No. 08-40746

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

The Bank of New York Mellon Trust Company, N.A., as Indenture Trustee for the Timber Notes, *et al.*

Appellants,

v.

Official Committee of Unsecured Creditors, Marathon Structured Finance Fund L.P., Mendocino Redwood Company LLC, The Pacific Lumber Company, United States Justice Department, and California State Agencies

Appellees.

Direct Appeal from the United States Bankruptcy Court for the Southern District of Texas, Corpus Christi Division
USBC No. 07-20027

APPELLEE CALIFORNIA STATE AGENCIES' BRIEF

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CERTIFICATE OF INTERESTED PERSONS PER FIFTH CIRCUIT LOCAL RULS 26.1.1, 27.4 AND 28.2.1

(1) 08-40746: *The Bank of New York Mellon Trust Company, N.A., as Indenture Trustee for the Timber Notes, et al. v. Official Committee of Unsecured Creditors, Marathon Structured Finance Fund L.P., Mendocino Redwood Company LLC, The Pacific Lumber Company, United States Justice Department, and California State Agencies*

(2) The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

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Noteholder Appellants[1]	**Counsel**
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Appellants	**Counsel**
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[1] Angelo, Gordon & Co. L.P., Aurelius Capital Management, LP, and Davidson Dempner Capital Management LLC collectively filed in the Bankruptcy Court a notice of appeal [Bankr. Ct. Docket No. 3305] from the Confirmation Order separate from that filed by Appellant-Petitioner Indenture Trustee.

Other Interested Parties	Counsel
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RECOMMENDATION ON ORAL ARGUMENT

This Court has set oral argument for October 6, 2008, at 9:00 a.m.

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The California Resources Agency, the California Department of Forestry and Fire Protection, the California Department of Fish and Game, the California Wildlife Conservation Board, the California Regional Water Quality Control Board, North Coast Region, and the State Water Resources Control Board (collectively, the "California State Agencies") hereby file their Appellee brief.

STATEMENT OF JURISDICTION

On July 8, 2008, the United States Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court") entered an order confirming the First Amended Joint Plan of Reorganization for the Debtors, as Further Modified, with Technical Amendments, Proposed by Mendocino Redwood Company, LLC, Marathon Structured Finance Fund L.P., and Official Committee of Unsecured Creditors (the "MRC/Marathon Plan"). Judgment and Order (I) Confirming First Amended Joint Plan of Reorganization for the Debtors, as Further Modified, with Technical Amendments, Proposed by Mendocino Redwood Company, LLC, Marathon Structured Finance Fund L.P., and Official Committee of Unsecured Creditors, (II) Denying Confirmation of Indenture Trustee Plan, and (III) Denying Motion to Appoint Chapter 11 Trustee, Bankruptcy Court Docket No. 3302 ("Confirmation Order").[1] The Confirmation Order is an appealable judgment

[1] References to record materials designated by a party are referred to as "Appellant-#" or "Appellee-#" as appropriate. References to other material on the docket are referred to as "Bankruptcy Court Docket No.-#."

under 28 U.S.C. § 157(b)(2)(L). See, e.g., *I.R.S. v. Prescription Home Health Care, Inc. (In re Prescription Home Health Care, Inc.)*, 316 F.3d 542, 547 (5th Cir. 2002).

On July 9, 2008, Appellants filed notices of appeal of the confirmation order.[2] Bankruptcy Court Docket Nos. 3304, 3305, 3314, 3315, and 3317. The Bankruptcy Court certified a direct appeal to this Court which this Court accepted and set for expedited consideration. Appellant 369. Thus, jurisdiction exists under 28 U.S.C. § 158(d)(2). *Drive Fin. Servs., L.P. v. Jordan*, 521 F.3d 343, 345 (5th Cir. 2008).

ISSUES PRESENTED

In its opening brief, the Indenture Trustee lists eight issues for this Court on appeal. In the various Appellants' statements of issues filed pursuant to Federal Rule of Bankruptcy Procedure 8006, the Appellants listed between 17 and 26 different issues. California State Agencies' Appendix ("CSA Appendix") Exhibits 1-4 (Bankruptcy Court Docket Nos. 3422, 3424, 3431, and 3434). Any issues not listed in the Indenture Trustee's brief should be considered abandoned. *Martin v. Atlantic Coast Line Railroad Co.*, 289 F.2d 414, 417 n.4 (5th Cir. 1961) ("An

[2] Appellants include the Bank of New York Mellon Trust Company, N.A. as Indenture Trustee (the "Indenture Trustee") for the Holders of Scopac Timber Notes (the "Noteholders"), Scotia Pacific Company LLC ("Scopac"), and several of the Noteholders, including Angelo Gordon & Co. L.P., Aurelius Capital Management, LP, Davidson Kempner Capital Management LLC, CSG Investments, Inc., and Scotia Redwood Foundation, Inc. Because Appellants filed one joint brief, for the convenience of the Court, we refer only to the Indenture Trustee.

original brief abandons all points not mentioned therein, and also these points assigned as error but not argued in the brief." Citing 14 Cyclopedia of Federal Procedure, § 66.06, p. 12 (3rd ed.)), cited by *Nissho-Iwai Co., Ltd. v. Occidental Crude Sales, Inc.*, 729 F.2d 1530, 1540 n.14 (5th Cir. 1984); see also, *The Piney Woods Country Life School v. Shell Oil Company*, 905 F.2d 840, 854 (5th Cir. 1990).

For example, the Indenture Trustee has abandoned the contention that the Bankruptcy Court erred in concluding that the MRC/Marathon Plan satisfied the "good faith" requirement of 11 U.S.C. § 1129(a)(3); that the Bankruptcy Court erred in concluding that the proponents of the MRC/Marathon Plan complied with 11 U.S.C. §1129(a)(2); that the Bankruptcy Court erred by entering the Confirmation Order after the plan proponents made material modifications to the MRC/Marathon Plan; that the Bankruptcy Court erred in determining that the Indenture Trustee's proposed plan of reorganization was not confirmable; and that the Bankruptcy Court erred in determining that the Indenture Trustee's proposed plan of reorganization would not be confirmed under 11 U.S.C. § 1129(c). Given this abandonment, the California State Agencies will not address these issues.

STANDARD OF REVIEW

When directly reviewing an order of the Bankruptcy Court, this Court applies the same standard of review that would have been used by the district

court. *Drive Financial Services, L.P. v. Jordan*, 521 F.3d at 346. Thus, the Bankruptcy Court's findings of fact cannot be overturned unless "clearly erroneous" and "due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." Fed. R. Bankr. P. 8013; *Webb v. Reserve Life Ins. Co. (In re Webb)*, 954 F.2d 1102, 1104 (5th Cir. 1992); *Drive Financial Services, L.P. v. Jordan*, 521 F.3d at 346. A factual finding is clearly erroneous only if:

> although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed…This standard does not entitle a reviewing court to reverse the finding of the trier of fact simply because it is convinced that it would have decided the case differently…If the district court's account of the evidence is plausible in light of the record viewed in its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as a trier of fact, it would have weighed the evidence differently. Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous.

