

C. Maynard
Dan
e-mail
07/07/03
Incoig
Robert J. Brown

**UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF KENTUCKY
LEXINGTON DIVISION**

IN RE:)	
	)	Case Nos.: 01-50969
LODESTAR ENERGY, INC.	)	01-50972
LODESTAR HOLDINGS, INC.	)	03-70015
INDUSTRIAL FUELS MINERALS COMPANY	)	(Jointly Administered)
)	
Debtors	)	Chapter 11

CERTIFICATE OF SERVICE

Pursuant to Local Rule 9022-1(c), I, Robert J. Brown, counsel for Congress Financial Corporation and The CIT Group/Business Credit, Inc., hereby certify that a true and correct copy of the Order Overruling Motion of Frontier Insurance Company in Rehabilitation Seeking Authority to File an Adversary Proceeding Pursuant to 11 U.S.C. § 506(c) was mailed on this the 24th day of July, 2003 by facsimile, electronic or first-class, postage prepaid U.S. mail to the parties listed on Consolidated Service List No. 36 dated July 11, 2003.

Respectfully submitted,

/s/ Robert J. Brown
Robert J. Brown
Maureen D. Carman
WYATT, TARRANT & COMBS, LLP
250 West Main Street, Suite 1600
Lexington, KY 40507-1746
Phone: (859) 233-2012
FAX: (859) 259-0649

COUNSEL FOR CONGRESS FINANCIAL
CORPORATION AND CIT GROUP/BUSINESS
CREDIT, INC.

**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
LEXINGTON DIVISION**

IN RE:	)	Case Nos.: 01-50969
	)	01-50972
LODESTAR ENERGY, INC.	)	03-70015
LODESTAR HOLDINGS, INC.	)	(Jointly Administered)
INDUSTRIAL FUELS MINERALS CO.)	
)	
)	
Debtors	)	Chapter 11

**ORDER OVERRULING MOTION OF FRONTIER INSURANCE COMPANY
IN REHABILITATION SEEKING AUTHORITY TO FILE AN
ADVERSARY PROCEEDING PURSUANT TO 11 U.S.C. § 506(c)**

This matter came before the Court on the motion (the "Motion") of Frontier Insurance Company in Rehabilitation ("Frontier") seeking authority for Frontier to file an adversary proceeding pursuant to 11 U.S.C. § 506(c) against Congress Financial Corporation ("Congress") and Wexford Capital LLC, Wexford Spectrum Investors LLC, Solitair Corp., and Valentis Investors LLC (collectively, "Wexford") (Docket Number 2466), and on the objections by Congress and by Wexford to the Motion (collectively, the "Objections") (Docket Numbers # 2545 & 2546, respectively); the Court having jurisdiction to consider and determine the Motion and Objections in accordance with 28 U.S.C. § 1334; due notice of the Motion and Objections having been provided, and it appearing that no other or further notice need be provided in accordance with Title 11 of the United States Bankruptcy Code, the applicable Federal Rules of Bankruptcy Procedure and the Local Bankruptcy Rules of the Eastern District of Kentucky; the Court having examined the Motion and Objections and having heard the arguments of counsel in support thereof and in opposition thereto at a hearing held on July 11, 2003 (Docket Number

2640

2579); after due deliberation and sufficient cause appearing therefore, the Court makes the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT:

1. On March 30, 2001, involuntary petitions were filed against Lodestar Energy, Inc. ("LEI") and Lodestar Holdings, Inc. ("LHI") (collectively, the "Original Debtors") under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101-1330 (the "Bankruptcy Code"). On April 27, 2001 (the "Relief Date"), the Court entered orders granting the Original Debtors relief under Chapter 11 of the Bankruptcy Code. On January 10, 2003, Industrial Fuels Minerals Company ("IFMC" and, together with the Original Debtors, the "Debtors") filed its voluntary petition for relief under Chapter 11 of the Bankruptcy Code, and the Court subsequently ordered IFMC's Chapter 11 case to be procedurally consolidated and jointly administered with LEI's and LHI's Chapter 11 cases.

