Current Proposal thus does not "cur[e] the alleged deficiency" in the Prior Proposal. Debtors Objection at 20 (capitalization omitted). It just substitutes a new, but equally unlawful proposal. And it confirms that the debtors-in-possession of the Non-Obligor Debtors will not hesitate to breach the fiduciary duties they owe their creditors, including the Noteholders. The need to appoint a disinterested trustee to control the Non-Obligor Debtors thus remains urgent, and, if anything, is only more urgent in light of the Non-Obligor Debtors' proven resolve to injure their own creditors.[8]

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[6] *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).

[7] While assuring the Court that the Current Proposal is lawful and the Termination Motion should be granted, the Debtors have meanwhile tried—unsuccessfully—to exclude interested parties like the Noteholders from opposing the motion at the upcoming proceedings.

[8] Remarkably, the Debtors assert that under the Prior Proposal, the VEBA Claim would have run against *only* the Obligor Debtors, and *not* against the Non-Obligor Debtors. Debtors Objection ¶ 33. In other words, the Debtors now argue—for the first time, and after much expense has been invested litigating the Trustee Motion—that the Noteholders' principal basis for bringing the motion rested on a misunderstanding of the Prior Proposal. If so, then why did the Debtors not simply contact the Noteholders to inform them of their error (which the Debtors did not do)? The reason for the Debtors' silence is clear: The Prior Proposal plainly contemplated that the VEBA Claim would run against all of the Debtors, including the Non-Obligor Debtors. There is no other plausible way to read the Prior Proposal. The declaration describing the VEBA stated that a "significant funding source for the VEBA will be an unsecured claim against ***the Debtors' estate***." Declaration of Paul P. Huffard (Dkt. 3224) ¶ 67 (emphasis added). The same declaration also made clear that the word "Debtors"

III. Cause Exists Under Section 1104(a)(1) To Appoint A Trustee Because The Non-Obligor Debtors Are Intentionally Harming The Interests Of Their Creditors

23. For the reasons just explained, the Non-Obligor Debtors have not only breached the fiduciary duties they owe their creditors, but have shown their resolve through the Current Proposal to continue violating those duties. The law could not be clearer that in these circumstances, there is "cause" to appoint a disinterested trustee under Section 1104(a)(1), and that such appointment is essential to protect the interests of the Non-Obligor Debtors' creditors, including the Noteholders. *See In re V. Savino Oil & Heating Co.,* 99 B.R. 518, 526 (Bankr. E.D.N.Y. 1989) ("The 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. 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."); *see also Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 355 (1985) (same); *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."); *In re Celeritas Techs., LLC*, 446 B.R. 514, 518 (Bankr. D. Kan. 2011) (same).

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means *all* of the Debtors, including the Non-Obligor Debtors. *Id.* ¶¶ 1-2 & n.1. In addition, the Debtors estimated the value of the VEBA Claim by reference to the value of debt that was owed by *all of the Debtors*, a comparison that would be nonsensical unless the VEBA Claim, too, was an obligation of all of the Debtors. *Id.* ¶ 69. The Debtors' only response is to point to a single, vague sentence that nowhere states that the VEBA Claim would run against just the Obligor Debtors. Debtors Objection ¶ 33. And of course, while protesting that the Noteholders misread the Prior Proposal, the Debtors admit that the *Current Proposal* uses the assets of the Non-Obligor Debtors to satisfy union-related debts, exactly as the Noteholders argue. If the Debtors were correct about the Prior Proposal—which we doubt—the Current Proposal would be *fresh evidence* of their intention to breach their fiduciary duties.