Webb v. Reserve Life Ins. Co. (In re Webb), 954 F.2d at 1104 (quoting *Anderson v. City of Bessemer*, 470 U.S. 564 (1985)). The Bankruptcy Court's conclusions of law are reviewed *de novo*. *Drive Financial Services, L.P. v. Jordan*, 521 F.3d at 346.

The Indenture Trustee argues that the issues presented to this Court are legal issues subject to *de novo* review. The California State Agencies submit that the Indenture Trustee has taken great pains to craft legal issues out of what are

ultimately factual determinations by the Bankruptcy Court entitled to great deference. As the Bankruptcy Court found in connection with the Indenture Trustee's stay motion:

> The primary arguments made by the Indenture Trustee are based on this Court's factual findings which are fully supported by the record and not subject to being reversed unless clearly erroneous. The factual issues were the subject of a contested hearing involving testimony from numerous fact and expert witnesses making reversal on appeal unlikely.

Findings of Fact, Conclusions of Law and Order Denying the Emergency Motion of the Indenture Trustee for Stay Pending Appeal and Petition for Direct Appeal to the Fifth Circuit Court of Appeals, ¶ 11 (Bankruptcy Docket No. 3381) ("Stay Findings").

A closer examination of the issues listed by the Indenture Trustee reveals the flaws in the Indenture Trustee's contention that the issues are legal. Whether the MRC/Marathon Plan violated the absolute priority rule by using proceeds of collateral to pay junior creditors is solely a question of the structure of the MRC/Marathon Plan and the value determinations by the Bankruptcy Court. Whether the MRC/Marathon Plan's treatment of the Indenture Trustee's claim is the "indubitable equivalent" again is solely a question of the Bankruptcy Court's valuation determinations. Whether the MRC/Marathon Plan is a substantive consolidation, failed to pay administrative claims, properly classified claims, or discriminated unfairly are all factual questions that the Bankruptcy Court

determined. The Bankruptcy Court's factual determinations are entitled to great deference.

STATEMENT OF THE CASE

This is a direct appeal of the Confirmation Order entered by the Bankruptcy Court on July 8, 2008 that confirmed the MRC/Marathon Plan for Debtors Pacific Lumber Company ("Palco") and Scopac (together with Palco, the "Debtors") proposed by Mendocino Redwood Company, LLC ("MRC"), Marathon Structured Finance Fund L.P. ("Marathon") and the Official Committee of Unsecured Creditors (the "Committee").[3] The Confirmation Order also denied confirmation of the plan (the "Indenture Trustee Plan") proposed by the Indenture Trustee for the Noteholders and denied the motion of the Indenture Trustee for appointment of a Chapter 11 Trustee. Those aspects of the Confirmation Order have not been challenged on appeal.

Scopac owned and operated approximately 211,700 acres of timberlands (the "Timberlands") in Humboldt County, California, and Palco, Scopac's parent, owned and operated a sawmill, a cogeneration plant, and the Town of Scotia, one of the last remaining company towns in the United States.

On January 18, 2007 (the "Petition Date"), the Debtors filed voluntary petitions for reorganization relief under Chapter 11 of the United States Code, 11

[3] Palco includes its Debtor subsidiaries Britt Lumber Co., Inc., Scotia Development LLC, Salmon Creek LLC and Scotia Inn Inc.

U.S.C. § 101 *et seq.* (the "Bankruptcy Code"). The bankruptcy cases were procedurally consolidated and jointly administered pursuant to Federal Rule of Bankruptcy Procedure 1015. Appellant 7 (Bankruptcy Court Docket No. 21).

After almost a year of intensely litigated bankruptcy proceedings and after the Debtors filed their first plan, the Bankruptcy Court terminated the Debtors' exclusive period to file and solicit acceptance of a plan of reorganization. Specifically, exclusivity was terminated with respect to Marathon, the Committee and the Indenture Trustee. Appellant 164 (Bankruptcy Court Docket No. 2004). Five proposed plans of reorganization were filed: the MRC/Marathon Plan, the Indenture Trustee Plan and three alternative plans filed by the Debtors. The Debtors' plans were subsequently withdrawn, leaving only the MRC/Marathon Plan and the Indenture Trustee Plan to be considered for confirmation. Appellant 250 (Bankruptcy Court Docket No. 2846).

The confirmation trial for these plans began on April 8, 2008 (the "Confirmation Hearing"). Over 25 fact and expert witnesses testified live or through deposition and hundreds of exhibits were admitted into evidence over a period of almost three weeks of trial. On June 6, 2008, the Bankruptcy Court issued a 119-page decision containing its detailed and thorough Confirmation Findings. Appellant 285 Findings of Fact and Conclusions of Law Regarding (A) Confirmation of MRC/Marathon Plan; (B) Denial of Confirmation of the Indenture

Trustee Plan; and (C) Denial of the Motion to Appoint a Chapter 11 Trustee (Bankruptcy Court Docket No. 3088) ("Confirmation Findings"). The Bankruptcy Court concluded that, subject to a few "technical" modifications, the MRC/Marathon Plan complied with the Bankruptcy Code and was confirmable, provided that the Indenture Trustee was paid at least $510 million in cash on the Effective Date. Further, the Bankruptcy Court found that the Indenture Trustee Plan was not confirmable for a multitude of reasons, including that it was not proposed in good faith and was not feasible.

On July 8, 2008, the Bankruptcy Court entered the Confirmation Order. The next day, the Indenture Trustee filed a Notice of Appeal. At the request of the Indenture Trustee, the Bankruptcy Court certified the Confirmation Order for direct appeal to this Court pursuant to 28 U.S.C. § 158(d)(2)(A) and Interim Bankruptcy Rule 8001(f). Appellant 369. On July 24, 2008, this Court accepted the direct appeal. The Indenture Trustee also filed emergency motions for a stay pending appeal in the Bankruptcy Court, the District Court and this Court. Appellant 339, 340, 347, 350, and 352 (Bankruptcy Court Docket Nos. 3309, 3310, 3319, 3323, and 3325). Each Court denied the motion for a stay. Appellant 370 (Bankruptcy Court Docket No. 3383), District Court Docket No. 53, and Order Denying Stay dated July 24, 2008.

