Conceived to Fail?
Bankrupt Patriot Coal Questions Its Origin

Most bankrupt companies don’t question the legitimacy of their own existence, but Patriot Coal has done exactly that. Patriot, a St. Louis-based company with most of its mines in West Virginia, filed for Chapter 11 bankruptcy last year. As part of the case, the company and its creditors’ committee investigated whether its former owner, Peabody Energy, committed a “fraudulent transfer” by spinning it off in 2007.

One creditor, the United Mine Workers of America (UMWA), made that claim in federal court in January 2013. The union alleged that Peabody created Patriot as a dumping ground for subsidiaries with unsustainable liabilities for retiree health care benefits and other burdensome “legacy obligations.”

According to the UMWA, Peabody intentionally undercapitalized Patriot from the start. As a group, the Peabody subsidiaries that moved to Patriot were insolvent at the end of 2006, but as part of the spinoff Peabody agreed to retain the health care liabilities for some of the retired workers. This agreement and some smaller balance sheet transfers were more than enough to make Patriot solvent when its stock debuted on Nov. 1, 2007. (Even so, the spinoff cut Peabody’s health care obligations by about $550 million.)

The companies further agreed that if Patriot’s retiree health care obligations ever decreased, Peabody’s obligations would decline proportionately. But when Patriot asked the bankruptcy court for permission to significantly reduce its obligations, Patriot and the UMWA filed suits seeking to prevent Peabody from reducing its obligations as well. The UMWA and other creditors also asked Patriot to investigate claims that it had been designed to fail.

Peabody and Patriot officials declined to be interviewed, but a statement on Peabody’s website disputes the charge that Patriot was conceived to fail. “Patriot was highly successful following its launch more than five years ago, with significant assets, low debt levels, and a market value that more than quadrupled in less than a year,” Peabody states. Patriot’s stock soared from $18.75 on Nov. 1, 2007, to $80.69 on June 18, 2008, and the company earned net income of $142.7 million in 2008 and $127.2 million in 2009.

Peabody’s online statement says Patriot should have bolstered its financial position during those good years instead of purchasing Magnum Coal, a spinoff of St. Louis-based Arch Coal. Magnum added about $500 million to Patriot’s legacy obligations, but in a conference call with analysts in 2008, Mark Schroeder, Patriot’s chief financial officer, downplayed the risk. The Magnum subsidiaries “do have legacy liabilities, like Patriot has legacy liabilities,” he said. “We’re very familiar with how to work with those, how to control those costs. We are not afraid of legacy liabilities.”

Four years later, amid declining demand, lower prices, and higher costs, the company cited “unsustainable labor-related legacy liabilities” as one of the problems forcing it into Chapter 11. When it entered bankruptcy, Patriot reported legacy liabilities of $1.8 billion, including obligations to provide health care benefits to several thousand UMWA retirees and their dependents.

As part of Patriot’s reorganization, the bankruptcy court gave the company permission in May to significantly reduce its funding of retiree health care benefits by transferring them to a trust that will be administered by UMWA appointees. Patriot agreed to help fund the trust with an ownership stake in the reorganized company, profit sharing, royalty payments, and “a portion of future recoveries from certain litigation.”

Those recoveries materialized in October 2013, when Peabody agreed to contribute $310 million over four years to help fund the trust and settle all Patriot and UMWA claims involving the Patriot bankruptcy. The settlement, however, leaves the question of Patriot’s legitimacy unanswered.

—Karl Rhodes

Retired miners took to the streets of St. Louis to protest proposed cuts in funding for health care benefits.
Back on the Market
IPO Succeeds for Northern Va.-based Hilton

In December, McLean, Va.-based Hilton Worldwide Holdings completed an initial public offering (IPO) of 117.6 million shares priced at $20 apiece. The sale raised $2.35 billion, making it the largest IPO ever for a hotel company, ahead of the $1.09 billion raised by Hyatt Hotels in 2009. At the IPO share price, Hilton has a stock market value of about $19.7 billion.

Private equity firm Blackstone Group, which acquired Hilton in the summer of 2007, did not sell any of its shares and maintains a 76 percent stake in the company. Blackstone’s record-setting purchase of Hilton for $26.3 billion during the heady days of the real estate boom gave the firm control of Hilton’s portfolio of nearly 3,000 franchised and company-owned hotels, including brands such as Hampton Inn and Embassy Suites, as well as the historic Waldorf Astoria hotel in New York City.

But when the real estate market turned south and the economy plunged into recession just a few months later, Blackstone’s acquisition, which had been financed largely by debt, looked much less favorable. Businesses and households alike cut back on travel expenses, and the entire hospitality industry declined.

Since that time, the hotel market has shown signs of recovery, returning to pre-recession levels of growth in occupancy and average revenue per room. Many analysts expect this trend to continue for another three to four years, in part because construction of new hotels largely stalled during the downturn and supply is constrained. According to Hilton’s IPO filing, Blackstone has added more than 1,000 new properties and 170,000 new rooms to Hilton’s portfolio, largely through franchising, since taking the company private six years ago.