24. The Debtors attempt several responses, but none is persuasive. Their primary response is based on a mischaracterization of our argument. The Debtors contend that we "rely exclusively" on a so-called "interdebtor and intercreditor conflict presented by [our] perception of the possibility of using value from the Non-Obligor Debtors to fund the VEBA." Debtors Objection ¶ 11.[9] The Debtors then invoke two cases, *Adelphia* and *WorldCom*, for the proposition that the "mere existence of such [interdebtor and intercreditor] conflicts does not" warrant the automatic appointment of a trustee. *Ibid.* The Debtors do not elaborate the meaning of "interdebtor and intercreditor conflict," but (as used in *Adelphia*) it refers to disagreements over what obligations different debtors in a corporate family owe one another.

25. The flaw in the Debtors' argument is that, in fact, we do not contend that the mere existence of an "interdebtor and intercreditor conflict" requires the appointment of a trustee. Nor do we seek the appointment of a trustee on the basis of any "interdebtor and intercreditor conflict." For that matter, the Trustee Motion does not even mention an "interdebtor and intercreditor conflict."

26. What we *do* mention (repeatedly), and what *is* the basis for our request for the appointment of a trustee, is that the debtors-in-possession of the Non-Obligor Debtors have breached the fiduciary duties they owe their creditors, including the Noteholders. They did so by seeking to divert value from their estates to pay union-related debt that they do not owe, while receiving nothing in return. In short, we seek appointment of a trustee because of an ongoing breach of fiduciary duty, and not because of any "interdebtor and intercreditor conflict."

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[9] The Official Committee of Unsecured Creditors ("**Committee**") offers a similar argument. *See* Objection Of The Official Committee Of Unsecured Creditors To The Motion For The Appointment Of A Chapter 11 Trustee ("**Committee Objection**") ¶ 29 (Dkt. 3686).

27. The Debtors reliance on *Adelphia* and *WorldCom* is not just inapposite, but ironic. Those cases illustrate the difference between a breach of fiduciary duty and a mere "interdebtor and intercreditor conflict," and if anything show why the appointment of a disinterested trustee is essential here.

28. In *Adelphia*, creditors sought the appointment of a trustee because of a dispute over what obligations different debtors owed one another, *i.e.,* an "interdebtor and intercreditor conflict." The court denied the request because the debtors-in-possession had fulfilled their fiduciary duties; they "maintained neutrality" in the disputes, "focused their efforts on maximizing value for every debtor," and "never acted adversely to the interests of any individual debtor." *In re Adelphia Communications Corp.*, 336 B.R. 610, 618, 656-57 (Bankr. S.D.N.Y. 2006). The court, however, expressly cautioned that the debtors-in-possession likely would have "stepp[ed] over the line" and "violat[ed] their fiduciary duties" if they had "bought off" one creditor group "at the expense of one or more of the other Debtors, and their creditor groups," because the "same fiduciary duties were owed to them." *Id.* at 638-39; *see also, e.g.*, *id.* at 671 n.163 ("the debtor's board and management have duties of loyalty to each of the debtors, and cannot take actions to harm any of them").

29. This case is the opposite of *Adelphia*. Here, there is no "interdebtor and intercreditor dispute" over what liabilities the different Debtors owe. We and the Debtors agree that the Obligor Debtors have union-related debt and the Non-Obligor Debtors do not. And here, also unlike *Adelphia*, the Debtors have hardly remained neutral. Rather, the entire purpose of the Current Proposal is to favor the Obligor Debtors and their union creditors by diverting value to them from the Non-Obligor Debtors, to the detriment of the Non-Obligor Debtors' creditors. Even the Committee, which opposes the Trustee Motion, acknowledges that

"management has held the reorganization of the Non-Obligor Debtors hostage to the labor negotiations of the Obligor Debtors." Committee Objection ¶ 5. And, "[a]s Judge Gerber held in *Adelphia*, in a case with multiple debtors, the debtors, as fiduciaries, have duties to refrain from favoring or appearing to favor one or another of their estates and its creditors over another." *In re Innkeepers*, 442 B.R. at 235.[10] The Non-Obligor Debtors cannot seriously claim they have complied with those "duties" here.

