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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

In re **PATRIOT COAL CORPORATION,** ***et al.*****,** **Debtors.**[1]	**Chapter 11** **Case No. 12-51502-659** **(Jointly Administered)** **Hearing Date:** **April 23, 2013 at 11:00 a.m.** **(prevailing Central Time)** **Hearing Location:** **Courtroom 7 North** **Re: ECF Nos. 416, 3445**

DEBTORS' OBJECTION TO MOTION OF CERTAIN INTERESTED SHAREHOLDERS FOR ENTRY OF AN ORDER DIRECTING THE APPOINTMENT OF AN OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS PURSUANT TO BANKRUPTCY CODE § 1102(a)(2)

[1] The Debtors are the entities listed on Schedule 1 attached hereto. The employer tax identification numbers and addresses for each of the Debtors are set forth in the Debtors' chapter 11 petitions.

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Patriot Coal Corporation ("**Patriot**") and its affiliated debtors (collectively, the "**Debtors**")[2] respectfully submit this objection (the "**Objection**") to the motion of certain interested shareholders (the "**Interested Shareholders**"), filed August 27, 2012 (the "**Motion**") (ECF No. 417), seeking an order directing the appointment of an official committee of equity security holders ("**Equity Committee**") in the above-captioned bankruptcy cases pursuant to section 1102(a)(2) under chapter 11 of title 11 of the United States Code (the "**Bankruptcy Code**").

PRELIMINARY STATEMENT

1. The Interested Shareholders' request to appoint an Equity Committee in these proceedings has already been independently rejected by the U.S. Trustee Offices in New York and Missouri (the "**U.S. Trustees**"). Despite being rejected twice and the universal opposition to their request by those parties in interest with a true economic stake in the outcome in these cases, including by the Official Committee of Unsecured Creditors (the "**Creditors' Committee**") and the administrative agents for the debtor-in-possession ("**DIP**") lenders, the Interested Shareholders now ask this Court to take the "extraordinary" step of appointing an Equity Committee. *In re Eastman Kodak Corp.*, No. 12-10202, 2012 WL 2501071, at *2 (Bankr. S.D.N.Y. June 28, 2012). It is firmly established that appointing an equity committee is the "exception rather than the rule in chapter 11 cases." *Id.* As courts nationwide have held, shareholders seeking to appoint equity committees bear the heavy burden of demonstrating that they are entitled to this extraordinary relief by establishing both that "(i) there is a substantial likelihood that they will receive a meaningful distribution in the case under a strict application of the absolute

[2] The terms "Debtors" and "Patriot" will be used interchangeably throughout this submission.

priority rule, and (ii) they are unable to represent their interests in the bankruptcy case without an official committee." *In re Williams Commc'ns Grp., Inc.*, 281 B.R. 216, 223 (Bankr. S.D.N.Y. 2002); *In re Spansion, Inc.*, 421 B.R. 151, 156 (Bankr. D. Del. 2009); *In re Nat'l R.V. Holdings, Inc.*, 390 B.R. 690, 696 (Bankr. C.D. Cal. 2008). As explained below, because the Interested Shareholders cannot satisfy either requirement, this Court should deny the Motion.

2. The Interested Shareholders' request for an Equity Committee rests predominantly upon the unfounded and factually baseless premise that there is "every indication that there is meaningful value for equity in these cases." (Motion ¶ 2.) The Interested Shareholders have not offered any credible or competent evidence or analysis to support their claim that "the Debtors are likely quite solvent with considerable enterprise value." (*Id.* ¶ 7.) They and their retained experts rely instead upon irrelevant metrics, flawed data and methodologies, speculation, and conjecture. This falls far short of meeting the Interested Shareholders' substantial burden.

3. As described below and in more detail in the expert declarations filed herewith—the Declaration of Paul P. Huffard, Senior Managing Director in the Restructuring & Reorganization Group of Blackstone Advisory Services L.P. ("**Blackstone Decl.**") and the Declaration of Seth Schwartz, President of Energy Ventures Analysis, Inc. ("**Schwartz Decl.**")—all of the available evidence shows that the Debtors are insolvent. Thus, the Interested Shareholders have not established and cannot establish the threshold showing that there is a "substantial likelihood" that equity will receive a "meaningful distribution." *In re Williams*, 281 B.R. at 223.

4. The Interested Shareholders have similarly failed to make the required showing that their interests would not be adequately protected without an Equity Committee. Other constituencies in this proceeding already exist to adequately protect shareholders' interests, including Patriot's executive management and Board of Directors, the Creditors' Committee, and the DIP agents have every incentive to maximize the value of the Debtors' estates, to the benefit of both shareholders and creditors alike. Similarly, the U.S. Trustee's Office is also involved, monitoring the interests of all constituencies from a neutral viewpoint. And, finally, the Interested Shareholders themselves are comprised of sophisticated investors represented by a well-known national law firm and financial advisors. There is no reason why they cannot ably represent the interests of shareholders generally, if and when separate representation is needed.

5. Furthermore, even if the Interested Shareholders had raised plausible concerns about the adequacy of representation (and they have not), those concerns would be outweighed by the substantial cost of appointing an Equity Committee, which would potentially entail significant additional professionals' fees, including for attorneys and as many as three sets of financial advisors.

6. Although the current evidence strongly suggests that shareholders are unlikely to receive any recovery, if that were to change in the future due to market movements or other unanticipated events, an Equity Committee could be formed at that time if necessary and upon an appropriate showing by movants to protect the interests of the shareholders. Until such time, there is no need to incur the substantial costs to the estates or to delay the progress of reorganization by adding another layer of expensive

and utterly duplicative efforts, especially where the shareholders here have no economic interest to protect.

BACKGROUND

I. PATRIOT'S BANKRUPTCY FILING AND FINANCIAL CONDITION

7. Patriot is a producer and marketer of coal in the United States with operations and coal reserves in the Appalachia (Northern and Central) and Illinois Basin coal regions. On July 9, 2012 (the "**Petition Date**"), each of the Debtors filed a voluntary petition with the United States Bankruptcy Court for the Southern District of New York for relief under chapter 11 of the Bankruptcy Code. Consequently, Patriot's stock was delisted from the New York Stock Exchange on July 10, 2012. The Debtors are currently operating their businesses and managing their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

8. The deterioration of Patriot's businesses leading up to the filing of its chapter 11 petition was fueled in part by three exogenous factors. (Declaration of Bennett K. Hatfield in Support of the Debtor's Motion to Reject Collective Bargaining Agreements and to Modify Retiree Benefits Pursuant to 11 U.S.C. §§ 1113, 1114 ("**Hatfield Decl.**") at ¶ 40-56.) (ECF No. 3322.) First, the demand for thermal coal has decreased sharply in recent years in light of, among other things, declining natural gas prices and mild winters. (*Id.* ¶¶ 42.) Second, demand for metallurgical coal, primarily used in manufacturing steel, has declined in part as a result of the global economic slowdown. (*Id.* ¶ 43.) Third, increased regulation of electricity generators has made it increasingly expensive for companies to use coal as an energy source. (*Id.* ¶¶ 46-51.)

9. Compounding these business challenges is Patriot's unsustainable cost structure. (*Id.* ¶ 60.) In addition to its substantial union labor costs and retiree health-care and pension obligations (*id.* ¶ 93), Patriot is also saddled with substantial costs resulting from the Coal Industry Retiree Health Benefit Act of 1992, the Federal Coal Mine Health and Safety Act of 1969, and other workers' compensation laws and environmental obligations. (*Id.* ¶¶ 60-61.) As a result of these and other factors, Patriot's costs exceed the cash it generates from coal sales. (*Id.* ¶ 60.) In the face of these challenges, Patriot's management team has taken numerous steps to preserve the company's value, including reducing production, minimizing capital expenditures, reducing the company's workforce, and seeking relief under Sections 1113 and 1114. (*Id.* ¶¶ 82, 90.)