Hilton moved its headquarters from Beverly Hills, Calif., to McLean in 2009; it employs roughly 7,400 people in the Washington, D.C., area. Hilton reported net income of $352 million and total revenue of $9.3 billion for 2012, up 39 percent and 6 percent, respectively, from the previous year. —Tim Sablik

Be Careful Crossing the Street in Maryland
State Upholds Rare Negligence Rule

In July, Maryland’s Court of Appeals, the highest court of the state, decided to uphold a rule that bars plaintiffs from winning payouts on negligence lawsuits if they were at fault in any way. That means if you’re hit by a car while jaywalking, you might walk (or limp) away empty-handed.

In Coleman v. Soccer Association of Columbia, a soccer coach in Fulton, Md., was severely injured when a set of goal posts fell on him — but only after he had jumped on and swung from them. The jury concluded that the soccer association was negligent by failing to make sure the posts were secured to the ground, but the coach was found to be negligent, too, by misusing the equipment. As a result, he was denied all damages.

The legal standard, adopted through judicial action by Maryland’s courts in 1847, is called “contributory negligence.” The court argued in its recent opinion that the state’s legislature had rejected dozens of bills over the years seeking to move away from the standard, so it would be inappropriate for the court to override clear legislative intent.

Meanwhile, 46 other states have abandoned contributory negligence: Outside of Maryland, it survives only in the District of Columbia, North Carolina, Virginia, and Alabama. Elsewhere, damages aren’t all or nothing. Instead, damages are reduced by the percentage of the harm a jury determines the plaintiff caused, a newer doctrine known as “comparative negligence.” (In most of those 46 states, the plaintiff’s recovery is eliminated if he or she is more than 50 percent responsible for the injury.)

The nation’s shift away from contributory negligence occurred with stunning speed, at least by tort law standards: Between 1968 and 1985, 38 states adopted comparative negligence. Why the (relatively) sudden change? The widespread adoption of product liability laws after the mid-1960s, which now govern the bulk of negligence lawsuits that manufacturers
face, has reduced business groups’ interest in opposing the shift to comparative negligence, argued economist Christopher Curran of Emory University in a 1992 article. That may have made room for the legal profession to lobby for comparative negligence, since it increases the need for legal services to quibble in courts over precise margins of negligence, according to Curran.

Another possibility is that courts and legislatures began to view contributory negligence as an outdated standard that harshly punishes victims for minor mistakes — or, in the words of the Coleman case’s dissenting judges, a “dinosaur” that the court should have extinguished “with the force of a modern asteroid strike.”

—RENEE HALTOM

Wage War

D.C. Living Wage Bill Prompts Retailer Pushback

In July, the Washington, D.C., city council approved a bill requiring large retailers to pay a “living wage” of $12.50 per hour, 50 percent higher than the city’s minimum wage of $8.25. The Large Retailer Accountability Act applied only to retailers with gross annual revenues of $1 billion and stores occupying 75,000 square feet or more. Mayor Vincent Gray vetoed the bill on Sept. 12 amid complaints from affected companies.

Since 1994, when Baltimore introduced the nation’s first living wage law, more than 140 jurisdictions have enacted such provisions. Living wages typically are higher than the minimum wage and apply only to companies receiving some form of business assistance or contracting with the city or state. (See “Above the Minimum,” Region Focus, Fall 2004.)

The D.C. bill was somewhat unusual in that it was not limited to businesses receiving assistance and it targeted retailers rather than government contractors. The wage requirements would have been waived for large retailers with a unionized workforce.

Wal-Mart, which plans to build at least five stores employing about 300 workers each in D.C., argued that this exemption would unfairly punish it relative to its competitors in the city, such as Giant Food and Safeway, both of which employ union workers. Wal-Mart threatened to cancel its expansion if the law went into effect. In his letter to the city council explaining his veto decision, Gray called the bill a “job killer.”

Economic theory predicts that raising the cost of a good (in this case labor) reduces demand for that good, and empirical evidence on wage floors largely confirms this theory. In a review of the data on living wage provisions, David Neumark, director of the Center for Economics and Public Policy at the University of California, Irvine, along with Matthew Thompson and Leslie Koyle of Charles River Associates, a consulting firm, found that, on average, a 50 percent increase in living wages reduces employment for low-skill workers by between 2.4 and 2.8 percentage points.

“We have a lot of evidence from minimum wages generally, and somewhat less from living wages, that those laws reduce employment for low-skilled workers a little bit,” says Neumark.

Still, it’s possible that the benefits of higher income for those with jobs could offset the job losses. The data suggest that living wages may lower overall poverty, but not much. “There’s very weak evidence statistically that actual urban poverty falls slightly when living wage laws are implemented,” says Neumark.

Following the mayor’s veto decision, Wal-Mart is moving ahead with its construction plans. It recently opened two new hiring centers and anticipates opening two of the retail stores by year-end.

Meanwhile, the debate over how to encourage job and wage growth continues. In August, Washington had an unemployment rate of 8.7 percent, and nearly a fifth of the population lives below the poverty line.

—TIM SABLIEK