30. The Debtors also rely on *WorldCom*, but that case is also inapposite and, if anything, favors our position. In *WorldCom*, as in *Adelphia*, the court denied the request to appoint a trustee because the court found that the debtors-in-possession "appropriately discharged their fiduciary duty," and the creditors were merely dissatisfied with the business judgment of the debtors-in-possession. *In re WorldCom, Inc.*, No. 02-13533, 2003 Bankr. LEXIS 2192, at *26-*27 (Bankr. S.D.N.Y. May 16, 2003). However, the court recognized that if the debtors-in-possession *had* breached their fiduciary duties, then appointment of a trustee would be warranted. *See id.* at *16-*17 ("The presumption [that the debtor should remain in possession of the estate] is also premised on the fiduciary duty owed to creditors, which presupposes that the debtor in possession will conduct the affairs of the estate in a manner beneficial to creditors.").

31. *Adelphia* and *WorldCom* show, then, that while mere "interdebtor and intercreditor disputes" do not justify the appointment of a trustee, breaches of fiduciary duty certainly do, as the numerous cases cited above confirm. And it is because the debtors-in-

[10] *Adelphia* is distinguishable for the further reason that there, the court was "troubled, to say the least," by the fact that the creditors waited more than three years before seeking appointment of a trustee, and did so only "as part of a scorched earth litigation strategy." 336 B.R. at 618-19. Here, in contrast, the Noteholders filed the Trustee Motion on March 28, 2013, just 14 days after the Debtors filed their Termination Motion and the Noteholders learned that their own purported fiduciaries intended to disregard their rights.

possession of the Non-Obligor Debtors have abandoned their fiduciary duties, and not because of any amorphous "interdebtor and intercreditor disputes," that the appointment of an impartial trustee is urgently needed.

32. The Debtors further argue that this case does not involve "any fraud, dishonesty, misconduct, improper dealings or the like." Debtors Objection ¶ 11. But this argument, like the Debtors' last argument, is also a strawman. We do not claim the Court should order the appointment of a trustee because there has been fraud. We claim the Court should order the appointment of a trustee because the current debtors-in-possession are actively working to injure their own creditors, including the Noteholders (who are collectively the largest creditors of most of the Debtors in these cases).[11]

33. What is more, many of the factors the Debtors acknowledge as relevant to establishing cause under Section 1104(a)(1) are clearly satisfied in this case, based on any common-sense interpretation of their meaning. By actively harming the interests of their own creditors, the Non-Obligor Debtors' conduct: (1) is "materia[l]"; (2) reflects a lack of "evenhandedness . . . in dealings with . . . affiliated entities in relation to other creditors"; (3) betrays "conflicts of interest [that] are interfering with [the Non-Obligor Debtors'] ability to fulfill [their] fiduciary duties"; and (4) amounts to "squandering of estate assets." Debtors Objection ¶ 9.

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[11] The Committee misses the point by arguing that appointment of a trustee is premature since "the mere filing of those motions is not a sufficient justification to appoint a trustee" because "[t]he Noteholders . . . will have the opportunity to object" at a later stage of the proceedings to the Debtors' proposal for funding the VEBA. Committee Objection ¶ 28. In fact, it *is* the filing of the Termination Motion that *demonstrates* the breach of fiduciary duties and shows that the appointment of a trustee is warranted, even if the Noteholders would also have the chance to object at a later stage.

34. The Debtors further argue that ordering the appointment of a trustee to control the Non-Obligor Debtors "would be unprecedented." Debtors Objection at 11 (capitalization omitted). But if the relief is unusual, that is only because the facts are too. There have been no other bankruptcy cases of this size, to our knowledge, where (1) massive liabilities were held by only a fraction of debtors, but (2) the *other* debtors, which did *not* owe those liabilities, diverted value from their estates to pay it, thereby severely prejudicing their own creditors.