The MRC/Marathon Plan became effective on July 30, 2008 (the "Effective

Date"). Bankruptcy Court Docket No. 3473. The MRC/Marathon Plan has been substantially consummated: MRC raised new money to fund the MRC/Marathon Plan, including $325 million from lenders who now have a first lien on the Timberlands;[4] the regulatory approvals for the transfers of property contemplated by the MRC/Marathon Plan have been obtained and the transfers have occurred; certain regulatory approvals for operation of the Timberlands have been obtained; $513.6 million was paid to the Indenture Trustee and approximately $37 million was paid to Bank of America; payments to other creditors have been made; and reorganization of Debtors' businesses, including significant changes to its operations, employees, and management, has been implemented.[5]

On August 21, 2008, MRC and Marathon moved this Court to dismiss this appeal as equitably moot. On August 22, 2008, the California State Agencies filed a statement in support of the motion to dismiss. Thereafter, the Federal Wildlife Agencies also filed a statement in support of the motion to dismiss. The California State Agencies are very concerned about the possibility of unwinding the implementation of the MRC/Marathon Plan. For the same reasons that irreparable

[4] The Agreement Relating to the Enforcement of AB 1986 (the "Enforcement Agreement") also is recorded as valid covenants, conditions, and restrictions which run with the land ("CCRs") and remain binding on HRC and Townco, and the CCRs are senior in priority to the Liens granted by the reorganized entity Humboldt Redwood Company ("HRC") to the lenders providing the $325 million of financing to HRC. MRC/Marathon Plan § 2.5 at Appellant 331 (Bankruptcy Court Docket No. 3300).

[5] As will be explained below, certain federal and state regulatory agencies must approve any transfer of the HCP covered lands, which consists primarily of the Timberlands.

injury was very likely to occur if a stay was imposed, unwinding the MRC/Marathon Plan would have harmful effects on the people of the state of California and irreparable consequences to the environment.

From the California State Agencies' perspective, it was critical that the MRC/Marathon Plan be implemented as quickly as possible given the precarious financial condition of both Palco and Scopac. As a result, the California State Agencies have worked with the reorganized entities Humboldt Redwood Company ("HRC") and Town of Scotia LLC ("Townco") since the Effective Date of the plan to transition operations to HRC. Significant work has occurred, and will continue to occur, to comply with the Environmental Obligations associated with the Timberlands, including but not limited to implementing the Habitat Conservation Plan ("HCP") discussed below, and resolving long-standing issues that were left unresolved by the prior owners.

In addition, the Regional Water Quality Control Board, North Coast Region ("RWQCB") is processing amendments to the watershed-wide waste discharge requirements, waste discharge requirements, monitoring and reporting programs, clean up and abatement orders, land disposal permits, National Pollution Discharge Elimination System permits ("NPDES permits"), to reflect the change in ownership. If the MRC/Marathon Plan were unwound, such efforts will have been wasted and the environment and the public interest would likely suffer.

The Dean Declaration in support of the motion to dismiss states that both Palco and Scopac are dissolved, and that neither have any operations, employees, management, board of directors, or assets. Dean Declaration ¶ 12. Regulatory approval of any transfer of the HCP covered lands back to Scopac could not occur if Scopac no longer exists and has no assets, employees or management. Even if Scopac could somehow be reborn, a transfer back to Scopac would be extremely problematic.

The California State Agencies are very concerned about a reconstituted Scopac's ability to fund its operations, to comply with the terms of the HCP including required endangered species monitoring and mitigation, to operate the Timberlands in compliance with all timber harvest plans, waste discharge requirements, clean up and abatement orders, NPDES permits, and to be able to comply with non-bankruptcy law as is required by 28 U.S.C. § 959(b). Scopac had no ability to perform the substantial backlog of roadwork ($14 million) when the motion for a stay was filed, and it would have no ability to do so after the appeal is decided.

Similarly, if the Indenture Trustee is seeking reinstatement of the unpaid amount of its debt, the detrimental effect on the reorganized entities, HRC and Townco, would be substantial. Essentially, such a remedy would put the reorganized entity in the same position as Scopac was at the time of the

bankruptcy, i.e., a company limping along with substantially too much debt, forced to harvest at unsustainable rates and unable to comply with all of its environmental obligations.[6]

STATEMENT OF THE FACTS

A. Procedural Background.

After the Bankruptcy Court terminated the exclusive period for the Debtors to file a plan, a total of five plans were proposed by three groups of plan proponents. The three groups of plan proponents were: (a) Marathon and MRC; (b) the Indenture Trustee; and (c) the Debtors with their ultimate parent companies MAXXAM Inc., MAXXAM Group Holdings Inc., and MAXXAM Group Inc.

Prior to the deadline for filing the plans, California Governor Arnold Schwarzenegger filed a statement of position outlining why the outcome of this case is of great importance to the people of the state of California:

> "My administration, through the California Resources Agency, the California Environmental Protection Agency and their boards and departments, has been active in the Pacific Lumber Company bankruptcy case to protect the investment that California made in the historic 1999 Headwaters Forest Agreement and to protect the environment and all of our state's natural resources. As California's Governor, I have an interest in the future of the debtors' lands and related assets located in Humboldt County, California. These lands and assets represent a unique public trust for the people of California. Pacific Lumber Company made assurances in 1999 for the future management of its lands that, as part of the Headwaters Agreement,

[6] A District Court from the Southern District of New York recently ruled that an appeal of a plan confirmation order was equitably moot. See *In re Source Enterprises, Inc.*, 2008 U.S. Dist. LEXIS 61558 (S.D.N.Y. Aug. 12, 2008). In the *Source* case, many of the same issues were presented on appeal as this appeal, including substantive consolidation, classification, and unfair discrimination. *Id.* at *10.

> included the expenditure of nearly $500 million of federal and state public funds. The United States and the people of California have a strong interest in a successful reorganization of a Pacific Lumber Company that will result in sound management practices for the future of these lands."

See State of California's Position by Governor Arnold Schwarzenegger for Proposed Plans of Reorganization, Appellee 41 (Bankruptcy Court Docket No. 2201).

The Governor's statement outlined five principles for any reorganization of Pacific Lumber Company to ensure that the reorganization plan preserves the state and federal governments' interest in Pacific Lumber's timberlands:

> 1. Manage the timberlands in accordance with state and federal laws, including but not limited to the existing regulatory permits and authorizations such as the Headwaters Forest Agreement and the Habitat Conservation Plan and all other state permits, AB 1986, the Agreement Relating to Enforcement of AB 1986 and the conditions, covenants and restrictions recorded in accordance with AB 1986.
>
> 2. Manage the timberlands in a manner that complies with all required regulatory permits and other authorizations in coordination with state and federal regulatory agencies.
>
> 3. Preserve the timberlands by maintaining a level of commercial harvest that will ensure sustainable, high-quality timber production over the long term while preserving and enhancing watershed and wildlife protection.
>
> 4. Minimize adverse impacts to the local economy and preserve as many local employment opportunities as possible.
>
> 5. Maximize the greenhouse gas reduction benefits that could be generated in timberland management.