2. The Debtors operated and managed their property and affairs as debtors-in-possession pursuant to Bankruptcy Code §§ 1107 and 1108 until February 3, 2003, when the Court appointed William D. Bishop as the Chapter 11 Trustee ("Trustee") for the Debtors' estates. Thereafter, the Chapter 11 cases were converted to cases under Chapter 7 of the Bankruptcy Code, as of July 15, 2003. William D. Bishop was appointed Interim Trustee on July 15, 2003. (Docket Number 2616).

3. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. Venue of these cases in this District is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

4. Congress made pre-petition loans and advances and agreed to provide other credit accommodations to the Debtors pursuant to the terms and conditions set forth in various agreements, documents and instruments, including, without limitation, the Amended and Restated Loan and Security Agreement, dated May 15, 1998 (as amended, modified, extended, restated or replaced, the "Existing Loan Agreement"), by and among LEI, LHI, Congress, as Agent, The CIT Group/Business Credit, Inc. ("CIT") in its capacity as co-agent for the Lenders, and certain other financial institutions from time to time party thereto (the "Lenders"), as amended, ratified, extended, restated and replaced by the Amended and Restated Ratification and Amendment Agreement, dated as of June 21, 2001 (as amended, modified, extended, restated or replaced, the "Ratification Agreement," and together with the Existing Loan Agreement, collectively the "Loan Agreement"; and together with all other agreements, documents, instruments, notes, pledges, guaranties, mortgages, deeds of trust and Uniform Commercial Code filings executed and/or delivered in connection therewith or related thereto, as all of the same have heretofore been amended, modified, extended, restated or replaced, collectively, the "Financing Agreements").

5. On the Relief Date, the Court entered an Emergency Order Pursuant to § 364(c) of the Bankruptcy Code and Rule 4001 of the Federal Rules of Bankruptcy Procedure Authorizing Debtors to (1) Obtain Post-Petition Financing, (2) Grant Senior Liens, Priority Administrative Expense Status and Adequate Protection, (3) Modify the Automatic Stay, and (4) Prescribe Form and Manner of Notice and Time for Interim Hearing under Federal Rule of Bankruptcy Procedure 4001(c) (Docket No. 36) (the "Emergency Financing Order"), pursuant to which, *inter alia*, LEI was authorized to obtain, on an emergency basis effective during the

“Emergency Financing Period” (as defined in the Emergency Financing Order), post-petition loans, advances and other credit and financial accommodations from Congress and CIT in their capacity as agents and lenders secured by first priority liens and security interests upon and in the “Collateral” (as defined in the Emergency Order). Congress and CIT also were granted a super-priority administrative expense claim against Debtors for all “Post-Petition Obligations” (as defined in the Emergency Order).

6. On May 7, 2001, the Court entered the Interim Order Pursuant to § 364(c) of the Bankruptcy Code and Rule 4001 of the Federal Rules of Bankruptcy Procedure Authorizing Debtors to (1) Obtain Post-Petition Financing, (2) Grant Senior Liens, Priority Administrative Expense Status and Adequate Protection, (3) Modify the Automatic Stay, (4) Enter into Agreements with Congress Financial Corporation, as Agent, and The CIT Group/Business Credit, Inc., as Co-Agent, and (5) Prescribe Form and Manner of Notice and Time for Final Hearing under Federal Rule of Bankruptcy Procedure 4001(c) (Docket No. 73) (the “Interim Financing Order”), pursuant to which, *inter alia*, LEI was authorized to obtain, on an interim basis, post-petition loans, advances and other credit and financial accommodations from Congress and CIT in their capacities as agents and lenders pursuant to the terms and conditions of the Existing Loan Agreement and the other Existing Financing Agreements (as defined in the Interim Financing Order), as ratified and amended by the Ratification Agreement (as defined in the Interim Financing Order), secured by first priority liens and security interests upon and in the “Collateral” (as defined and set forth in the Interim Financing Order). Congress and CIT also were granted a super-priority administrative expense claim against the Debtors for all Obligations (as defined in the Ratification Agreement).