10. Patriot's financial condition has continued to deteriorate since the Petition Date, as amply demonstrated by the Debtors' monthly operating reports. For example, on November 16, 2012, the Debtors filed a Monthly Operating Report for the period ending October 31, 2012 (the "**October 2012 Report**") showing a net loss of $38.06 million. (ECF. No. 1584 at 11.) The October 2012 Report contained an unaudited combined balance sheet showing total assets of $3.84 billion and total liabilities of $3.88 billion, resulting in a book value for shareholders' equity of approximately *negative* $41.77 million. (*Id.* at 12.) On December 21, 2012, the Debtors filed a Monthly Operating Report for the period ending November 30, 2012 (the "**November 2012 Report**"), showing a net loss of $27.58 million. (ECF No. 1806 at 11.) The November 2012 Report contained an unaudited combined balance sheet showing total assets of $3.81 billion and total liabilities of $3.81 billion, resulting in a book value for shareholders'

equity of approximately *negative* $63.71 million. *Id.* at 12. On February 22, 2013, the Debtors filed a Monthly Operating Report for the period ending December 31, 2012 (the "**December 2012 Report**"), showing a net loss of $19.4 million. (ECF No. 2904 at 11.) The December 2012 Report contained an unaudited combined balance sheet showing total assets of $3.84 billion and total liabilities of $4.07 billion, resulting in a book value for shareholders' equity of approximately *negative* $223 million. (*Id.* at 12.) Also on February 22, 2013, the Debtors filed a Monthly Operating Report for the period ending January 31, 2013 (the "**January 2013 Report**"), showing a net loss of $42.19 million. (ECF No. 2905 at 11.) The January 2013 Report contained an unaudited combined balance sheet showing total assets of $3.79 billion and total liabilities of $4.06 billion, resulting in a book value for shareholders' equity of approximately *negative* $268 million. (*Id.* at 12.) On March 21, 2013, the Debtors filed a Monthly Operating Report for the period ending February 28, 2013 (the "**February 2013 Report**"), showing a net loss of $47.14 million. (ECF No. 3351 at 11.) The February 2013 Report contained an unaudited combined balance sheet showing total assets of $3.75 billion and total liabilities of $4.05 billion, resulting in a book value for shareholders' equity of approximately *negative* $308 million. (*Id.* at 12.)

11. In total, Patriot experienced net losses of $730.6 million during calendar year 2012. (Hatfield Decl. ¶ 57.) And as demonstrated by the January 2013 Report and the February 2013 Report, Patriot has continued to experience net losses in 2013.

II. THE INTERESTED SHAREHOLDERS' MOTION

12. On July 18, 2012, the U.S. Trustee for the Southern District of New York appointed the Creditors' Committee. On that same day, the Interested Shareholders

asked the U.S. Trustee to appoint an Equity Committee. The Debtors opposed that request by letter to the U.S. Trustee dated August 15, 2012.

13. On August 24, 2012, the U.S. Trustee for the Southern District of New York denied the Interested Shareholders' request to appoint an Equity Committee. (Declaration of Amelia T.R. Starr in Support of Debtors' Objection to Motion of Certain Interested Shareholders for Entry of an Order Directing the Appointment of an Official Committee of Equity Security Holders Pursuant to Bankruptcy Code § 1102(a)(2) ("**Starr Decl.**"), Ex. B.)

14. The Interested Shareholders filed this Motion on August 27, 2012, seeking the appointment of an Equity Committee. On September 14, 2012, the U.S. Trustee for the Southern District of New York filed a brief in opposition to the Interested Shareholders' Motion, noting that the Interested Shareholders had failed to satisfy the stringent standard required to demonstrate that an official equity committee should be appointed. (ECF No. 565.)

15. On September 13, 2012, the Interested Shareholders issued a series of discovery requests to the Debtors. (Starr. Decl., Ex. A.) Although the Debtors maintained that discovery was neither necessary nor appropriate in the context of the Interested Shareholders' Motion, following a series of discussions, the Debtors produced numerous documents in response to the discovery requests.

16. The parties held a discovery conference before Judge Chapman on November 15, 2012 to discuss a dispute regarding certain additional documents requested by the Interested Shareholders. (Starr Decl. ¶ 3.) During that conference, Judge Chapman stated that under the operative legal standard, the Interested Shareholders must

demonstrate both a substantial likelihood of a meaningful recovery for equity holders *and* that existing constituencies cannot adequately represent the interests of the equity holders. (*Id.*) In addition, Judge Chapman noted that the Interested Shareholders' Motion was premature and advised them to put off resolution of the Motion at least until after the deadline for submission of claims against the Debtors so that the Interested Shareholders could properly account for those claims and potential liabilities in their analysis. (*Id.*) Judge Chapman also asked that the Debtors make a witness available for a deposition to assist the Interested Shareholders in understanding the methodology behind some of the coal reserve documentation already provided by the Debtors to the Interested Shareholders. (*Id.*)

17. On December 20, 2012, after these proceedings were transferred from the Southern District of New York, the Interested Shareholders asked the U.S. Trustee for the Eastern District of Missouri to appoint an official equity committee. That U.S. Trustee denied the request on January 15, 2013. (Starr Decl., Ex. C.)

18. On February 19, 2013, the Interested Shareholders conducted an interview with Michael D. Day, Patriot's Executive Vice President – Operations, regarding the Debtors' coal reserves and other background information underlying the documents produced by the Debtors to the Interested Shareholders in response to their discovery requests. (Starr Decl. ¶ 4.)

19. On February 28, 2013, the Interested Shareholders served the Debtors with copies of certain purported expert reports in support of the instant Motion. The reports were not filed with the Court. These reports include: (1) the Declaration of Christopher K. Wu (the "**Wu Declaration**") (Starr Decl., Ex. D); (2) a report prepared by the KLR

group entitled "Patriot Coal: Indication of Estimated Value to Existing Equity Holders and Discussion" (the "**KLR Report**") (attached as Ex. A to the Wu Declaration) (Starr Decl., Ex. E); and (3) a letter dated February 26, 2013, from Lloyd S. Foight of the Ross Companies to Michael Carney (the "**Foight Letter**") (attached as Ex. B to the Wu Declaration) (Starr Decl., Ex. F).

20. At the same time that the Interested Shareholders are pursuing this Motion, the Debtors filed a motion to reject collective bargaining agreements and to modify retiree benefits pursuant to 11 U.S.C. §§ 1113, 1114. The Court has scheduled a hearing on this motion commencing on April 29, 2013. A decision on that motion will be relevant to the instant Motion as it will provide a definitive answer regarding the Debtors' labor costs going forward and potential claims against the estates resulting therefrom.

ARGUMENT

21. Section 1102(a)(2) of the Bankruptcy Code provides that the court "may order the appointment of additional committees of creditors or of equity security holders *if necessary* to assure adequate representation of creditors or of equity security holders." 11 U.S.C. § 1102(a)(2) (emphasis added). Although the Bankruptcy Code does not define the test to determine what is "necessary to assure adequate representation," courts have regularly held that the statute imposes a "high standard that is far more onerous than if the statute merely provided that a committee be useful or appropriate." *Kodak*, 2012 WL 2501071, at *2. Indeed, "[t]he appointment of official equity committees should be the *rare exception.*" *Williams*, 281 B.R. at 223 (emphasis added); *Kodak*, 2012 WL 2501071, at *2 ("[T]here appears to be uniform recognition that such an appointment [of an equity committee] constitutes extraordinary relief and is the exception rather than the

rule in chapter 11 cases."); *In re Allied Holdings, Inc.*, No. 05-12515, 2007 WL 7138349, at *1 (Bankr. N.D. Ga. March 13, 2007).