Appellee 41 (Bankruptcy Court Docket No 2201). The Bankruptcy Court

recognized these principles as indicative of the public interest and the general goals of chapter 11 reorganization. Appellant 411, Transcript of Hearing February 28, 2008, beginning page 55, line 22 to page 56, line 8.

In response, each of the parties filing plans included provisions in their plans attempting to comply with these principles. For example, the Debtors and MAXXAM's plans contended that their plans would be implemented in compliance with all non-bankruptcy environmental laws, even though some of the language in the plans did not reflect that commitment. See Appellee 67 California State Agencies Objection to Confirmation ¶ 40-44 (Bankruptcy Court Docket 2609). The MRC/Marathon Plan went further by providing pass through treatment for all environmental obligations, assurances of compliance with non-bankruptcy environmental laws, regulations and permits, and full compliance with all Environmental Obligations.[7] Appellant 331 MRC/Marathon Plan §§ 2.5 and 7.13 (Bankruptcy Court Docket No. 3300).

The Indenture Trustee plan purported to comply with all non-bankruptcy environmental laws. However, the Indenture Trustee plan was built around an auction sale to an unknown buyer whose capability to operate Timberlands that are considered one of the State of California's most precious natural resources in

[7] The term "Environmental Obligations" is a defined term under the MRC/Marathon Plan that includes all obligations described in the proofs of claim filed by the California State Agencies, the U.S. Fish and Wildlife Service, the U.S. Department of the Interior, the National Marine Fisheries Service, and the U.S. Department of Commerce. Appellant 331 at Appendix A to the MRC/Marathon Plan.

compliance with complex environmental laws, regulations and permits was unknown and uncertain. This was very troubling to both the California State Agencies and the Federal Wildlife Agencies. See Appellee 67 California State Agencies Objection to Confirmation ¶ 6-8 (Bankruptcy Court Docket 2609) and Appellee 62 Federal Wildlife Agencies' Comments on and Limited Objections to Proposed Plans of Reorganization ¶ 7 (Bankruptcy Court Docket No. 2599).

During the confirmation trial, the Palco Debtors (Pacific Lumber, Scotia Development LLC, Britt Lumber Co., Inc., Salmon Creek LLC, and Scotia Inn Inc.), MAXXAM, and the MRC/Marathon Plan proponents entered into a settlement that resulted in the withdrawal of the Palco Debtors' plans. Scopac eventually withdrew its plan as well.

The ultimate issue at the confirmation trial was the value of the Timberlands. See Confirmation Findings at page 8. The Bankruptcy Court heard from seven different experts on this factual issue. Considering the experience, credibility, valuation methodologies, opinions on discount rates, opinions on harvest levels, opinions on log prices, and opinions on costs projections of all the experts, the Bankruptcy Court made a determination of the value of the Timberlands. See Confirmation Findings pages 31-61. As will be shown below and in the other Appellee briefs, that conclusion was correct and is entitled to great deference. That conclusion is the genesis of the Indenture Trustee's appeal and the ruling

underlying virtually every issue presented by the Indenture Trustee.

B. The Environmental Obligations under Non-Bankruptcy Law.

1. Species and Habitat Conservation Regulation.

The California Endangered Species Act (Cal. Fish & Game Code, §§ 2050 et seq.) ("Act") prohibits the "take" of any species protected by the Act. The Act allows the "take" of species in the course of another lawful activity if the responsible person obtains an incidental take permit from the California Department of Fish and Game ("DFG"). DFG may issue an incidental take permit if all of the permit issuance criteria set forth in Fish and Game Code §§ 2081(b) and (c) are satisfied. There are similar provisions under the federal Endangered Species Act (16 U.S.C. §§ 1531 et seq.) for the issuance of an incidental take permit by the U.S. Fish and Wildlife Service ("FWS") and the National Marine Fisheries Service ("NMFS").

Relying on a draft HCP and draft Implementation Agreement for the HCP, Palco, Scopac, and Salmon Creek applied for incidental take permits from DFG and FWS and NMFS to legally "take" state and federally listed species in the course of lawful timber harvesting activities. Thereafter, DFG determined that the negotiated final Habitat Conservation Plan and Implementation Agreement embodied sufficient measures to meet the incidental take permit issuance criteria, as well as other requirements of the Fish and Game Code, e.g., avoidance of take

of certain fully protected species. On or around March 1, 1999, DFG approved the HCP and Implementation Agreement ("HCP IA"), and granted the Incidental Take Permit ("ITP"). Appellee 191 and 194. Similarly, FWS and NMFS approved the HCP and HCP IA and issued incidental take permits under the federal ESA.

The ITP required the Debtors to comply with all applicable laws, the conservation measures in the HCP, all the terms of the HCP IA, all monitoring, and the reporting and other requirements in the Mitigation Monitoring and Reporting Program. These obligations arise from DFG's issuance of the ITP under the Act and are regulatory requirements the Debtors must follow as a condition of obtaining the ITP.

Assembly Bill 1986 ("AB 1986") appropriated $130 million of state public money for the purchase of the Headwaters Forest and related properties. Appellee 193. The appropriation was conditioned upon certain requirements. AB 1986 expressly prescribes the minimum protections that must be included in the HCP. All the restrictions and requirements placed on timber harvesting activities on the HCP Covered Lands are regulatory restrictions as they stem from this legislation and the state and federal ITPs.

The Agreement Relating to the Enforcement of AB 1986 ("Enforcement Agreement") enforces the requirements of AB 1986. Appellee 192. The Enforcement Agreement, and all its restrictions and obligations related to land

management, were recorded against approximately 211,700 acres of the Debtors' land as covenants, conditions, and restrictions ("CCRs") running with the land for a period of 50 years. The Enforcement Agreement requires the Debtors to pay liquidated damages in the amounts provided in the Enforcement Agreement for specific breaches of AB 1986, the Enforcement Agreement, the HCP, the HCP IA, the ITP, and any timber harvest plan ("THP"). HCP IA § 3.3 and Enforcement Agreement § 7 at Appellee 191 and 192.

Sections 5.3.1 and 5.5 of the HCP IA require advance approvals by DFG, FWS and NMFS of any transfer of "covered lands" and an amendment to the ITPs to the extent such transfer is not considered a minor modification.[8] In addition to the HCP and the HCP IA, AB 1986 and the Enforcement Agreement (which is recorded as the CCRs) require prior DFG, WCB, Resources Agency and CDF approval of transfers of Covered Land. Appellee 192. Section 9.1 of the Enforcement Agreement requires the application of Sections 5.3, 5.4 and 5.5 of the HCP IA for the transfers of any Covered Lands. In addition, Section 9.1 of the Enforcement Agreement requires the Debtors to insure that the terms of the Enforcement Agreement remain on the transferred land as CCRs and that the transferee has assumed in writing the Debtors' obligations under the Enforcement

[8] In addition, Section 5.3.1(a) provides for processing certain transfers as minor modifications under Section 7.1 of the HCP IA. However, even a transfer that can be processed as a minor modification requires the prior approval of DFG, FWS, and NMFS. Under Section 7.1.1 of the HCP IA, a proposed minor modification is not effective until DFG, FWS, and NMFS approve it.