35. Not until the final four paragraphs of their objection do the Debtors at last confront the argument we do make: That the debtors-in-possession of the Non-Obligor Debtors have abandoned the fiduciary duties they owe their creditors, by diverting value from their estates for the benefit of the Obligor Debtors and the Obligor Debtors' creditors. Debtors Objection ¶¶ 36-39.

36. Notably, the Debtors do not deny that a breach of fiduciary duty (unlike the mere "interdebtor and intercreditor dispute") is a quintessential ground for the appointment of a trustee. Nor could the Debtors plausibly deny this, in light of the clear case law cited above (including *Adelphia* and *WorldCom*).

37. Instead, the Debtors are left to argue that it is perfectly acceptable for the Non-Obligor Debtors intentionally to divert value from their estates for the immediate benefit of other creditors, because all Debtors will benefit if a joint reorganization plan is confirmed.

38. The defect of this argument, apart from its total lack of legal support, is that its conclusion does not follow from its premise. The mere fact that affiliated debtors stand to benefit if they reorganize does not give them license to *break the law* in order to accomplish (or try to accomplish) that task. But that is exactly what the debtors-in-possession of the Non-Obligor Debtors have done, by showing complete disrespect for basic notions of corporate

separateness. Put simply, the Non-Obligor Debtors cannot divert value from their own creditors, in favor of creditors of legally separate entities, just because the debtors-in-possession of the Non-Obligor Debtors think that doing so is a "good idea." For a debtor-in-possession intentionally to strip value from its own creditors is fundamentally unlawful and a textbook example of a breach of fiduciary duty. None of the three cases the Debtors cite (at ¶ 39) remotely says otherwise—indeed, none even involves the appointment of a trustee—and one of them specifically cautions against conduct that amounts to a "sacrifice of fundamental rights." *In re Gen. Growth Properties, Inc.*, 409 B.R. 43, 63 (Bankr. S.D.N.Y. 2009) (rejecting notion that "the interests of the subsidiaries or their creditors should be sacrificed to the interests of the parents and their creditors"); *see also In re Mirant Corp.*, No. 03-46590, 2005 Bankr. LEXIS 1686, at *3 (Bankr. N.D. Tex. Jan. 26, 2005); *In re U.I.P. Engineered Products Corp.*, 831 F.2d 54, 55 (4th Cir. 1987). Much closer on point is *In re Veblen W. Dairy, LLP*, 434 B.R. 550 (Bankr. D.S.D. 2010), where the court ordered the appointment of a trustee for cause where the debtor-in-possession used the debtor's assets to pay down a debt of a related entity, suggesting an "inten[t] to benefit insiders and the several affiliated entities, rather than Debtor's creditors." *Id.* at 554.

39. It is no answer for the Debtors to say that it is "routine" in Chapter 11 cases for unions to receive equity in the reorganized enterprise. *See* Debtors Objection ¶ 39; see also *id.* ¶ 35. While that concept is nominally uncontroversial, what the Debtors neglect to say is that in these "routine" cases—unlike here—the union receives value that is *commensurate to its claims*.

40. In short, the intentional subversion of the interests of the Non-Obligor Debtors and their creditors by their own fiduciaries provides cause for the Court to order the appointment of a trustee. And, "[i]f cause is found, the appointment of a trustee is mandatory." *In re Keeley*

& Grabanski Land P'ship, 455 B.R. 153, 163 (B.A.P. 8th Cir. 2011) (internal quotation marks omitted).

IV. Appointment Of A Trustee Under Section 1104(a)(2) Is In The Interest Of The Non-Obligor Debtors And Their Creditors

41. As our Trustee Motion explained, the appointment of a disinterested trustee to control the estates of the Non-Obligor Debtors is independently warranted by Section 1104(a)(2), because "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). The 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.

