

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

IN RE:)	Jointly Administered at
)	Case No. 3(2-00979
PEN HOLDINGS, INC., et al.,)	Chapter 11
)	
Debtors.)	Judge Keith M. Lundin

**MOTION FOR SUBSTANTIVE CONSOLIDATION
COMBINED WITH NOTICE AND OPPORTUNITY FOR HEARING**

The Official Committee of Unsecured Creditors for Pen Coal Corporation ("Committee") and the Debtors (collectively the "Movants") submit this Motion for Substantive Consolidation (the "Motion") pursuant to 11 U.S.C. § 105 and Federal Rule of Bankruptcy Procedure 1007(b)(1).

I. Notice and Opportunity for Hearing

ANY PARTY OBJECTING TO THE RELIEF SET FORTH HEREIN MUST FILE A WRITTEN OBJECTION AND FILE SUCH OBJECTION BY CLOSE OF BUSINESS ON JULY 7, 2003, AND MUST SERVE SUCH OBJECTION UPON COUNSEL IDENTIFIED AT THE END OF THIS MOTION. IN THE EVENT OF ANY SUCH OBJECTION, IT IS ANTICIPATED THAT A HEARING WILL BE CONDUCTED ON JULY 24, 2003, IN CONJUNCTION WITH THE CONFIRMATION HEARINGS ALREADY SCHEDULED WITH REGARD TO PENDING CHAPTER 11 PLANS IN THIS CASE.

II. Introduction

1. This Court has jurisdiction over the subject matter pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper in this district pursuant to 28 U.S.C. § 1409. The instant proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(ii)(A) and (O). The Court possesses the requisite authority to grant the relief requested herein pursuant to 11 U.S.C. § 105 and Rule 1015 of the Federal Rules of Bankruptcy Procedure.

III. Background

2. The Debtors consist of 6 interrelated entities, all of which are corporations. Pen Holdings, Inc. ("Pen Holdings") acts as the holding corporation which owns 100% of all the stock and beneficial interest in the 5 other related corporations: Pen Coal Corporation ("Pen Coal"); The Elk Horn Coal Corporation ("Elk Horn"); River Marine Terminals, Inc. ("River Marine"); Pen Land Company ("Pen Land"); and Marine Terminals Incorporated ("Marine Terminals") (each a "Debtor", collectively, the "Debtors").

3. In considering various restructuring options during the course of the above-referenced Chapter 11 bankruptcy cases, the Movants have concluded that any plan of reorganization should treat all of the Debtors' creditors without distinction as to the individual entity to which the claims are owed. None of the Debtors' creditors have independently relied upon the separate credit of any particular debtor. Moreover, the affairs and business operations of the Debtors are extensively commingled. Accordingly, the Joint Plan of Reorganization Filed by the Debtors and the Official Committee of Unsecured Creditors is premised upon the substantive consolidation of the Debtors. Likewise, a competing plan filed by the secured lenders in this case is premised upon substantive consolidation.

4. While the Movants do not believe that a separate motion is absolutely essential, this Motion is being filed to provide a separate opportunity for any creditors or parties in interest to receive notice and an opportunity to object to the relief granted. Because the relief sought is intertwined with the two competing plans in this case, the Motion seeks the substantive consolidation as of the effective date of the Plan after notice and hearing.

A. The Debtors' Consolidated Matrix and List of 20 Largest Unsecured Creditors

5. On January 25, 2002 the Debtors filed their Emergency Motion to File Consolidated Matrix and List of 20 Largest Unsecured Creditors. In that motion, the Debtors alleged that due

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to the complex nature of their business, the list of creditors required under Local Rule 1007-2 would be extremely inefficient to generate on a debtor-by-debtor basis, and the result would be impractically voluminous. Accordingly, the Debtors received from this Court an order allowing them to file a consolidated matrix for purposes of notices and commencement of the bankruptcy case. In addition, the Court authorized the Debtors to file a consolidated list of the 20 largest unsecured creditors rather than separate lists of the 20 largest unsecured creditors for each Debtor.

6. The order authorizing the consolidated matrix and list of 20 largest creditors was based on a showing by the Debtors that they have many overlapping creditors, and the process of determining the nature of each particular Debtor's obligations to the creditors on the consolidated matrix was extremely difficult based upon the Debtors' review of its accounts payable and other records. Requiring the Debtors to file separate "Top Twenty" lists would have required the Debtors to expend a significant amount of time and energy to provide the separate data for the Court. That has not changed since the filing of these bankruptcy cases. The Court signed its order granting the motion on February 2, 2002.