7. On June 21, 2001, almost two months after the entry of the Emergency Financing Order and following extensive negotiations among Congress, the Debtors, and counsel for the Official Committee of Unsecured Creditors over the terms of the post-petition financing arrangements, the Court entered the Final Order Pursuant to § 364(c) of the Bankruptcy Code and Rule 4001 of the Federal Rules of Bankruptcy Procedure Authorizing Debtors to (1) Obtain Post-Petition Financing, (2) Grant Senior Liens, Priority Administrative Expense Status and Adequate Protection, (3) Modify the Automatic Stay, and (4) Enter into Agreements with Congress Financial Corporation, as Agent, and The CIT Group/Business Credit, Inc., as Co-Agent (Docket No. 228) (the "Final Financing Order"), pursuant to which, *inter alia*, LEI was authorized to obtain, on a final basis, post-petition loans, advances and other credit and financial accommodations from Congress and CIT in their capacities as agents and lenders pursuant to the terms and conditions of the Amended and Restated Ratification Agreement, as amended from time to time, and the other Financing Agreements (as such terms are defined in the Final Financing Order), secured by first priority liens and security interests upon and in the "Collateral" (as defined and set forth in the Final Financing Order). Congress and CIT also were granted a super-priority administrative expense claim against Debtors for all Obligations (as defined in the Amended and Restated Ratification Agreement).

8. Since the entry of the Final Financing Order more than two years ago, the post-petition financing arrangements among Congress and the Debtors have been amended, ratified and extended 13 times pursuant to Orders dated May 14, 2002, August 15, 2002, September 13, 2002, October 29, 2002, November 22, 2002, January 31, 2003, February 4, 2003, February 10, 2003, February 14, 2003, March 6, 2003, April 7, 2003, April 21, 2003, and May 9,

2003 (together with the Emergency Financing Order, the Interim Financing Order and the Final Financing Order, sometimes collectively referred to herein as the “Congress Financing Orders”). The last three Congress Financing Orders extending, amending and ratifying the Final Financing Order and the Financing Agreements were entered upon the approval of successive motions brought by the Trustee seeking authority to amend, ratify and adopt the terms of the post-petition financing arrangement with Congress on behalf of the estates.

9. The provisions of the Final Financing Order were ratified seven times by the Trustee.

10. Paragraph 19 of the Final Financing Order provides in relevant part:

“19. As additional security for all of the Obligations of Debtors to Agent and the Lenders now existing or hereafter arising pursuant to this Final Order, the Financing Agreements or otherwise, Agent, for itself and the ratable benefit of the Lenders, is hereby granted an allowed super-priority administrative claim in accordance with Section 364(c)(1) of the Bankruptcy Code having priority in right of payment over any and all other obligations, liabilities and indebtedness of Debtors, now in existence or hereafter incurred by any Debtor and over any and all administrative expenses or priority claims of the kind specified in, or ordered pursuant to, Sections 105, 326, 328, 330, 331, 503(b), 506(c), 507(a), 507(b) and 726(b) of the Bankruptcy Code” (Emphasis supplied.)

11. Similarly, Paragraph 22 of the Final Financing Order provides in relevant part:

“22. Except with respect to the Professional Fee Carve-Out and fees and expenses of the Clerk of the Court and the Office of the United States Trustee, Debtors have agreed that no costs or expenses of administration which have or may be incurred in Debtors’ Chapter 11 cases, any conversion of any Debtor’s Chapter 11 case pursuant to Section 1112 of the Bankruptcy Code, pursuant to Section 506(c) of the Bankruptcy Code, or in any future proceedings or cases related thereto, shall be charged against Agent and/or the Lenders, their claims, or the Collateral, ... and no

obligations incurred or payments or other transfers made by or on behalf of any Debtor on account of the financing arrangements with Agent and the Lenders shall be avoidable or recoverable from Agent or the Lenders under Sections 547, 548, 550, 553 or any other provision of the Bankruptcy Code." (Emphasis supplied.)