22. The movant bears the burden of demonstrating that it is entitled to this "extraordinary relief." *In re Dana Corp.*, 344 B.R. 35, 38 (Bankr. S.D.N.Y. 2006); *Spansion*, 421 B.R. at 156. Importantly, courts have held that equity committees "should not be appointed unless equity holders establish that (i) there is a *substantial likelihood* that they will receive *a meaningful distribution* in the case under a strict application of the absolute priority rule, and (ii) they are unable to represent their interests in the bankruptcy case without an official committee." *Williams*, 281 B.R. at 223 (emphasis added); *Spansion*, 421 B.R. at 156.[3] As explained below, the Interested Shareholders have failed to carry their heavy burden on either requirement.

I. THE INTERESTED SHAREHOLDERS HAVE NOT DEMONSTRATED THAT THERE IS A SUBSTANTIAL LIKELIHOOD THAT EQUITY HOLDERS WILL RECEIVE ANY MEANINGFUL RECOVERY

23. The Interested Shareholders have failed to establish *any* likelihood, much less a substantial one, that they will receive any distribution from the estates. Indeed, the available evidence strongly suggests that there is *no* reasonable likelihood of *any* recovery for equity holders. Because the Interested Shareholders have not shown and cannot show that they have any economic interest to protect in these cases, the appointment of an Equity Committee is unjustified.

[3] The Debtors are not aware of any case law in this Circuit discussing the standard to apply when considering whether to appoint an official equity committee. Nonetheless, courts around the country have consistently applied the Second Circuit's standard described in *Williams*. In addition, when confronting a related but not identical question regarding the appointment of a bondholders' committee where there was no case law in this Circuit, this Court has previously looked to Second Circuit case law for guidance. *See In re Interco Inc.*, 141 B.R. 422, 424 (Bankr. E.D. Mo. 1992).

24. At the outset, the Debtors note that the Interested Shareholders have misstated the applicable legal standard. According to the Interested Shareholders, they need only show that there is "*credible evidence* that the Debtors are *not hopelessly* insolvent," or even just that there is a "good faith dispute" regarding solvency. (Motion ¶¶ 21, 25 (emphasis in original) (citing *Exide Techs. v. State of Wis. Inv. Bd. (In re Exide Techs.)*, No. 02-1572-SLR, 2002 WL 32332000, at *4-5 (D. Del. Dec. 23, 2002)).) That is not the correct standard. As set forth above, the Interested Shareholders must establish that there is a *substantial likelihood* that the equity holders will receive a *meaningful* distribution after application of the absolute priority rule, pursuant to which shareholders are the very last constituency to recover. *See* 11 U.S.C. § 1129(b). The remote possibility of a distribution is inadequate to justify the appointment of an equity committee. *Williams*, 281 B.R. at 222; *In re Hills Stores Co.*, 137 B.R. 4, 6-7 (Bankr. S.D.N.Y. 1992). The Interested Shareholders must show "substantial evidence" that equity will be entitled to a meaningful distribution, *see Kodak*, 2012 WL 2501071, at *4—not mere speculation and improbable theories about solvency and untapped value. During the discovery conference held on November 15, 2012, Judge Chapman confirmed that the *Williams* approach is the governing standard. (Starr Decl. ¶ 3.) Indeed, the case relied on by the Interested Shareholders for their proposed standard, *Exide Techs.*, in fact cites the *Williams* standard as reflecting prevailing law. *See Exide Techs.*, 2002 WL 323320000, at *1 (noting that an equity committee should not be appointed unless equity holders meet the *Williams* test).[4]

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[4] The remainder of the cases cited by Plaintiffs in support of their standard predate the *Williams* decision and accordingly do not represent the currently prevailing view.

25. The Interested Shareholders advance a series of arguments in their brief and expert reports in an attempt to demonstrate that there is a substantial likelihood for a meaningful distribution for equity, none of which come remotely close to making that required showing. First, the Interested Shareholders focus on Patriot's book value as an indicator of solvency, which courts have held is the wrong metric in this context. In any event, since the filing of the Interested Shareholders' Motion, Patriot's book value has become negative, underscoring that there is no value for equity holders. Second, the Interested Shareholders ignore current market conditions. In reality, market indicators regarding Patriot's current financial condition, such as the current trading levels of Patriot's debt instruments and its current share price, all reflect the market's consensus view that Patriot is insolvent. Third, the Interested Shareholders have served several expert reports that purport to show that Patriot has sufficient assets to make a material distribution to shareholders. Those reports, however, fail to withstand even the most cursory examination. None of the experts actually opines that there is a substantial likelihood of a meaningful distribution to shareholders. Instead, they merely claim that Patriot, absent all liabilities, in a hypothetical world, would have a positive enterprise value. Even that more modest proposition collapses, however, when the Interested Shareholders' experts admit that their positive enterprise valuations can only be reached by ignoring all creditors' claims against the estates. Each of these three arguments is addressed below.

A. The Interested Shareholders' Focus on Book Value Is Meritless

26. The Interested Shareholders argue that Patriot's "own numbers indicate that there is meaningful equity value available to the Company's shareholders." (Motion

¶ 1.) In support of this argument, they refer to Patriot's balance sheet as of the Petition Date, which reported a book value for stockholders' equity of approximately $495 million. (*Id.*) This argument should be rejected for two reasons.

27. First, that figure is outdated and does not comport with Patriot's current financial situation. The Debtors' Form 10-K for 2012 states that the current book value of Patriot shareholders' equity was *negative $233 million* as of December 31, 2012. (Patriot Coal 2012 Form 10-K, Starr Decl., Ex. G at F-4.) And as demonstrated by the most recent monthly operating report, the February 2013 Report, shareholders' equity value has now declined to *negative $308 million*. Even these book values likely overstate the actual market values because many of the Debtors' assets are listed at their acquisition values for accounting purposes, which are likely higher than the values that could be realized on the market today. Thus, even the shareholders' own proposed measure shows that there is no value remaining for the equity holders.

28. Second, the Interested Shareholders use the wrong measure of solvency. It is well established that book value is an inappropriate measure of solvency of a debtor-in-possession. *See Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 443 (1968) ("going-concern value, not book or appraisal value, must govern" valuation in bankruptcy); *Cellmark Paper, Inc. v. Ames Merch. Corp. (In re Ames Dep't Stores Inc., et al.)*, 470 B.R. 280, 283 (S.D.N.Y. 2012) ("[B]ook values are not ordinarily an accurate reflection of the market value of an asset."). The proper measure of solvency in this context is provided by Section 101(32) of the Bankruptcy Code, which defines insolvency as a "financial condition such that the sum of such entity's debts is greater than all of such entity's property, *at a fair valuation*"

(emphasis added). Where, as here, the debtor is a going concern, fair valuation means "the fair market value of the debtor's assets that could be obtained if sold in a prudent manner within a reasonable period of time to pay the debtor's debts." *In re Nirvana Rest., Inc.*, 337 B.R. 495, 506 (Bankr. S.D.N.Y. 2006); *see also In re Coated Sales, Inc. et al.*, 144 B.R. 664, 668 (Bankr. S.D.N.Y. 1992) ("fair market valuation entails a hypothetical sale, not a hypothetical company"). In fact, the Interested Shareholders' own witness, Mr. Wu, testified that book value is "not necessarily representative of either market equity value or intrinsic value." (Starr Decl., Ex. I (Wu Dep. Tr. at 100:6-8).)