Agreement.

2. Water Quality Regulation.

The RWQCB is one of nine regional boards established by the Porter-Cologne Water Quality Control Act (Cal. Water Code § 13000 et. seq.) to regulate water quality, and is, along with the California State Water Resources Control Board, the state agency with primary responsibility for the coordination and control of water quality in the North Coast region. Cal. Water Code § 13001. The United States Environmental Protection Agency ("USEPA") has authorized the State of California, through the State Water Resources Control Board and the regional water quality control boards, to administer portions of the Clean Water Act (33 U.S.C. §§ 1251 et seq.). See 40 C.F.R. Part 123; Cal. Wat. Code § 13160. The North Coast region consists of all basins draining into the Pacific Ocean from the California-Oregon state line southerly to the southerly boundary of the watershed of Estero de San Antonio and Stemple Creek in Marin and Sonoma Counties. Cal. Wat. Code § 13200(a). This area includes the approximately 211,700 acres of land owned by Palco, Scopac and Salmon Creek, and now HRC.

The RWQCB adopts and implements a Water Quality Control Plan for the North Coast Region (hereinafter "Basin Plan") that designates beneficial uses, establishes water quality standards (33 U.S.C. § 1313) and objectives, and contains implementation programs and policies to achieve those objectives for all waters

addressed through the plan. Cal. Wat. Code §§ 13240-47. The RWQCB's core functions also include issuing waste discharge requirements ("WDRs") (Cal. Wat. Code § 13263) and National Pollution Discharge Elimination System ("NPDES") permits (33 U.S.C. § 1342; Cal. Wat. Code § 13377), issuing clean up and abatement orders (Cal. Wat. Code § 13304), and taking other enforcement actions, including issuing administrative civil liability orders for violation of the Basin Plan, permits or other orders. See e.g., Cal. Wat. Code §§ 13323, 13350, and 13385. In addition, the RWQCB implements certain provisions of the California Health and Safety Code and other laws regarding the regulation of hazardous materials and hazardous waste. Most actions by the RWQCB, including Basin Plan amendments, must comply with CEQA to identify and mitigate where feasible any environmental impacts from projects subject to water board approval.

The Debtors' regulatory obligations administered and enforced by the RWQCB arose from three primary areas: (a) the Debtors' obligations under environmental laws administered by the RWQCB; (b) the Debtors' previous and, in some cases, ongoing violations of those environmental laws and administrative orders; and (c) the Debtors' obligation to investigate and/or remediate property or waters affected by the Debtors' discharges of waste.

Pursuant to Water Code section 13304, the RWQCB has issued a number of cleanup and abatement orders ("CAOs") against the Debtors for discharges into the

waters of the state caused by the Debtors' timber harvest-related activities.[9] The RWQCB also has identified four sites in the North Coast Region owned and/or operated by the Debtors at which significant petroleum and/or hazardous waste remediation is necessary.

The Debtors' instream activities, including stream crossings and gravel extraction, are subject to water quality certification orders issued pursuant to section 401 of the Clean Water Act (33 U.S.C. § 1341; Cal. Wat. Code § 13160) and the RWQCB's general waste discharge requirements (WDRs) for gravel and sand extraction. The Debtors' point source discharges to surface waters from the Scotia wastewater treatment facility and steam electric power plant are subject to requirements under NPDES permits. 33 U.S.C § 1342; Cal. Wat. Code §13370 et seq. The Debtors also are subject to WDRs and Monitoring and Reporting Orders (Cal. Wat. Code § 13267) for their operations on land disposal sites. See Cal. Code of Regs., Title 27 (containing regulatory requirements for wastes other than hazardous waste). Storm water discharges from the Scotia Mill, Tank Gulch SWDS, and Yager Camp are subject to the requirements of the general Stormwater NPDES permit. State Water Board Water Quality Order No. 97-03-DWQ.

Further, there are numerous WDRs issued to the Debtors for their timber

[9] The specific references to the Water Board permits and orders are contained in the California State Agencies' Statement of Support for MRC/Marathon Plan and Comments on and Limited Objections to Confirmation of Plans at Appellee 67 (Bankruptcy Court Docket No. 2609).

operations that establish water quality requirements, technical report requirements, and reporting requirements. The general WDRs, *inter alia*, prohibit the discharge of waste (including, for example, sedimentation resulting from timber harvest-related activities) into waters of the state in violation of water quality standards and other requirements and require the Debtors to submit technical reports that identify discharge sources, the measures that address each source, and a schedule implementing these measures. The two watershed-wide WDRs ("WWDRs") for the Freshwater and Elk River watersheds limit the overall disturbance that may result in waste discharges from timber harvest operations and require compliance with the Water Quality Control Plan for those discharges. The WWDRs require, *inter alia*, the Debtors to submit technical reports to the RWQCB, including annual pre-harvest planning reports, compliance monitoring plans and data, spill prevention control and countermeasure plans for petroleum, erosion control plans, and treatment and implementation schedules.

The RWQCB's Water Quality Control Plan contains specific requirements and prohibitions that apply to discharge of waste from timber harvest-related activities. In addition, Section 303(d) of the federal Clean Water Act requires the RWQCB to further amend its Water Quality Control Plan to promulgate total maximum daily loads ("TMDLs") for Freshwater Creek, Elk River, and other watersheds that are listed as impaired due to excessive sediment and/or elevated

water temperatures. These TMDLs will be accompanied by Implementation Plans (Cal. Wat. Code § 13242) that will utilize a variety of regulatory mechanisms to ensure restoration of beneficial uses and attainment of water quality standards.

With respect to the transfers of lands subject to the CAOs, the WDRs and the contaminated sites, the MRC/Marathon Plan specifically provides for the satisfaction and compliance with Environmental Obligations, including but not limited to the CAOs, WDRs, and remediation on contaminated sites. However, there is no automatic "transfer" provision for enrollments under general WDRs and WWDRs. Any new owner must submit an application package in accordance with the WDR to be authorized to discharge, which HRC has done.

With respect to CAOs and site remediation, when a new owner acquires property on which a discharge of waste is occurring or has occurred, that new owner becomes responsible for the remediation, in addition to the former owner. HRC as the new owner is now responsible for the remediation under California law and the confirmed MRC/Marathon Plan.

A change in ownership of NPDES permits and water quality certifications requires various administrative procedures and in some cases requires RWQCB action amending the permit. Such procedures and actions are taking place at the time this pleading is filed and are expected to be completed by early September.