B. The Debtor's Motion for Order Directing Joint Administration of Cases

7. On January 24, 2002, the Debtors filed their Motion for Joint Administration of Cases. In that Motion, Debtors alleged that separate notices to creditors, filing of duplicate pleadings and notice with respect to each of the Debtors would waste the resources of the estate. Debtors also alleged that many, if not all, of the motions, applications, hearings, and orders in the cases would affect each of the Debtors. Accordingly, the Debtors received an order from this court allowing joint administration of the Debtors' case.

IV. Relief Requested

8. There is no statutory authority specifically authorizing substantive consolidation. The authority of a bankruptcy court to order substantive consolidation is generally derived from its discretionary equitable powers and Section 105 of the Bankruptcy Code. *FDIC v. Colonial Realty Co.*, 966 F.2d 57 (2nd Cir. 1992); *In re DRW Property Co.*, 82, 54 B.R. 489, 494 (Bankr. N.D. Tex. 1985). Consolidation is also referenced in Rule 1015 of the Federal Rules of Bankruptcy Procedure.

9. In determining whether or not substantive consolidation is appropriate, each case requires its own analysis because substantive consolidation is a judicial doctrine that must be determined on a case-by-case basis. *FDIC*, 966 F.2d at 57; *Central Claims Services, Inc. v. Eagle-Picher Ind., Inc. (In re Eagle-Picher Ind., Inc.)*, 192 B.R. 903, 905 (Bankr. S.D. Ohio 1996) ("[b]ecause the cases so much turn on their individual facts, we find that the lists presented by the several courts in their decisions, of factors which must be present in order to determine the issue of substantive consolidation, are of limited use").

10. As noted by one Bankruptcy Court, factors that the Court considers in deciding whether to order substantive consolidation of a debtor and nondebtor are not, standing alone, dispositive of the issue. *White v. Creditors Service Corporation (In re Creditor Service Corporation)*, 195 B.R. 680 (Bankr. S.D. Ohio 1996). Such factors must be evaluated within the larger context of balancing prejudice resulting from a proposed order of consolidation against prejudice that will occur from a continued recognition of the debtor's separateness. *In re Creditors Serv.*, 195 B.R. at 690; *In re Hemingway Transport, Inc.*, 954 F.2d 1 (1st Cir. 1992).

Although the factors considered by the courts for purposes of determining whether or not substantive consolidation is appropriate are all very similar, the courts have articulated different

standards for determining whether or not substantive consolidation should be granted. Some of these factors are set out below.

A. Substantive Consolidation in the Sixth Circuit

Impact of Consolidation on Creditors.

11. The Sixth Circuit has said that consolidation should only occur if the protection of recovery for a majority of unsecured creditors that it would afford far outweighs any prospective harm to any particular creditor. *In re Baker & Getty Financial Services, Inc.* 974 F.2d 712 (6th

Cir. 1992)(citing *Matter of Evans Temple Church of God in Christ & Community Center, Inc.*,

55 B.R. 979 (Bankr. N.D. Ohio 1986). Substantive consolidation will benefit many of the

Debtors' creditors, and will have little effect, if any, on the others. New Elk Horn will deliver to

the Lender Group a secured promissory note in the principal amount of the Lender Group's

Allowed Secured Claim, secured by all assets of New Elk Horn. As a consequence, the Lender

Group will be unaffected if the relief sought under this Motion is granted. Those creditors of the

Debtors whose claims were incurred in the ordinary course of business did not rely upon the

separate credit of any of the individual Debtors. Accordingly, they will likewise be unaffected.

The claims register reflects that a large number of the claims filed were filed against Pen Coal

Corporation, rather than the other Debtors. Principally, only large creditors filed multiple

claims. The detriment to the estate in having to separately assess claims and assets in the present

case far outweighs any prospective harm to any particular creditor that would result from

substantive consolidation.

Debtors Are Hopelessly Intertwined.

12. Another important factor in evaluating substantive consolidation is whether the

debtors are hopelessly intertwined, and whether creditors considered the debtors to be one in

assessing creditworthiness. *Id.* The Debtors' business, assets, and finances are hopelessly

intertwined. In this case, most creditors relied on the credit of the consolidated Debtors, rather than the separate creditor of any one specific debtor. Moreover, the Debtors have reported consolidated financial information both prepetition and postpetition.