29. Thus, the Court should reject the Interested Shareholders' argument that book value supports a finding that there is a substantial likelihood of recovery for shareholders.

B. The Relevant Market Evidence and Financial Performance <u>Show That Patriot Is Insolvent</u>

1. Patriot's Debt Instruments and Equity Are Trading at Significant Discounts

30. Although exhaustive valuation exercises in response to requests for appointments of equity committees have been held to be inappropriate—*see Williams*, 281 B.R. at 221; *Kodak*, 2012 WL 2501071, at *3—the available evidence shows that the fair market value of Patriot's assets is well below its book value, further confirming that Patriot is insolvent.

31. The current depressed market for Patriot's debt instruments reflects the market consensus that Patriot is insolvent. Patriot's senior notes, for example, as of March 27, 2013, are trading at a price of 47.5%, reflecting a discount from face value of $131 million. (Blackstone Decl. ¶ 19.) Moreover, Patriot's convertible notes trade at a

price of 10.5%, reflecting a discount to face value of $179 million. (*Id.*) The senior notes trade at a higher price because they have joint and several guarantees from substantially all of Patriot's subsidiaries. The convertible notes reflect the market's view of the solvency of Patriot Coal Corp., the issuer of the stock. Importantly, the holders of the convertible notes must be paid in full before the current equity holders can receive any recovery.

32. Courts have recognized that when "publicly held bonds are trading at a steep discount on the market," it is a "useful . . . indicator of insolvency." *Williams*, 281 B.R. at 221. That is because such depressed trading values show that the investing public does not believe that the company's debt holders will ever be fully repaid. And if debt holders will not be fully repaid, equity holders will not receive any recovery whatsoever pursuant to the application of the absolute priority rule. The steep discounts on Patriot's bonds reflect the market's real world judgment that Patriot's equity holders are unlikely to recover anything, much less a "meaningful recovery."

2. Patriot's Financial Condition Further Illustrates That an Equity Recovery Is Unlikely

33. Examining the Debtors' distressed current financial condition underscores how unlikely an equity recovery is in these cases. As discussed above, Patriot's business reached the point of unsustainability due to conditions that will continue to exist for the foreseeable future. As recently explained in the Declaration of Paul P. Huffard in Support of the Debtors' Motion to Reject Collective Bargaining Agreements and to Modify Retiree Benefits Pursuant to 11 U.S.C. §§ 1113, 1114 ("**Huffard Decl.**") (ECF No. 3224), "[d]eclining coal prices and demand in both thermal and metallurgical coal markets, as well as increased operating costs, permitting requirements and environmental

compliance costs, have driven profit margins down throughout the coal mining industry." (Huffard Decl. ¶ 10; *see also* Declaration of Seth Schwartz in Support of the Debtors' Motion to Reject Collective Bargaining Agreements and to Modify Retiree Benefits Pursuant to 11 U.S.C. §§ 1113, 1114 ("**Schwartz 1113/1114 Decl.**") ¶¶ 13-40.) In part because alternative sources of fuel, particularly natural gas, are more attractive and affordable, coal's share of total United States electricity generation declined an average of 4% per year from 2007 to 2011 and an additional 12% in 2012. (Huffard Decl. ¶¶ 12, 15; Schwartz 1113/1114 Decl. ¶¶ 14-21.) In addition, the sluggish global economy has resulted in lower demand for metallurgical coal (used in manufacturing steel), further undermining the overall demand for coal. (Huffard Decl. ¶¶ 21, 24; Schwartz 1113/1114 Decl. ¶¶ 21-22.)

34. Meanwhile, Patriot faces increasing operating costs due to (i) increased staffing required as a result of heightened government regulations, (ii) more stringent permitting requirements that reduce Patriot's flexibility by forcing it to mine currently permitted reserves, even if they are more costly to mine compared to other non-permitted reserves, and (iii) natural depletion of low-cost reserves, resulting in more difficult mining geology and lower yields. (Huffard Decl. ¶ 28; Schwartz 1113/1114 Decl. ¶¶ 23-27.) In addition to these operating costs, the Debtors face substantial commitments that generally cannot be adjusted in bankruptcy, including costs related to health benefits for certain retired union miners and their dependents under the Coal Industry Retiree Health Benefit Act of 1992 and costs relating to selenium discharge compliance. (Huffard Decl. ¶ 29.)

35. These patterns of reduced demand and increased costs have severely damaged the Debtors' financial situation and have eroded the Debtors' free cash flow. For the year ended December 31, 2012, Patriot reported a 21 percent decline in coal sale revenues. (*Id.* ¶ 73.) The Debtors' net loss has more than quintupled over the past year, from $139 million in 2011 to $731 million in 2012. (*Id.*) Finally, as set forth in the February 2013 Report, Patriot lost $47.1 million in the month of February 2013 alone. *See Kodak*, 2012 WL 2501071, at *4 ("Kodak's first four monthly operating reports show net losses of approximately $100 million per month," undermining any claim that there would be any meaningful distribution for equity). Patriot's persistent losses are another telling indicator of insolvency.[5] *In re Roblin Indus., Inc.*, 78 F.3d 30, 35-38 (2d Cir. 1996).

36. In sum, Patriot is facing an acute liquidity crisis. and is supporting itself through DIP financing. (Huffard Decl. ¶ 93.) Under these circumstances, it is very unlikely that Patriot's shareholders will receive any distribution in these cases.

C. The Interested Shareholders' Experts Do Not Opine That There Is a Substantial Likelihood of a Meaningful Recovery for Equity

37. Given the total absence of any evidentiary support for their Motion, the Interested Shareholders have retained three purported "experts" to invent a basis for concluding that there is equity value here. Although the Interested Shareholders did not submit these reports to the Court in connection with the Motion, they have produced them to the Debtors, and the Debtors anticipate that the Interested Shareholders will rely

[5] Net losses by month: February 2013, $47 million (ECF No. 3351); January 2013, $42 million (ECF No. 2905); December 2012, $19 million (ECF No. 2904); November 2012, $28 million (ECF No. 1806); October 2012, $38 million (ECF No. 1584); September 2012, $51 million (ECF No. 1500); August 2012, $30 million (ECF No. 793); July 2012, $136 million (ECF No. 474).

upon the Wu Declaration, the KLR Report, and the Foight Letter in their arguments before the Court.

38. The three reports are tightly connected. Mr. Stufsky, from KLR, provides a report purporting to calculate a positive enterprise value for Patriot under several different hypothetical scenarios. Mr. Foight provides only a letter, with no substantive analysis, purporting to opine that Patriot's labor liabilities are overstated, but with no indication as to what would be a more appropriate valuation. Mr. Wu's report includes no independent analysis at all, but simply relies on the Stufsky valuation and the Foight Letter to reach his views on the possibility of an equity distribution.