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3. **Timberland Management Regulation.**

The California Department of Forestry and Fire Protection ("CDF") is the California state agency that is responsible for forest protection and for managing, maintaining, and enhancing California's forests. Cal. Pub. Res. Code § 713. CDF meets its statutory duties through administering and enforcing the Z'Berg-Negedly Forest Practice Act of 1973 (the "Forest Practice Act") (Cal. Pub. Res. Code § 4511 et seq.) and its implementing regulations (the "Forest Practice Rules") (Cal. Code Regs., 14 tit. §§ 895-1112), among other laws. As required by the Forest Practice Act and Forest Practice Rules, CDF reviews and approves timber harvesting plans ("THPs"), which govern timber harvesting of non-federal lands in California. Thus, with certain exceptions, a THP must be submitted and approved by CDF before any timber is harvested in California. Cal. Pub. Res. Code § 4581. It is important to recognize that a THP is considered a "functional equivalent to an environmental impact report ("EIR") as described in the California Environmental Quality Act ("CEQA"). Cal. Pub. Res. Code § 21080.5. As such a functional equivalent, a THP must meet the substantive requirements of CEQA as part of a legally sufficient EIR such as an accurate project description, an alternatives analysis and an analysis of potential cumulative impacts. Each Palco THP relies heavily upon analyses and mitigation measures contained in both the HCP and its accompanying certified EIR/EIS. Thus, CDF relies upon the HCP and the EIR/EIS

in order to approve a THP as containing complete and accurate information to meet CEQA's substantive requirements.

CDF issued the THPs under which the Debtors, and now HRC, operate. THPs result in timber harvesting permits that typically require measures to mitigate the adverse effects of harvesting. These mitigation measures often include erosion control, prescribed maintenance for erosion controls, restocking requirements, and repairs to roads, bridges and culverts. See e.g., Cal. Pub. Res. Code §§ 4562.5, 4562.7, and 4562.9; Forest Practice Rules 923.1, 923.2, 923.3, 923.4, and 923.6). These important measures are required by law as part of the approved timber harvesting plans in this case.

Consistent with the HCP IA, the requirements of the HCP are incorporated into each of the Debtors' THPs. The failure to comply with THPs approved by CDF also may constitute a violation of the HCP or the HCP IA, as well as create the potential for significant adverse environmental impacts in violation of CEQA. Cal. Pub. Res. Code § 21000 et seq.; Cal. Code of Regulations Title 14, Chapter 3, Sections 15000-15387. THPs require the landowner to comply with all other regulatory agency requirements. Thus, failure to comply with the requirements in a THP also may constitute violations of other environmental statutes.

To process a transfer of lands subject to a THP, certain requirements must be met. If a THP has been submitted to and approved by CDF but a notice of

completion has not yet been issued by CDF, Forest Practice Rule 1042 requires a change of ownership to be filed with the Director of CDF. The timberland owner must inform the new owner that the new owner must comply with the incomplete THP, the stocking standards of the Forest Practices Act, and all rules of the Board of Forestry. This means that all mitigations that are a part of a THP become the responsibility of the new owner, here HRC.

In addition to the THP requirements, any timberland owner must demonstrate that it meets the sustained yield requirements of the Forest Practice Act, Public Resources Code § 4551 et seq. and Forest Practice Rule 1091.1. To meet this requirement, the Debtors elected to provide CDF with a document known as an Option A pursuant to FPR 1091.4.5(a). This document must demonstrate that the Debtors will achieve maximum sustained yield production of high quality timber products consistent with the protection of soil, water, air, fish and wildlife resources. Specifically, the Option A must demonstrate that average projected harvest over any rolling ten year period shall not exceed the long term sustained yield estimate for the ownership. HRC is currently operating the Timberlands under the Debtors' Option A.

SUMMARY OF ARGUMENT

The evidence below fully supports the Bankruptcy Court's conclusion of the value of the Noteholders' collateral. The Indenture Trustee relies solely on the fact

that an offer to purchase the Timberlands existed to establish that the Bankruptcy Court's valuation determination is clearly erroneous. However, among other things, the Indenture Trustee failed to produce evidence that the alleged potential purchaser could obtain the regulatory approvals all agreed were required to obtain title. An offer from an unqualified buyer does not set the value of property. The remaining issues presented by the Indenture Trustee are merely arguments about the terms of the MRC/Marathon Plan, which the California State Agencies will leave to the MRC/Marathon plan proponents to address.[10]

ARGUMENT

A. The Bankruptcy Court's Valuation Determination is Supported by the Record.

As shown in the Bankruptcy Court's detailed findings of fact and conclusions of law, the Bankruptcy Court's ruling on the value of the Timberlands was a complicated, highly factual determination. The Bankruptcy Court considered the experts' experience and credibility, the valuation methodologies used, and the varying opinions on discount rates, harvest levels, log prices, and costs projections. Harvest rates are of particular importance to valuation. In examining evidence of projected harvest rates, the Bankruptcy Court recognized that sustainable harvest is an important concept for valuation determinations.

[10] The Indenture Trustee brief implies that the Bankruptcy Court entertained a jaded philosophy in making its rulings on confirmation citing Appellee 135, which is a partial transcript of a hearing July 2, 2008. However, the Bankruptcy Court already had issued its Confirmation Findings nearly a month earlier on June 6, 2008.

The Bankruptcy Court's conclusions with regard to proper harvest level consideration in its valuation determination are supported by the record. The evidence demonstrated that the MRC/Marathon Plan most closely met the intent of the California Legislature to maximize sustainable timber production while preserving and enhancing natural resource and environmental values as expressed in California Public Resources Code sections 4512 and 4513.

The testimony of Mr. Dean established that the harvest rates proposed by the MRC/Marathon Plan are sustainable in the long term and preserve and enhance the watershed and wildlife. Mr. Dean considered both the constraints based on regulation and public opinion as well as ground based constraints. Neither of these constraints was considered by the Indenture Trustee from the view of an experienced operator with a proven record of environmental compliance by any plan proponent or potential purchaser. Appellant 638 Proffer of Alexander L. Dean ¶ 49-76 ("Dean Proffer").

The timber harvest level testimony was distinguishable from another perspective as well. The harvest level that maximizes long term profits is not the one that tries to harvest as many trees as quickly as possible. Appellant 638 Dean Proffer ¶ 49. While the Debtors' and the Indenture Trustee's experts were determined to show the Court the maximum harvest levels legally achievable, such experts did not consider the harvest rate that will maximize long term profits and

the value of the Timberlands, which is what a willing buyer is likely to examine and which is what an operator would need to do to comply with California law post-confirmation. The Bankruptcy Court recognized this in its findings. See Confirmation Findings at pages 3-4; ¶ 34, 67-68, 245-248, 264, 270-273; pages 95-97, 102, 108, and 118.