13. In addition to reporting consolidated financial information, the need for substantive consolidation is illustrated by the large number of prepetition intercompany claims that exist in these cases. As reported in the Debtors' schedules of assets and liabilities, many substantial intercompany claims exist. These claims arose in part by virtue of the Secured Lender's arrangement with Pen Holdings. Under the applicable loan documents, Pen Holdings borrowed funds from the Secured Lenders and in turn made loans to its subsidiaries. To secure these loans Pen Holdings took a security interest in the assets of these Debtors and collaterally assigned its security interest to the Secured Lender. Despite these loans, there has been no attempt by the Secured Lenders to apportion any prepetition or postpetition payment among the Debtors.

14. Intercompany claims continued to accrue postpetition. Specifically, Elk Horn generated the majority of postpetition receivables and income of the Debtors. This was income in excess of its operating costs. However, the liquid assets of the Debtors did not increase during the pendency of the Debtors' cases and in fact decreased. Thus, the excess cashflow generated by Elk Horn was subsumed by the revenue losing operations of the Debtors' other operations. Specifically, the Debtors' Fork Creek operations were losing approximately \$500,000 per month before its sale in August, 2002. The Debtors' court filings also showed that from the Petition Date through July 31, 2002, the Debtors had a consolidated net loss from continuing operations in excess of \$17.8 million despite the fact that Elk Horn generated positive cashflow during the same period.

15. Many other factors justify substantive consolidation in the Debtors' cases. Pen Holdings is the 100% shareholder of all of the other Debtors. Pen Holdings and the subsidiary

Debtors share common officers and directors. Pen Holdings has provided financing to the subsidiary Debtors. Certain of the subsidiary Debtors have been inadequately capitalized. Pen Holdings paid the prepetition and postpetition salaries, expenses and losses of its subsidiaries. Little distinction has been made between the corporate entities, as is evidenced by the fact that the large number of trade claims filed against Pen Holdings and the absence of claims filed against other Debtors despite the fact that Pen Holdings is merely a holding company and does not have independent operations. The total of these claims was \$329,348,178.63, which is substantially higher than the amount of filed claims submitted against any of the other Debtors. The Debtors have reported their financial condition on consolidated financial statements. Moreover, the subsidiary Debtors have guaranteed the obligations of Pen Holdings through suretyship agreements.

16. The majority of the Debtors' creditors have not relied on the creditworthiness of the separate Debtor entities. Rather, creditors have dealt with the Debtors as a single entity. Furthermore, the Debtors' financial affairs are extensively entangled such that a complete reconciliation of the Debtors' books and records is not possible. Indeed, the Debtors were not even able to provide separate matrices or lists of their 20 largest unsecured creditors without the need for consolidation of this information. Under these circumstances, substantive consolidation is warranted.

Difficulty of Segregating and Ascertaining Individual Assets and Liabilities.

17. The Movants assert that segregating the liabilities of the various Debtors and taking appropriate account of all intercompany prepetition unsecured and possible secured claims as well as postpetition administrative claims would be unduly burdensome. In some instances, an accurate reconciliation of these claims will be impossible based upon the state of the Debtors' books and records. Moreover, even if such a reconciliation could be created it would be a such a

cost so great that any benefit the creditors might obtain would be outweighed. Under these circumstances substantive consolidation is warranted and in fact necessary in order to justly treat the Debtors' creditors.

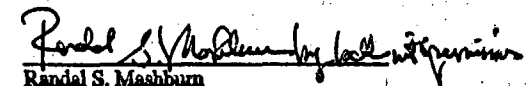
28. As set forth herein, the Movants seek an order of the Court substantively consolidating all of the Debtors' estates for claims and distribution purposes. This is the basis of the Movants' joint plan of reorganization. The Movants contemplate in their Plan that only one legal entity, New Elk Horn, will survive following substantive consolidation. This proposal has come after extensive examination of the Debtors' financial condition, books and records, and the likelihood of a maximum recovery for all unsecured creditors.

Conclusion

As set forth herein, and as will be set forth in testimony by the Debtors' officers and parties with knowledge of the Debtors' operations as well as their books and records, substantive consolidation is appropriate in the above-referenced bankruptcy cases. Creditors will not be prejudiced by an order granting the substantive consolidation of the Debtors. The Debtors' affairs have been commingled, and the Debtors have operated as one economic unit. Accordingly, the Debtors seek an order of the Court substantively consolidating their assets and liabilities and granting all further and other relief as the Court deems just and proper.

Dated this 13th day of June, 2003.

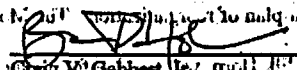
Respectfully submitted,


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