42. Here, the Debtors and the other objecting parties do not dispute that a fiduciary's inability to fulfill its obligations warrants the appointment of a trustee under Section 1104(a)(2). *See, e.g.*, *In re Celeritas Techs.*, 446 B.R. at 520. Nor do they seriously deny that most of the other factors courts consider under Section 1104(a)(2) favor the appointment of a trustee. Specifically, the debtors-in-possession of the Non-Obligor Debtors are not "trustworth[y]" stewards in light of their conduct—especially the Current Proposal, which proves their commitment to sacrificing the interests of their own creditors. *In re Keeley*, 455 B.R. at 164-65. And, the uniform opposition to the Debtors' motion to extend their exclusive period for filing a plan of reorganization makes clear that the "debtor's past and present performance and prospects for . . . reorganization" are severely lacking, as is the "confidence . . . of the business community and creditors in present management." *Ibid.*

43. The Debtors and other objecting parties instead focus on the practical consequences that would result if a trustee were appointed to control the estates of the Non-Obligor Debtors. Their concerns include, among others, whether the Patriot enterprise would

continue to operate as it now does, and whether adequate post-petition financing would be available to provide the Debtors the cash needed to continue operating and to reorganize.

44. The Noteholders take these concerns very seriously, and we address each of them below. But the most basic answer is that the appointment of a trustee would not have the disruptive effect on the Non-Obligor Debtors (or, for that matter, on the Obligor Debtors) that some parties have hypothesized. The trustee would not be a manager, but would simply oversee restructuring efforts with an eye toward maximizing the value of the Non-Obligor Debtors—rather than *reducing* their value, as the current debtors-in-possession seek to do.

A. The Debtors Would Continue To Function If A Trustee Were Appointed

45. The Debtors and the UMWA note that the Obligor Debtors and Non-Obligor Debtors are operationally interdependent, for example because they use a single cash management system, share various administrative services, benefit from blanket purchase agreements for fuel and other items, and for additional reasons. *See* Debtors Objection ¶¶ 29-32; UMWA Objection ¶ 8. The Debtors and the UMWA argue that appointing a trustee to control the Non-Obligor Debtors would disrupt the operations of the Patriot enterprise.

46. These concerns are based on a misimpression of what role the trustee would have. The trustee would *not* function as a "second" or "super" CEO, and would not interfere with the daily management of the Non-Obligor Debtors (or, of course, of the Obligor Debtors). Rather, the trustee's sole function would be to oversee the reorganization of the Non-Obligor Debtors. Toward that end, the trustee would work to maximize the value of those Debtors, while respecting corporate separateness, as the law requires. The trustee would *not* change the direction of the business, tell the miners how to mine coal, *etc.* The appointment of a trustee would thus enhance the value of the Non-Obligor Debtors, and would in no way impair the value

of the Obligor Debtors. In this regard, it is worth emphasizing that the Noteholders are themselves creditors of the Obligor Debtors (as well as of the Non-Obligor Debtors), and have no interest in seeing the value of the Obligor Debtors decline.

47. Part of the Debtors' concern arises from our statement in the Trustee Motion that a responsible debtor-in-possession would have taken the Non-Obligor Debtors out of bankruptcy already. The Debtors seize upon this statement to argue that if a trustee were appointed, the trustee would immediately follow this path, and that once the Non-Obligor Debtors exited bankruptcy, the Patriot enterprise could no longer function at all.[12]

48. The Noteholders continue to believe that the Non-Obligor Debtors could have emerged from bankruptcy, in light of their substantial value. But the key point here is that, if a disinterested trustee were appointed, the trustee would answer these questions, not the Noteholders. The trustee would determine what is in the best interest of the Non-Obligor Debtors, and act accordingly. If, as the Debtors contend, removing the Non-Obligor Debtors from bankruptcy is value destructive, then the trustee would not pursue that path. But no matter what the actual path turns out to be, what is clear is that the creditors of the Non-Obligor Debtors are better off with a trustee who is advancing their interests, than with the current debtors-in-possession, which are injuring them. [13]

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[12] The Committee offers a variation on this argument by asserting that the emergence of any Non-Obligor Debtor from bankruptcy would "accelerate the DIP Facility." Committee Objection ¶ 21-23 (capitalization omitted). If the trustee agreed, and was unable to negotiate a waiver and thought the result unwise, the trustee would not pursue that option. There is no reason to deny appointment of a trustee merely because the Committee fears the consequences of a proposal that a trustee has not considered, much less proposed.