For example, the Scopac expert Dr. Reimer readily admitted that his OPTIONS model was calibrated to maximize cash flow from the property, not what a likely buyer would harvest from the property. Appellant 569 Expert Report of D.R. Systems § 1.1 ("The scope of the project was to determine the timberland management strategies which would result in feasible harvest levels that generate maximum net cash flow contributions from the Scopac Timberlands, taking into account all applicable environmental and regulatory requirements."); Appellant 591 Declaration of Don. R. Reimer ¶ 40 ("harvesting priority was assigned to harvest activities that provided the highest net cash flow"); Appellant 427-428 Trial Transcript April 30, 2008, beginning page 122, line 3 to page 123, line 22 (Dr. Reimer testifying that the Debtors "implied" a maximum cash flow analysis was needed to support a reorganization). The Bankruptcy Court recognized the flaws in Scopac's expert's analysis in the Confirmation Findings. See Confirmation Findings at ¶ 193.

The analysis of the projected harvest levels by the Indenture Trustee's

expert, Mr. Fleming, had several flaws as well. First, it is undisputed that his appraisal used a 10 year forecast rather than the standard in the industry of a 50 year forecast. Confirmation Findings at ¶ 140. The testimony showed that the impact of this error is to dramatically increase the risk associated with his analysis. It is undisputed that the Indenture Trustee's expert also used a simple Excel spreadsheet for his analysis rather than a computerized model like the other experts. Confirmation Findings at ¶ 141. The evidence demonstrated that a complex computer model must be used to determine if the harvest level is sustainable and determine if the future harvest level is stabilized. This can only be done by forecasting timber harvest and tree growth for one rotation of a tree, from planting to harvest, or 50 years. Appellee 144 Declaration of Richard La Mont ("La Mont Declaration") ¶ 40.

Another flaw in the analysis of the Indenture Trustee's expert was his generalizations. It is undisputed that he performed no modeling to ascertain if his projected harvest level was sustainable, or if the species mix relied upon was available over time. The Indenture Trustee does not dispute that its expert did nothing to account for adjacency limitations, age class distribution or regulatory limits in certain watersheds. He did not know if his harvest forecast even complied with the applicable sustained yield plan. He provided no basis for his assumed growth rate of 3.75%. In light of the age distribution on the Timberlands, the

evidence showed that the forest-wide growth rate will likely decline over the next 20 years before increasing. Appellee 144 La Mont Declaration ¶ 41-42; see also Appellant 417-418 Trial Transcript April 8, 2008, Testimony of Richard La Mont page 355, lines 7-13 ("[Mr. Fleming's] modeling or his analysis, which it's not really modeling, would not stand the test for any sustained yield plan by the state of California, so it's not really a feasible harvest level."). Confirmation Findings at ¶ 143-153.

The other consideration on maintaining sustainable, high quality timber production is that the MRC/Marathon Plan keeps the Timberlands as working timberlands under one owner that has a proven, favorable track record for sustainable timberland management. The MRC/Marathon Plan was the only plan that assured one owner of all the lands covered by the HCP. There is no question that maintaining under one owner all of the HCP covered lands, which includes Palco's timberlands and other real property, is most likely to maintain the effectiveness of the HCP as is required by law. The Indenture Trustee Plan, due to its structure of not including Palco and providing for an uncertain owner of the Timberlands and possibly a different owner of the marbled murrelet conservation areas (known as the MMCAs), presented the real risk that the effectiveness of the HCP could be compromised. All parties agreed that it was unlikely that the required regulatory approvals could be obtained for a transfer of the covered lands

if the effectiveness of the HCP would be compromised. Appellant 429 Trial Transcript May 1, 2008, page 123, lines 14-24.

The undisputed evidence demonstrated that watershed and wildlife protection is enhanced by MRC/Marathon's commitment to uphold and maintain the HCP and the other Environmental Obligations (including THPs, WDRs, WWDRs, and CAOs), its proven track record of being able to operate commercial timberlands in northern California, and the commitment to obtain Forest Stewardship Council certification for the Scopac lands. These considerations made the MRC/Marathon Plan the best opportunity by far to advance and protect both the economic and environmental value of these assets over the long term. To the contrary, the Indenture Trustee Plan could not make such promises as it did not present any evidence to show that a likely buyer had any knowledge, let alone a proven track record, of environmental compliance, long term sustainable management of timberlands, or Forest Stewardship Council certification. Without such evidence, the Indenture Trustee Plan was not shown to be feasible as required by section 1129(a)(11) (Confirmation Findings at page 4), although the Indenture Trustee abandoned its challenge to that finding on appeal.

The Bankruptcy Court's determination of value which was the ultimate issue in the case, notwithstanding the Indenture Trustee's efforts to call it a legal issue, clearly is supported by the record and must be upheld on appeal. The Indenture

Trustee does not even attempt to address the evidentiary record supporting the Bankruptcy Court's valuation findings.

B. The Indenture Trustee's Alleged Purchaser Did Not Establish the Value of the Timberlands.

Despite its abandonment of any challenge to the Bankruptcy Court's denial of confirmation of the Indenture Trustee Plan, the Indenture Trustee contends that the Bankruptcy Court did not maximize the value of the Timberlands by failing to hold an auction sale. A closer examination of the record and the Bankruptcy Court's unchallenged findings reveals the many flaws in this argument.

The Indenture Trustee's argument that it had prospective purchasers for the Timberlands, and thus the Bankruptcy Court's findings are clearly erroneous, fails to take into consideration the certain regulatory requirements for any transfer and operation of the Timberlands. With respect to these Timberlands, it is not as easy as finding a buyer willing to pay more, as the Indenture Trustee suggests. Rather, the Bankruptcy Court properly considered the regulatory requirements and restrictions, and the lack of any evidence of the prospective purchasers' ability to meet any of those requirements, in making its factual valuation determinations.

The starting point in the analysis is the legal requirement that any transfer of lands covered by the HCP must be approved by the California State and Federal Wildlife Agencies. As the Bankruptcy Court and all of the plan proponents were well aware, all of the approximately 211,700 acres of land owned by the Debtors,

including the Scopac Timberlands, are subject to significant state and federal regulation, described above as Covered Lands.

None of the parties in this case, including the Indenture Trustee, quarreled with the California State Agencies' and the Federal Wildlife Agencies' position that the law requires prior regulatory approval of the transfer of any of the Covered Lands. In fact, the Bankruptcy Court asked all parties if anyone was contending that such approvals were not necessary or whether the Bankruptcy Court could override any such requirements. The answer was no. Appellant 429 Trial Transcript May 1, 2008, pages 315-318.