12. The post-petition financing provided by Congress was supplemented by post-petition financing provided by Wexford to the Debtors pursuant to loan agreements which were approved pursuant to that certain Final Order Authorizing (1) Debtors, Pursuant to § 364 of the Bankruptcy Code and Rule 4001 of the Federal Rules of Bankruptcy Procedure, to (a) Obtain Supplemental Post-Petition Financing from Wexford Capital LLC, (b) Grant Senior Liens, Priority Administrative Expense Status and Adequate Protection to Wexford Capital LLC and (c) Modify the Automatic Stay, and (2) Amendments to Financing Agreements with Congress Financial Corporation, as Agent, and the CIT Business Group/Business Credit, Inc. as Co-Agent entered on October 18, 2001 (the "Wexford Final Order") (Docket Number 635). The Wexford Final Order was amended, ratified and extended three times pursuant to the Orders dated November 2, 2001, February 13, 2002, and March 5, 2002 (collectively with the Wexford Final Order, the "Wexford Financing Orders"). (The Congress Financing Orders and the Wexford Financing Orders are hereinafter referred to collectively as the "Financing Orders.") The Wexford Financing Orders granted to Wexford a lien on substantially all of the Debtors' assets and super-priority administrative expense status, subject to the prior lien of Congress on the Debtors' assets.

13. The Wexford Final Order provided in paragraph 20 thereof as follows:

The Lender and the Collateral shall be exempt from and not be subject to any surcharges, excises, liens or charges of any nature or type pursuant to 11 U.S.C. § 364, 11 U.S.C. § 506(c) and 11 U.S.C. § 510 in this Chapter 11 proceeding or in any subsequent

Chapter 7 proceeding, including, without limitation, expenses of administration or liquidation except as expressly provided below. Further, Lender does not consent to a surcharge by a subsequently appointed trustee under 11 U.S.C § 506(c). Notwithstanding the foregoing, Lender consents to a surcharge of its collateral (in which Lender has a first priority lien, mortgage or security interest) under 11 U.S.C. § 506(c) for the Senior Encumbrances (other than Permitted Liens). Except as provided in this Order, and only to the amount of the Professional Fee Carveout, Lender shall have no obligation to fund any other professional fees or administrative expenses, whether by surcharge or otherwise. (Emphasis supplied.)

14. Congress received payments on account of the post-petition financing as a result of its super-priority security interests in all of the Debtors' accounts receivable and other collateral, including the sale of five mining sites (i.e., "Tug River," "Transcontinental," "Chaparral," "Colorado Grand Valley Deep Mine" and "West Virginia Eagle Land Lease"). None of these sales resulted in any abandonment or unpaid reclamation expenses. Other than payment of certain interest and expenses, Wexford has not received any payments on account of its post-petition financing provided to the Debtors.

15. The Debtors have other mining sites for which there are presently no buyers. The Debtors have not undertaken final reclamation of these sites and, to the extent the sites are not sold, the Debtors do not have any unencumbered resources available to pay the expense of such final reclamation.

16. Frontier is a New York insurer that is subject to the provisions of the New York Uniform Insurers Liquidation Act, New York Insurance Law § 7401, et, seq. (McKinney 2001). On October 15, 2001, the New York Supreme Court issued an order of rehabilitation with regard

to Frontier. Frontier provided reclamation bonds (“Reclamation Bonds”) for certain mining permits of the Debtors.

17. Frontier has not made any payment under any of the Reclamation Bonds. As Frontier acknowledged in its Motion, Frontier has received \$3,000,000 under a letter of credit issued by Congress that was pledged by the Debtors to secure the Debtors’ reclamation obligations.