39. Despite being presented as supportive of the Interested Shareholders' Motion, not one of these "expert witnesses" has offered an opinion that there is a substantial likelihood of a meaningful distribution to equity holders. Mr. Stufsky testified at his deposition that he had not "actually formulated [his] own personal authoritative opinion" as to the likelihood of a recovery by the equity holders in connection with the Patriot chapter 11 case, and the KLR Report expresses no such opinion. (Starr Decl., Ex. H (Stufsky Dep. Tr. at 57:20-58:6).) Likewise, Mr. Wu was unwilling to opine that the equity holders are likely to receive a meaningful distribution. Mr. Wu also refused to categorize even a hypothetical shareholder recovery as material. ("Q: Do you have an opinion as to whether it will be a material amount? . . . A: I guess I am opining that [the equity holders] are not going to receive one penny. So I am opining that there is a likelihood of value, and I am not opining on how much value that is."). (Starr Decl., Ex. I (Wu Dep. Tr. at 92:17-93:2).) The only opinion Mr. Wu was willing to provide regarding the likelihood of a recovery for equity was the lukewarm assertion that it was

"more likely than not" that there would be value for equity holders. (*Id.* at 89:10-90:18.) "More likely than not" is far short of the "substantial likelihood" of a "meaningful distribution" that the Interested Shareholders are required to show. Likewise, Mr. Foight's letter provides no opinion at all regarding the likelihood of any recovery for equity in these proceedings. Thus, even taking at face value the opinions of the Interested Shareholders' experts, those opinions do not satisfy the burden that the Interested Shareholders are required to carry here. For that reason alone, the reports should be disregarded.

D. The Narrow Opinions That the Interested Shareholders' Experts Do Advance Are Flawed, Unsupported and Do Not Establish That There Is a Substantial Likelihood of Recovery for Equity

1. The Foight Letter Contains No Analysis and No Legitimate Opinions and Should Be Disregarded by the Court

40. The Foight Letter is entirely improper and cannot reasonably be deemed an "expert report."[6] To begin with, Mr. Foight expresses no opinion regarding the likelihood of recovery for equity. Mr. Foight claims only that Patriot's stated liability for its post-retirement pension plans—which he concedes have been prepared in accordance with GAAP—are overstated because "the discount rates used to calculate" them are "too low." (Starr Decl., Ex. F at 1.) Mr. Foight does not suggest what a more appropriate discount rate would be, and the only support cited for his view that Patriot's rate may be too low is that interest rates will likely rise "once the country is out of the current economic downturn." (*Id.*) Nor does Mr. Foight offer any opinion regarding any alternative valuation for the post-retirement pension liability.

[6] The letter provides no information regarding Mr. Foight's qualifications as an "expert," and it is not a sworn declaration, in violation of Rule 26 of the Federal Rules of Civil Procedure.

41. Next, Mr. Foight suggests that Patriot's pension liabilities might be overstated because "legacy costs will likely be restructured" in the bankruptcy process. (*Id.*) Mr. Foight entirely ignores, however, that any such restructuring of legacy costs could create significant claims against Patriot. He then speculates, on the basis of a frequently asked questions document prepared by the United Mine Workers of America ("**UMWA**"), that Peabody and Arch may be required to pay some share of Patriot's post-retirement pension liabilities.[7] (*Id.* at 1-2) Such a contention amounts to utter speculation about the potential outcome of potential litigation, not independent expert analysis, and should be disregarded. *See In re Hills Stores Co.*, 137 B.R. 4, 6-8 (Bankr. S.D.N.Y. 1992) (speculation inadequate to support the appointment of an official committee); *Kodak*, 2012 WL 2501071, at *4 (rejecting speculation about the value of Kodak's patent portfolio as evidence of solvency).

42. Finally, Mr. Foight suggests that pension liabilities may decrease as a result of the impact of the Patient Protection and Affordable Care Act. (Starr Decl., Ex. F at 2.) Not surprisingly, Mr. Foight does not explain why or how Patriot's costs might decrease as a result of this legislation, nor does he make any attempt to quantify its likely effect.

43. In sum, Mr. Foight's letter contains no analysis whatsoever, suggests no range of potential values for Patriot's post-retirement pension liabilities, and is otherwise comprised of pure speculation. The Foight Letter should not be accorded any weight in the Court's analysis.

[7] The Interested Shareholders make the same speculative claim in their Motion.

2. *Mr. Wu Conducted No Independent Analysis of the Likelihood of Recovery for Equity*

44. Remarkably, Mr. Wu—the only individual who submitted a signed declaration on behalf of the Interested Shareholders—performed no analysis of his own. Instead, the Wu Declaration amounts to a mere regurgitation of the flawed conclusions of the KLR Report and the Foight Letter and should therefore be disregarded as an improper "expert" opinion on this basis alone. Mr. Wu concedes in his Declaration that his opinion is based entirely on his "experience in corporate restructuring and the KLR Report and the [Foight] Letter." (Starr Decl., Ex. D ¶ 17.) Mr. Wu's opinion that "the KLR Report and the [Foight] Letter support, at the very least, the likelihood of value for Patriot Coal's current equity holders" (*id.*) is thus based solely on his reading of those reports, not any independent analysis of his own. As such, Mr. Wu's declaration is a mere conduit for the KLR Report and the Foight Letter, which (as described above and below) are plainly inadequate to support the Interested Shareholders' burden.

45. Mr. Wu not only failed to conduct his own analysis, but also failed to confirm that the analyses in the KLR Report and the Foight Letter were reliable. (Starr Decl., Ex. I (Wu Dep. Tr. at 41:3-7 ("Q: Did you do—in any way verify any of the data or assumptions used in Mr. Stufsky's report? . . A: No.").) In fact, there are aspects of the KLR Report that Mr. Wu conceded he did not even understand. (*Id.* at 88:17-89:2 ("Q: And what was the basis for [Mr. Stufsky's] premium calculation, to your understanding? A: I don't know.").) Mr. Wu also conceded that he took no "steps to verify Mr. Foight's qualifications and expertise" (*id.* at 80:17-22), that he has never met Mr. Foight, that he has never discussed Mr. Foight's analysis with Mr. Foight or provided

any comments to him regarding it, and that the sum total of his "analysis" of the Foight Letter is that Mr. Wu "read it." (*Id.* at 35:5-38:22.)

3. *KLR's Definition of Equity Value Fails to Properly Account for the Liabilities of and Claims Against the Debtors*

46. Mr. Stufsky, author of the KLR Report, is the only one of the Interested Shareholders' three experts who actually attempted to conduct an analysis. The KLR Report, however, suffers from several serious, irredeemable flaws, the most prominent of which is that the KLR Report entirely ignores the impact that claims against Patriot's estate and Patriot's other liabilities will have on the likelihood for shareholder recovery. (Blackstone Decl. ¶¶ 13-18.) Neither Mr. Stufsky nor Mr. Wu "include[d] an analysis of the claims pool" or other important potential claims and liabilities when evaluating the likelihood for the Debtors' shareholders to receive a recovery at the conclusion of these chapter 11 cases. (*See* Starr Decl., Ex. E at 12; Starr Decl., Ex. H (Stufsky Dep. Tr. at 60:12-61:17); Starr Decl., Ex. I (Wu Dep. Tr. at 49:8-20; 104:16-105:11).)

47. For purposes of determining potential equity values, KLR subtracted Patriot's debt instruments and only a single type of liability—unsecured trade payables—from the enterprise values calculated by Mr. Stufsky. That approach entirely ignores a wide variety of other types of liabilities and claims, including but not limited to retiree health care costs, rejected executory contract and lease claims, pension and benefit claims, vendor claims, and past mining obligations (including reclamation costs, selenium water treatment costs, healthcare costs attributable to the Coal Industry Retiree Health Benefit Act of 1992, costs relating to the Federal Coal Mine Health and Safety Act of 1969, and worker's compensation costs). (Hatfield Decl. ¶¶ 61,73.) When pressed at his deposition, Mr. Stufsky could not explain why those costs were not

included in his analysis—instead, he said that Mr. Wu had advised him as to which liabilities to include. (Starr Decl., Ex. H (Stufsky Dep. Tr. at 173:25-174:16).) During Mr. Wu's deposition, however, Mr. Wu testified that he provided no such advice to Mr. Stufsky and that any decisions regarding which liabilities to include in the analysis were made solely by KLR. (Starr Decl., Ex. I (Wu Dep. Tr. at 74:14-75:16).)