While the Indenture Trustee pledged compliance with all Environmental Obligations and a willingness to obtain all environmental approvals required under the Environmental Obligations, there was virtually no evidence that any of the offered potential operators of the Timberlands (appellant Scotia Redwood Foundation ("SRF") or the Noteholders under a credit bid scenario) would be able to obtain the required approvals and comply with the Environmental Obligations (including THPs, WDRs, WWDRs, and CAOs). This is particularly important because the Bankruptcy Court and all parties, including the Indenture Trustee, conceded that the Bankruptcy Court could not approve a plan that did not show that the eventual operator was capable of complying with the environmental laws. Appellant 422 Trial Transcript April 11, 2008, starting at page 177, line 24 to page

178, line 6.

The Indenture Trustee's proposed buyer was a purported offer from SRF and the testimony of its representative, Jacob Cherner. The evidence showed that SRF is an entity formed by one of the Noteholders that owned a blocking position for any substantive instructions to the Indenture Trustee that were contrary to the terms of the indenture. The sum total of the evidence that SRF could obtain regulatory approval and could comply with the Environmental Obligations was that it would hire whomever it needed to accomplish those tasks. Appellant 422 Trial Transcript April 11, 2008, page 252, lines 9-14 (testimony of Jacob Cherner). The evidence also showed, however, that SRF had not hired anyone as of the date of Mr. Cherner's testimony, some four months after exclusivity had been terminated. Appellant 422 Trial Transcript April 11, 2008, page 252, lines 14-18; see also Confirmation Findings at ¶ 270-271.

The Bankruptcy Court had no evidence before it to conclude that any eventual purchaser, whether it was SRF or anyone else, would be capable of complying with the Environmental Obligations. The testimony of Dr. Barrett, the CEO and responsible person from Scopac for environmental law compliance, established that there is a "steep learning curve" for someone unfamiliar with the Scopac HCP, regulations and other permits. Appellant 422 Trial Transcript April 11, 2008, page 91, lines 13-22. Dr. Barrett's testimony also established that if an

operator does not know what it is doing, there could be seriously harmful consequences to the environment, costly fines, and loss of political capital.[11]

Moreover, the SRF offer contemplated the possibility of over $400 million of debt to fund the offer. The Supplemental Declaration of Jacob Cherner (IT exhibit 237) showed loan availability on certain terms of approximately $200 million, with another $200 million from a potential capital contribution. Appellant 563. That left an additional $200 million of debt needed to fund the offer. Assuming that $200 million would have come from loans, the SRF offer contemplated at least $400 million of debt on the property that would need to be serviced by cash flow from the Timberlands. Neither the Indenture Trustee nor SRF has submitted any evidence that the property could provide sufficient cash flow to service that amount of debt and comply with the Environmental Obligations. Confirmation Findings at ¶ 265.

While in bankruptcy, 28 U.S.C. § 959(b) requires debtors-in-possession to "manage and operate the property in [their] possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof." Consistent with this requirement, Bankruptcy Code section

[11] To the contrary, the uncontradicted and undisputed evidence showed MRC has a proven track record of environmental law compliance in the State of California for redwood forest operations. Confirmation Findings ¶ 46-54.

1129(a)(3) provides that debtors may not propose plans that are "forbidden by law." See also, *In re Texas Extrusion Corp.*, 844 F.2d 1142, 1160 (5th Cir. 1988) (court reviews assertion that plan was "forbidden by law" because it would violate antitrust laws); *In re Cajun Electric Power Co-op, Inc.*, 150 F.3d 503, 519 (5th Cir. 1998) (Plan may not propose "independent illegality"); see also Collier on Bankruptcy § 1129.03[3][b][ii] (plan that would violate other regulatory law would be "forbidden by law" and would preclude confirmation even if no provision of title 11 was violated). Just as a debtor-in-possession must comply with applicable approval requirements relating to its property under environmental law, *a fortiori*, a reorganized debtor must comply with the same requirements, and any plan that suggested otherwise would be "forbidden by law" and not confirmable. Indeed, this Court has emphasized the limited role of bankruptcy courts once a debtor emerges from chapter 11. See *In re Craig's Stores of Texas, Inc.*, 266 F.3d 388 (5th Cir. 2001).

Further, a plan must provide adequate means for its implementation. See 11 U.S.C. § 1123(a)(5) (requiring a plan to provide adequate means for its implementation). This requirement has been interpreted to prevent confirmation of plans that violate non-bankruptcy law. See, *Pacific Gas & Elec. Co. v. California*, 350 F.3d 932 (9th Cir. 2003) (Congress did not intend section 1123(a)(5) to permit the debtor to make transfers of assets in violation of state laws). A plan that does

not show it can be implemented in compliance with applicable non-bankruptcy law is not feasible. 11 U.S.C. § 1129(a)(11).

The undisputed evidence established overwhelmingly that the MRC/Marathon Plan provided for the management of the Timberlands in accordance with state and federal laws and all required regulatory permits. It was within this framework that the Bankruptcy Court properly valued the Timberlands. Moreover, the Indenture Trustee failed to provide evidence that SRF or any other of the potential purchasers was capable of obtaining the approvals for transfer of the HCP covered lands and complying with the Environmental Obligations. Thus, these indications of interest were not proper comparables from which to base any valuation finding. Structurally, the Indenture Trustee Plan had the inherent risk of an unknown buyer of the Timberlands, which presented a significant feasibility problem for the Indenture Trustee and could not support confirmation of a plan under section 1129(a)(11).

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CONCLUSION

The California State Agencies respectfully request that this Court affirm the Confirmation Order in all respects.

Dated: September 8, 2008

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Lori N. McCleerey, declare:

I am a resident of the State of California and over the age of eighteen years, and not a party to the within action. I am an employee of Felderstein Fitzgerald Willoughby & Pascuzzi LLP and my business address is 400 Capitol Mall, Suite 1450, Sacramento, CA 95814-4434.

On September 8, 2008, I served the foregoing:

APPELLEE CALIFORNIA STATE AGENCIES' BRIEF

☑ (By Electronic Mail) I caused to be transmitted the above-described document(s) via electronic mail to the electronic addresses as indicated on the attached list.

I declare under penalty of perjury, under the laws of the State of California and the United States of America that the foregoing is true and correct.

Executed on September 8, 2008, at Sacramento, California

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CERTIFICATE OF COMPLIANCE

Pursuant to 5th Cir. R. 32.2.7(c), the undersigned certifies this brief complies with the type-volume limitations of 5th Cir. R. 32.2.7(b).

1. Exclusive of the exempted portions in 5th Cir. R. 32.2.7(b)(3), the brief contains 9,879 words.

2. The brief has been prepared in proportionally space typeface using Word 2003.

3. If the Court so requests, the undersigned will provide an electronic version of the brief and/or a copy of the word or line printout.

4. The undersigned understands a material misrepresentation in completing this certificate, or circumvention of the type-volume limits in 5th Cir. R. 32.2.7, may result in the Court's striking the brief and imposing sanctions against the person signing the brief.

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