18. In connection with a motion to approve the procedures for the sale of the Debtors’ assets, in March 2003 Frontier filed an objection to the sale of the Debtors’ assets to the extent a sale would result in an abandonment of unreclaimed mining sites. (Docket Number 2029). In addition, Frontier requested an order charging Congress and Wexford with the cost of post-petition reclamation pursuant to §506(c). (Docket Number 2030). At the hearing held on March 21, 2003, the Court overruled the objection and denied Frontier’s request for a § 506(c) surcharge. (See Docket Number 2081). In its present motion, Frontier seeks leave to commence an adversary proceeding pursuant to § 506(c) against Congress and Wexford to surcharge the collateral of Congress and Wexford for all reclamation expenses that may be incurred by the Debtors, including reclamation expenses for which Frontier is obligated under the Reclamation Bonds. Frontier also requests that the States of Utah and Kentucky be granted the right to intervene in its proposed adversary proceeding.

CONCLUSIONS OF LAW:

19. Under controlling case law, Frontier has a heavy burden in order to establish its standing under § 506(c) which, by the statute's express terms, provides for standing only by the Trustee. Frontier has not satisfied its burden under the facts of the present case.

20. To the extent that Frontier is claiming an independent right to pursue an adversary proceeding against Congress and Wexford under § 506(c), controlling case law precludes a creditor from asserting such a claim, which can be asserted only by the Trustee.

21. Even if independent standing were not precluded under controlling case law, Frontier would not have an independent right to assert a § 506(c) claim under the theory of equitable subrogation to the Trustee's rights because Frontier has made no payment under the Reclamation Bonds and has presented no evidence showing that the equities are in its favor as against Congress and Wexford.

22. Under controlling case law, neither § 509(a) nor § 1109(b) of the Bankruptcy Code provides a basis for Frontier to assert independent standing under § 506(c).

23. Section 509(a) also is inapplicable because, by its terms, that section applies only to a party who has paid the claim of another creditor of the debtor and Frontier has made no such payment.

24. To the extent that Frontier is claiming derivative, rather than independent, standing to bring an adversary proceeding against Congress and Wexford under § 506(c), the case law generally precludes derivative standing under § 506(c) because the question of who has standing under that section must be analyzed in a different context than derivative standing under

other sections of the Bankruptcy Code, such as §§ 547 and 548 where the claim sought to be asserted will benefit all unsecured creditors of the estate rather than the creditor seeking standing.

25. There would be no benefit to the estate if Frontier were successful, since the claims of Congress and Wexford against the estate would increase to the extent of any surcharge allowed under § 506(c) and the only creditor who would benefit would be Frontier.

26. Even if derivative standing were available to Frontier under § 506(c), such standing could be granted only where: (a) demand has been made upon the trustee to bring the adversary proceeding; (b) the demand is declined; (c) a colorable claim that would benefit the estate exists; and (d) inaction by the trustee constitutes an abuse of discretion in light of the trustee's fiduciary duties in a Chapter 11 case.

27. The record does not support a finding that Frontier has satisfied these requirements, other than that a demand has been made upon the Trustee by Frontier.

28. Although a demand was made upon the Trustee, the explanation given by the Trustee for his inaction, as stated by him on the record at the hearing on the Motion (namely, that he has not yet determined whether or not there is a meritorious basis for seeking relief under § 506(c) under the facts of this case, including the waiver provisions of the Financing Orders), is reasonable, and the record does not support a finding that the Trustee's failure to seek relief under § 506(c) was unjustified in light of his fiduciary duties.

29. Frontier had notice of the Financing Orders and never objected to their terms.

30. In order for the Trustee to obtain relief under §506(c), the Trustee would be required to prove that Congress and Wexford received a direct and quantifiable benefit from any reclamation to be performed at any of the sites. There is nothing in the record at the present time to support a claim that Congress and Wexford received any such direct and quantifiable benefit, and, therefore, the Trustee cannot be held to have breached his fiduciary duties by failing to seek a § 506(c) surcharge.

IT IS HEREBY ORDERED that the motion is overruled. Frontier does not have standing to bring an action seeking surcharge against Congress and Wexford for reclamation expenses.

At the hearing on December 11, 2002, the Court stated, and has stated in open court at subsequent hearings in this case, that from December 11, 2002 forward the administrative costs of this case would be borne by the secured creditors. Nothing in this order should be construed to state that the issue of surcharge is precluded. The issue of surcharge is reserved, and this order is not binding upon the chapter 7 trustee.