48. The notion that the Interested Shareholders may disregard a substantial amount of claims against and liabilities of the Debtors when seeking to establish a substantial likelihood of recovery for equity is ludicrous. Mr. Stufsky's erroneous assumption was apparently based in part upon an instruction by counsel for the Interested Shareholders. According to the "Note to Analysis" included with the Stufsky Report (Starr Decl., Ex. E at 12), McKool Smith advised Mr. Stufsky and his colleagues that, at an off-the-record conference on November 15, 2012, Judge Chapman ruled that "estimations of the claims pool, the impact of the assumption/rejection of certain executory contracts, and the contracts that were the subject of Adv. Proc. Nos. 12-01793, 12-01791, 12-01786 would not be part of the Court's analysis related to whether an official equity committee should be appointed in these cases."

49. That information is false. Counsel for the Debtors attended the November 15, 2012 conference and Judge Chapman made no such ruling. (Starr Decl. ¶ 3.) Indeed, given the applicable legal standard, such a ruling would make no sense. The shareholders must show that there is a substantial likelihood they will receive a meaningful recovery at the conclusion of these chapter 11 cases upon a strict application of the absolute priority rule. *Williams*, 281 B.R. at 223. To assess that likelihood without considering the claims that must be paid before any equity recovery is possible would be meaningless. In fact,

Judge Chapman expressly advised the Interested Shareholders to delay the resolution of their Motion until after the claims submission deadline precisely *because* it would enable the Interested Shareholders to take the requisite account of the claims pool.[8] (Starr Decl. ¶ 3.)

50. To reiterate, the Interested Shareholders must show a substantial likelihood of a meaningful recovery for equity *upon strict application of the absolute priority rule*. *Williams*, 281 B.R. at 223. Such a showing necessarily requires the Court to consider whether there will be any value left in the estate *after* the subtraction of restructuring expenses, administrative and other priority claims, and unsecured claims. Contrary to the Interested Shareholders' erroneous approach, substantial claims against the estates cannot be ignored.

51. As of March 23, 2013, the Debtors' claims register contains approximately $4.4 billion in priority claims and nearly $26 billion in unsecured claims. (Starr Decl., Ex. K.) Some number of claims currently on the register may ultimately be disallowed, including claims that are determined to be duplicative, but even if only a small portion of the claims are permitted, that would amount to billions of dollars of liabilities that would need to be paid by the estates before a single penny could be paid to equity holders. The KLR analysis completely disregards this indisputable fact.

52. Moreover, the current claims pool total does not reflect one of the Debtors' most significant potential liabilities, namely potential claims from the Debtors' employees and retirees at issue in the ongoing 11 U.S.C. §§ 1113, 1114 process. In the event the Debtors' motion is successful or resolved consensually, the UMWA may make

[8] To the extent the Court has any questions regarding Judge Chapman's instructions, the Debtors would be happy to participate in a conference between Judge Chapman, the Court, and the parties.

a very substantial claim against the estates and/or may receive a significant ownership stake in the reorganized company, which will decrease even further the likelihood that there will be any recovery for existing equity holders.

53. The Wu Declaration and the KLR Report do not account for substantial claims and liabilities against the estates in reaching their unfounded conclusions that there "may" be some recovery for the equity holders, and they therefore fail to provide *any* support for the Interested Shareholders' motion.

4. *The KLR Report Suffers From Numerous Other Flaws*

54. Setting aside their failure to account for very substantial claims and liabilities against the estate, the Wu Declaration and the KLR Report should be disregarded for the independent reason that the range of possible equity values they present are grossly inflated due to a number of serious methodological flaws and faulty underlying data. (Blackstone Decl. ¶¶ 20-65; Schwartz Decl. ¶¶ 15-37.) By simply correcting some of the most egregious flaws in the KLR Report's methodology and data, the range of possible equity values for Patriot become negative even using KLR's own approach. (Blackstone Decl. ¶ 67)

55. As discussed in further detail in the Blackstone Declaration and the Schwartz Declaration, the flaws in KLR's methodology include:

- <u>KLR's coal reserve analysis includes companies that are not comparable to Patriot and fails to properly deduct costs</u>: The first valuation methodology employed by the KLR Report is an attempt to value Patriot using only one piece of data about the Debtors—the volume of their proven and probable reserves. (Starr Decl., Ex. E at 7.) This valuation methodology is fundamentally flawed because it fails to account for

critical differences between coal companies, including types and quality of coal, costs, and legacy liabilities. By failing to account for these differences, KLR's valuation includes as "comparable" coal companies that have reserve profiles that look nothing like Patriot. (Blackstone Decl. ¶¶ 22-25.) In fact, only two of the companies cited by KLR—Alpha Natural Resources and James River Coal—are in fact comparable to Patriot on a reserve profile basis. (*Id.* ¶ 26.) Focusing on just those two companies results in a much lower range of enterprise values (*Id.* ¶¶ 27-33.) To translate those enterprise values into implied equity values, one must deduct Patriot's various liabilities and claims. (*Id.* ¶ 34.) Once this is done, the resulting implied equity value ranges from negative (*Id.* at ¶ 33.)

- <u>KLR's range of potential coal tons sold is grossly inflated</u>: The second and third valuation methodologies employed by the KLR Report assume that Patriot might sell anywhere from 24 million tons to 33 million tons of coal per year in the next few years. (Starr Decl., Ex. E at 8.) The range[9] is based on the unsupported assumption that the volume of Patriot's coal sales is certain to increase in the next few years from the 24.9 million tons that Patriot sold in 2012. (Starr Decl., Ex. H (Stufsky Dep. Tr. at 122:4-24).) In reality, however, these theoretical ranges do not resemble Patriot's actual performance, nor are they consistent with market demand. (Blackstone Decl. ¶ 45.) For example, Patriot's coal sales decreased in two out of the last three years (Starr Decl., Ex. G at 63),

Using a more realistic range

[9] Mr. Stufsky admitted at his deposition that these ranges did not represent his opinion of how much coal Patriot was likely to sell, but instead was only a range of possibilities "that may become a reality." (Starr Decl., Ex. H (Stufsky Dep. Tr. at 197:11-198:15).) In other words, the hypothetical sales of a hypothetical Patriot.

of potential coal sales corrects this error and substantially lowers KLR's estimates. (Blackstone Decl. ¶ 46.)

- The range of potential coal prices used by KLR is also grossly inflated: As explained in more detail in the Blackstone Declaration and the Schwartz Declaration, the second and third valuation methodologies employed by the KLR Report assume that Patriot will receive anywhere from $77.00 to $96.00 per ton on every single ton of coal that it sells. (Starr Decl., Ex. E at 8.) This prediction is substantially inflated as a result of numerous methodological flaws and unsupported assumptions. (Blackstone Decl. ¶¶ 37-44.)

This price correction has a substantial deflating impact on KLR's estimates.