[13] The Committee offers a red herring by suggesting that the Non-Obligor Debtors face potential joint and several liability for a billion-dollar pension claim if one Non-Obligor Debtor emerges from bankruptcy. Committee Objection ¶¶ 30-32. The Non-Obligor Debtors would face that contingent liability only if Patriot withdraws from the pension and

B. <u>The Debtors Would Continue To Have Access To Post-Petition Financing If A Trustee Were Appointed</u>

49. The Debtors, the Committee, and the DIP Lenders note that the appointment of a trustee is an event of default under the DIP Facility. If a trustee were appointed, the DIP Lenders would have the right (but not the obligation) to refuse further lending to the Debtors. And unless the order directing the appointment of the trustee were vacated or reversed within thirty days of entry, the DIP Lenders would be entitled (but not required) to declare all outstanding loan amounts immediately due and payable, and enforce other remedies.

50. Whether the DIP Lenders would exercise any of their rights, however, is completely within their control. And neither the Debtors nor the Committee explains how the DIP Lenders would benefit from exercising their rights more than they would benefit from continuing to extend financing.

51. If a trustee were appointed, then of course an immediate task for the trustee would be to work with the DIP Lenders to obtain a waiver of a default. And there are very strong reasons to think a deal would be reached. The DIP Lenders loaned money against the value of the Debtors, and the sole function of the trustee would be to maximize that value (at least with respect to the Non-Obligor Debtors). Indeed, the entire purpose of appointing a trustee is that

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then declines to annuitize its pension obligation. However, ERISA permits annuitization, 29 U.S.C. § 1399(c)(1)(C)(i), Patriot has said it intends to annuitize (*see* Fourth Section 1113 Proposal at 6), and annuitization is in the best interest of all creditors. Indeed, the *Committee* agrees that this would be the best alternative. *See* Statement Of The Official Committee Of Unsecured Creditors In Connection With The 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. 3609) ¶ 8 & n.7 (arguing that annuitization is permissible and in the best interest of creditors). In any event, this argument is no reason to avoid appointing a Trustee, but is simply a factor that a trustee would consider in controlling the restructuring process for the Non-Obligor Debtors.

doing so would create *more* value for the Non-Obligor Debtors by ousting debtors-in-possession that are actively trying to *divert* value from those Debtors.

52. There are additional reasons why the prospect of a default cannot bear the dispositive weight that the Debtors and Committee would assign it. First, the Debtors have already acknowledged that due to their weak financial condition, they will likely default on the DIP Facility as soon as this July. Thus, the question is not whether there will be a default, but when the default will occur, and how to deal with it. It would seem counterproductive to wait for a DIP default and *then* appoint a trustee for the Non-Obligors. For the reasons above, the Non-Obligor Debtors will be better poised to address the inevitable default if they are supervised by a trustee who seeks to maximize their value.

53. Finally, under the Debtors' logic, a trustee could never be appointed where there is DIP financing, because virtually all DIP agreements treat the appointment of a trustee as an event of default—which is unsurprising given that incumbent management are usually the ones negotiating the terms of those agreements. Thus on the Debtors' logic, the debtors-in-possession of the Non-Obligor Debtors can breach their fiduciary duties with impunity, knowing that they can always wield the threat of a DIP default (as the Debtors are trying to do here). But Congress cannot possibly have intended Section 1104(a) to be so manipulable, especially not where, as here, there are strong reasons to believe that a disinterested trustee could ensure that post-petition financing continues without interruption.

CONCLUSION

For all these reasons, the Court should grant the Trustee Motion.

Dated: April 19, 2013

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing *Noteholders' Reply In Support Of 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* was filed on April 19, 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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