Copy to:

Robert J. Brown, Esq. – to serve on the Official Service List

Jonathan N. Helfat, Esq.

Robert V. Sartin, Esq.

W. Robinson Beard, Esq.

William D. Bishop, chapter 7 trustee



Signed By:
Joseph M. Scott, Jr.
Bankruptcy Judge
Dated: Wednesday, July 23, 2003
(jms)

WEST, PAT

From: KYEBml_ECF_DO_NOT_Reply@kyeb.uscourts.gov
Sent: Wednesday, July 23, 2003 4:10 PM
To: tomail@kyeb.uscourts.gov
Subject: 01-50969-jms "Miscellaneous Relief Order"

*****NOTE TO PUBLIC ACCESS USERS*** You may view the filed documents once without charge. To avoid later charges, download a copy of each document during this first viewing.**

United States Bankruptcy Court

Eastern District of Kentucky

Notice of Electronic Filing

The following transaction was received from gsc, entered on 7/23/2003 at 4:09 PM EDT and filed on 7/23/2003

Case Name: Lodestar Energy, Inc.
Case Number: 01-50969-jms
Document Number: 2640

Docket Text:

Order OVERRULING Emergency Motion by Frontier Insurance Company in Rehabilitation for Authority to File Adversary Proceeding Pursuant to 11 USC 506(c) (Related Doc # [2466]). (gsc)

The following document(s) are associated with this transaction:

Document description:Main Document

Original filename:N:\01-50969+15254+gsc+.pdf

Electronic document Stamp:

[STAMP bkecfStamp_ID=993667351 [Date=7/23/2003] [FileNumber=767387-0]
[32d62bd3fe3a4935b74a36ff21d4c2a6f541984944a542cb824e23f0e63334a532e29
a26c2d4529c7ffa139c4fdc6bacd43d8d7bb3605ab9809902b907f7eda9]]

01-50969-jms Notice will be electronically mailed to:

Ryan R. Atkinson rra@ask-law.com,
Daniel A Austin daustin@mcguirewoods.com,
Marilyn L Baker mbaker@mooneygreen.com,
Frank T Becker sara.griffith@dinslaw.com
Nicole Sergent Biddle nbiddlebk@stites.com
Richard Boydston rboydston@ulmer.com,

7/23/2003

Miscellaneous:

01-50969-jms Lodestar Energy, Inc.

**United States Bankruptcy Court
Eastern District of Kentucky**

Notice of Electronic Filing

The following transaction was received from Brown, Robert entered on 7/24/2003 at 11:45 AM EDT and filed on 7/24/2003

Case Name: Lodestar Energy, Inc.

Case Number: 01-50969-jms

Document Number: 2641

Docket Text:

Certificate of Service (RE: related document(s)[2640] Miscellaneous Relief Order). (Brown, Robert)

The following document(s) are associated with this transaction:

Document description:Main Document

Original filename:H:\Lodestar COS 2640.pdf

Electronic document Stamp:

[STAMP bkecfStamp_ID=993667351 [Date=7/24/2003] [FileNumber=768895-0]
[08e4e8eb19f2c50e23646236bf1ee9779159d944c960a14793f7d0161177350abbbb
95c68b5ca0b22cdb5189b629c46bc8a46d8ffb02b1591801955db541532]]

01-50969-jms Notice will be electronically mailed to:

Ryan R. Atkinson rra@ask-law.com,

Daniel A Austin daustin@mcguirewoods.com,

Marilyn L Baker mbaker@mooneygreen.com,

Frank T Becker sara.griffith@dinslaw.com

Nicole Sergent Biddle nbiddlebk@stites.com

Richard Boydston rboydston@ulmer.com,

Robert J Brown lexbankruptcy@wyattfirm.com

Kimberly H Bryant lexbankruptcy@gdm.com

Matthew B Bunch matt@bunchlaw.com,

W Thomas Bunch WTB@BunchLaw.com,