- KLR's range of Patriot's potential operating costs is grossly understated: KLR's second valuation methodology assumes that Patriot's operating costs will be between $53 and $65 per ton. (Starr Decl., Ex. E at 8.) This range is substantially understated as a result of numerous methodological flaws, faulty assumptions, and data that is simply incorrect. KLR calculates Patriot's costs by using an average of Patriot's costs for the three-year period between September 1, 2009 and September 1, 2012.[10] By using the average over such a long historical period, KLR ignores the fact that Patriot's costs have been steadily rising over that period. (Schwartz Decl. ¶¶ 31-32; Blackstone Decl. ¶ 47-48.) KLR similarly ignores the significant change to Patriot's cost structure

[10] KLR's range of potential coal prices is based in part on erroneous calculations. The graph in Appendix C of the KLR Report shows that Patriot's Q2 2012 costs were $53.12 per ton sold when, in fact, they were $63.97 per ton sold. (Blackstone Decl. ¶ 48; Schwartz Decl. ¶ 30.) When this data point is corrected, it becomes clear that Patriot's costs have generally trended upwards over the last three years, and are highly unlikely to return to Q1 2010 levels. (Blackstone Decl. ¶ 48; Schwartz Decl. ¶ 31.)

that occurred in 2011 due to the ratification of the 2011 National Bituminous Coal Wage Agreement. (Blackstone Decl. ¶ 50.) If KLR had instead calculated Patriot's costs based on an average of Patriot's costs for fiscal 2012, and then adjusted that average for inflation, it would have arrived at a more accurate range of costs closer to $65 to $75 per ton. (*Id.* ¶ 52.) Once the ranges for Patriot's potential coal tons sold, potential prices received, and potential operating costs have been corrected, the resulting implied equity value ranges for KLR's second valuation methodology range from a low of negative $1.657 billion to a high of negative $771 million. (*Id.* ¶ 59.)

- <u>KLR fails to account for the liabilities that would be generated by any potential reorganization</u>: KLR's final valuation methodology assumes that, upon emergence from bankruptcy, Patriot will be able to achieve EBITDA margins comparable to other coal companies, which in turn, KLR suggests, implies that there is equity value in the company *now*. (Starr Decl., Ex. E at 9-11.) But this ignores the claims that would be created by that very reorganization. (Blackstone Decl. ¶ 63.)

* * * *

56. In sum, the Interested Shareholders offer the flawed Wu Declaration, the KLR Report, and the Foight Letter in an attempt to show that equity holders *might* obtain some recovery in these chapter 11 cases. Upon examination, these reports convey an unreliable and misleading view of Patriot's likely equity value. When the serious flaws in these reports are corrected, even using the Interested Shareholders' dubious methodology, there is simply no likelihood of a recovery for equity in these cases—a fact

apparently ultimately recognized by the Interested Shareholders' own experts, none of whom actually offer an opinion that a substantial likelihood in fact exists.

II. THE INTERESTED SHAREHOLDERS HAVE FAILED TO SHOW THAT AN EQUITY COMMITTEE IS NECESSARY TO REPRESENT THE INTERESTS OF SHAREHOLDERS

57. Even if the Interested Shareholders were able to establish a substantial likelihood of recovery for equity, the Motion would still fail because they cannot prove that their interests would not be adequately represented without an official committee. *Williams*, 281 B.R. at 223; *In re Interco Inc.*, 141 B.R. at 424-25. They fail to make the necessary showing, merely rehashing the same arguments that twice failed to persuade two separate U.S. Trustees in these cases.[11] The Interested Shareholders cannot and do not controvert that Patriot's Board of Directors, its executive management, the Creditors' Committee, and the DIP agents are already diligently working toward the same goal that a shareholders' committee would pursue: maximizing the value of the bankruptcy estates. Rather, the Interested Shareholders merely express a preference to have their advisors obtain a paid seat at the table. Because that falls far short of satisfying the "high standard" that an official equity committee be "necessary" for adequate representation, *Kodak*, 2012 WL 2501071, at *2, the Interested Shareholders' request must fail.

A. The Board of Directors and Management Will Adequately Represent Shareholders' Interests

58. It is well established—and Interested Shareholders do not dispute—that a company's board of directors has a fiduciary duty to protect shareholders' interests, even

[11] Although this Court's review of the U.S. Trustee's decision not to appoint an Equity Committee is *de novo*, courts have held that the review should nonetheless give "due consideration . . . to the views of the U.S. Trustee." *In re Oneida Ltd.*, No. 06-10489, 2006 WL 1288576, at *1 (Bankr. S.D.N.Y. May 4, 2006). Here, the Interested Shareholders have not explained why either U.S. Trustee's decision was erroneous in any way.

in bankruptcy. *Kodak*, 2012 WL 2501071, at *2 ("[T]he insolvency of a company does not absolve the board of its fiduciary duty to shareholders.) (citations omitted); *In re Sec. Asset Capital Corp.*, 390 B.R. 636, 644 (Bankr. D. Minn. 2008) (stating that it "is not the law" that an insolvent corporation owes a fiduciary duty exclusively to the insolvent debtor's unsecured creditors; "[t]he duty remain[s] owing to . . . the corporation, with unsecured creditors protected as included beneficiaries of the duty due to the insolvency"). Indeed, "the usual presumption [is] that the Board will pay due (perhaps special) regard to the interests of shareholders" in bankruptcy. *In re Oneida Ltd.*, 2006 WL 1288576, at *2. Accordingly, "the existence of a functioning board of directors supports the inference that equity's interests will be adequately represented" without an official equity committee. *Kodak*, 2012 WL 2501071, at *2. There is no question here that Patriot's Board of Directors remains "functioning," and the Interested Shareholders have presented no contrary facts that would overcome the "usual presumption" that the Board will adequately represent shareholder interests in bankruptcy.

59. The Interested Shareholders make the conclusory assertion that "[n]o other party will have an incentive to ensure that the concerns of equity holders are taken into account during the restructuring process." (Motion ¶ 28.) But they ignore the fact that the Debtors' officers and directors have significant personal stakes as shareholders of Patriot. As the Court in *Kodak* noted, "[t]here is no reason to think that the interests of shareholders will be ignored . . . where [Debtor's] directors and officers" owned significant shares of stock themselves. *Kodak*, 2012 WL 2501071, at *2.

60. The Interested Shareholders alternatively contend that it would be "unfair" to "force[]" shareholders to rely on Patriot's current officers and directors because

Debtors went into bankruptcy during the current management's tenure. (Motion ¶ 27.) This claim is entirely baseless and ignores that Patriot faces simultaneous challenges of lower demand for coal and higher costs imposed by new regulations, not to mention enormous legacy costs for employee and retiree pension and health benefits. (*supra* ¶¶ 8-9, 33-35.) Indeed, management has responded aggressively by reducing production costs, shutting down higher-cost operations, slashing capital spending, and reducing the company's workforce to streamline its operations. (*supra* ¶ 9) The Interested Shareholders' vague assertions that they would somehow bring greater value to shareholders are thus woefully inadequate.

61. In sum, there is no evidence supporting the view that the Debtors' management cannot adequately represent shareholder interests. In the absence of such a showing, the Interested Shareholders are not entitled to the "rare exception" of appointment of an Equity Committee. *See Williams*, 281 B.R. at 223.

B. The Creditors' Committee Will Adequately Represent Shareholder Interests

62. In addition to the Board and management of Patriot, the Creditors' Committee will provide yet another layer of protection to shareholders' interests. Interested Shareholders fail to contend otherwise, merely repeating that the Creditors' Committee "owes its fiduciary duty solely to unsecured creditors" (Motion ¶ 29), which is the same assertion that the U.S. Trustees rejected. The fact remains that the Creditors' Committee is motivated to maximize the value of the estate, to the benefit of creditors and shareholders alike. *See Kodak*, 2012 WL 2501071, at *3 ("[The] unsecured creditors' committee has a duty to maximize the value of the [Debtors'] estates which

would inhere to the benefit of shareholders."). Indeed, precisely the same argument that the Interested Shareholders make here was emphatically rejected in *Kodak*:

> The Shareholders wholly fail to support the position taken in their papers that the creditors' committee will cease to attempt to maximize value once the point is reached at which creditors will be paid in full—as if it were possible to divine that point at this stage in these cases. For present purposes, creditors and shareholder interests are generally aligned.

Id.; *see also Williams*, 281 B.R. at 222-23 ("[T]he Creditors' Committee has sufficiently aligned or parallel interests with the Shareholders to preclude the need for an additional committee."); *In re Leap Wireless Int'l, Inc.*, 295 B.R. 135, 139-40 (Bankr. S.D. Cal. 2003).

C. An Ad Hoc Group of Shareholders Would Adequately Represent Shareholders' Interests

63. The Interested Shareholders themselves, along with other potential members of an ad hoc group of shareholders, would also be well-placed to represent the interests of shareholders in general. The Interested Shareholders are sophisticated investors: Indeed, for example, they include Eric Wagoner, whose firm Source Capital Group specializes in distressed companies. They are, moreover, already represented by a national, well-known trial firm with expertise in bankruptcy litigation. *See Kodak*, 2012 WL 2501071, at *3 ("[G]iven the quality of the legal talent hired by the Shareholders, there is no reason to conclude that the Shareholders cannot be represented ably through an unofficial, or ad hoc, committee."); *accord In re Spansion*, 421 B.R. at 163 ("[T]he Ad Hoc Equity Committee is well organized, well represented by counsel, and adequate to the task of representing its interests without 'official' status.").

64. Indeed, the only reason the Interested Shareholders provide for their claim that an ad hoc group could not adequately represent other shareholders is the same one

that they unsuccessfully made to the U.S. Trustees—that they owe "no fiduciary duty to the entire group." (Motion ¶ 30.) That mischaracterizes the issue. Presence of a fiduciary obligation can be relevant to determining adequacy of representation: for example, the fact that the Board of Directors has a fiduciary obligation to shareholders is surely relevant in showing that it will adequately represent them. But the mere absence of a fiduciary obligation does not render representation inadequate. *See Kodak*, 2012 WL 2501071, at *3 (concluding ad hoc committee could adequately represent all shareholders); *Spansion*, 421 B.R. at 163 (same). As in both *Kodak* and *Spansion*, Interested Shareholders' *interests* are aligned with those of other shareholders in seeking the greatest possible recovery to the estates. Given Interested Shareholders' interests and their legal and financial sophistication, there is no reason why they would not adequately represent shareholders' interests without official committee status. *See Kodak*, 2012 WL 2501071, at *3

D. The Size and Complexity of These Chapter 11 Cases
Do Not Justify an Equity Committee

65. Interested Shareholders next assert that an Equity Committee must be appointed because Patriot has "approximately 840 shareholders" and these cases are "large and complex." (Motion ¶ 33). This argument does not come close to meeting the applicable standard. While the size and complexity of a chapter 11 case can be one factor in deciding whether to appoint an Equity Committee, "not every case with . . . a large number [of shareholders] will require an official equity committee." *Williams*, 281 B.R. at 223. To the contrary, official equity committees have been denied in cases of far greater size and complexity than the instant bankruptcy.

66. For example, both the U.S. Trustee and bankruptcy court denied authorization of an Equity Committee in the Lehman Brothers bankruptcy, perhaps the largest and most "massively complex" bankruptcy of all time, because the facts did not "appear to reflect any value in the equity securities." *See* Transcript at 100, *In re Lehman Bros. Holdings, Inc*., No. 08-13555 (JMP) (Bankr. S.D.N.Y. Oct. 16, 2008). Similarly, the court held in Kodak that "[a]lthough Kodak's chapter 11 cases are large and complex," the costs of appointing an equity committee were not justified by the benefits, in light of the presence of other constituencies ably representing shareholders. *Kodak*, 2012 WL 2501071, at *4. The reasoning in each of those cases applies *a fortiori* here where the bankruptcy is smaller and more manageable. The chart below, which compares the Kodak and Lehman bankruptcies to the much smaller Patriot, underscores the point:

	Number of Companies	Employees (approx.)
Kodak	121	17,000
Lehman	7,000+ in over 40 countries	25,000
Patriot	99	4,200

67. The Interested Shareholders' other reason for arguing that this case is complex—that the Debtors "have engaged sophisticated counsel and restructuring advisors" (Motion ¶ 33)—counsels *against* appointment of an Equity Committee, as it highlights that management and its advisors are more than up to the task of responsibly restructuring the Debtors.

III. ANY POTENTIAL BENEFIT OF AN EQUITY COMMITTEE IS SIGNIFICANTLY OUTWEIGHED BY THE INEVITABLE COSTS

68. Even if there were any plausible concerns about adequate representation in these cases (which there are not), those concerns would need to be balanced against the substantial costs of an Equity Committee. "The appointment of an equity committee raises cost concerns since such appointments are closely followed by applications to retain attorneys and accountants." *Williams*, 281 B.R. at 220 (internal quotation marks and emphasis omitted). Appointment of an Equity Committee also raises potential "intangible costs, such as delay." *Id.* It would be particularly wasteful for the Debtors' estate to bear those additional expenses and complications when the shareholders are extremely unlikely to recover and have no economic interest to protect. *Id.*

69. Indeed, Interested Shareholders' response—that an Equity Committee should be granted access to "other estate professional[s], and existing and investigative materials" (Motion ¶ 36) and that the Court can "operate[] as a check against an official equity committee" through "oversight of [its] professional fees" (*Id.* ¶ 35)—merely highlights that an official equity committee would present yet another costly party that the Court must oversee in this bankruptcy. In fact, appointing an official equity committee in this case would likely entail not only the cost of retaining McKool Smith, but also additional separate financial advisors. As indicated in the retention agreement between McKool Smith and Mr. Wu, McKool Smith has agreed to seek the appointment of Mr. Wu in the event that an official equity committee is appointed. (Starr Decl., Ex. J.) And Mr. Stufsky testified that he expects there will be an opportunity for him to be retained if the Interested Shareholders are successful. (Starr Decl., Ex. H (Stufsky Dep. Tr. at 40:4-10).)

70. In the unlikely event that the Interested Shareholders eventually do make a substantial contribution to the progress of the chapter 11 cases, they can petition the Court for compensation, without obliging the estates "to fund a constituency that appears to be out of the money." *Kodak*, 2012 WL 2501071, at *3-4. Thus, the costs of an Equity Committee outweigh the benefits, especially where, as here, equity holders are sophisticated, represented by counsel, and likely to pursue their objections at hearings in the future. *Id.* at *3-4; *In re Ampex Corp.*, No. 08-11094 (AJG), 2008 WL 2051128, at *3 (Bankr. S.D.N.Y. May 14, 2008).

71. In addition, the Interested Shareholders have not identified any incremental value that they and their costly financial advisors would bring to these proceedings. They have not, for example, identified any issues of alleged mismanagement of this chapter 11 process, nor have they even alleged that any of the existing constituencies are not diligently seeking to maximize the value of the estates. In short, appointing an official equity committee would impose significant additional cost and complexity on these proceedings, but would not provide any additional value to the estates.

72. The Debtors acknowledge that, while all presently available evidence suggests that there will be no recovery for equity holders in these cases, in the event circumstances were to change, an Equity Committee could be formed at that time, if appropriate, to represent shareholder interests. Appointing such a committee now, however, when the possibility of an equity recovery appears very remote, would impose significant costs and time delays while providing no benefit to the Debtors' real stakeholders.

CONCLUSION

For the foregoing reasons, the Debtors respectfully request that the Court deny the Interested Shareholders' Motion for appointment of an Equity Committee.

Dated: New York, New York
March 29, 2013

By: /s/ Amelia T.R. Starr

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SCHEDULE 1
(Debtor Entities)

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