

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

IN RE: SCOTIA PACIFIC, *
DEBTOR * CASE NO. 07-20027
*

TRIAL ON THE MERITS
TAKEN ON APRIL 8, 2008

On the 8th day of April, 2008, the above entitled
and numbered cause came on to be heard before said
Honorable Court, RICHARD S. SCHMIDT, United States
Bankruptcy Judge, held in Corpus Christi, Nueces
County, Texas.

Proceedings were reported by machine shorthand.

2

1 A P P E A R A N C E S
2 SOME PARTIES APPEARING TELEPHONICALLY
3
4 BANK OF AMERICA:
5 MR. EVAN JONES
6 O'Melveny & Myers
7 400 S. Hope Street
8 Los Angeles, CA 90071-2899
9 (Appearing telephonically)
10
11 BANK OF NEW YORK TRUST CO.:
12 MS. ALLISON BYMAN
13 MR. IRA HERMAN
14 Thompson & Knight, LLP
15 1700 Pacific Avenue, Suite 3300
16 Dallas, TX 75221
17 (Appearing telephonically)
18 BANK OF NEW YORK INDENTURED TRUSTEE:
19 MR. WILLIAM GREENDYKE
20 MR. ZACK A. CLEMENT
21 MR. TOBY L. GERBER
22 MR. RICHARD KRUMHOLZ
23 Fulbright & Jaworski, L.L.P.
24 1301 McKinney, Suite 5100
25 Houston, TX 77010
26 BANK OF NEW YORK INDENTURED TRUSTEE:
27 MR. MARK A. WORDEN
28 Fulbright & Jaworski
29 (No address given)
30 (Appearing telephonically)
31 THE BLACKSTONE GROUP:

19 MR. PETER LAURINAITIS
(No address provided)
20 (Appearing telephonically)

21 BLOOMBERG, LLP:
MR. STEVEN H. CHURCH
22 Bloomberg, LLP
(No address provided)
23 (Appearing telephonically)

24

25

AK/RET REPORTING, RECORDS & VIDEO, INC.

3

1 CALIFORNIA STATE AGENCIES:
MR. PAUL PASCUZZI
2 Felderstein Fitzgerald & Pascuzzi
400 Capitol Mall, Suite 1450
3 Sacramento, CA 95814

4 CALIFORNIA STATE ENTITIES:
MR. MICHAEL NEVILLE
5 (No address provided)
(Appearing telephonically)

6 CNA INSURANCE COMPANIES:
7 MS. RUTH VAN METER
Munsch Hardt Kopf & Harr, P.C.
8 (No address provided)
(Appearing telephonically)

9 CSG INVESTMENTS:
10 MR. JEFFREY JACOB CHERNER
CSG Investments
11 (No address provided)
(Appearing telephonically)

12 DEUTSCH BANK:
13 MR. JAMES A. DELAUNE
(No Address Provided)
14 (Appearing telephonically)

15 DK PARTNERS:
MR. EPHRAIM DIAMOND
16 (No address provided)
(Appearing telephonically)

17 HOULIHAN LOKEY HOWARD & ZUKIN:
18 MR. TODD HANSON
Houlihan Lokey Howard & Zukin
19 (No address provided)
(Appearing telephonically)

20 LEHMAN BROTHERS:
21 MR. DAN KAMENSKY
Lehman Brothers
22 No address provided
(Appearing telephonically)

23

24

25

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 MARATHON FUNDING:
 2 MR. CRAIG P. DRUEHL
 MR. ALLEN GLENN
 Goodwin Procter, LLP
 3 (No address provided)
 (Appearing telephonically)
 4

MARATHON STRUCTURED FINANCE FUND:
 5 MR. STEVEN SCHWARTZ
 Winston & Strawn, LLP
 6 200 Park Ave.
 New York, NY 10166
 7

MR. DAVID NEIER
 8 Winston & Strawn, LLP
 200 Park Ave.
 9 New York, NY 10166

10

MARATHON STRUCTURED FINANCE FUND:
 11 MR. JOHN PENN
 Haynes & Boone, L.L.P.
 12 201 Main Street, Suite 2200
 Fort Worth, TX 76102
 13

MAXXAM, INC.:
 14 MS. JOLI PECHT
 Maxxam, INC.
 15 (No address provided)
 (Appearing telephonically)
 16

MAXIM, INC.:
 17 MR. JEFFREY E. SPIERS
 Andrews Kurth
 18 (No address provided)
 (Appearing telephonically)
 19

MENDOCINO FOREST:
 20 MR. KEN CRANE
 Perkins Cole, LLP
 21 (No address provided)
 (Appearing telephonically)
 22

MURRAY CAPITAL MANAGEMENT, INC.:
 23 MS. FRANCINE BRODOWICZ
 Murray Capital Management, Inc.
 24 (No address provided)
 (Appearing telephonically)
 25

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 NATURE CONSERVENCY:
 MR. DAVID F. STABER
 2 Akin, Gump, Strauss, Hauer & Feld, L.L.P.
 (No address provided)
 3 (Appearing telephonically)

4 OFFICIAL COMMITTEE OF UNSECURED CREDITORS:
 MR. MAXIM LITVAK
 5 Pachulski Stang Ziehl & Jones
 150 California St., 15th Floor
 6 San Francisco, CA 94111

7 MR. JOHN D. FIERO
 Pachulski Stang Ziehl & Jones

8 150 California St., 15th Floor
San Francisco, CA 94111

9

PACIFIC LUMBER COMPANY:

10 MR. SHELBY JORDAN
MR. NATHANIEL PETER HOLZER
11 Jordan, Hyden, Womble & Culbreth
500 N. Shoreline, Suite 900
12 Corpus Christi, TX 78471

13 MR. FRANK BACIK
The Pacific Lumber Company
14 (No address provided)
(Appearing telephonically)

15

16 MR. JIM PRINCE
MR. GEORGE LAMB
Baker Botts, LLP
17 (No address provided)

18 MR. GARY CLARK
The Pacific Lumber Company
19 (No address provided)
(Appearing telephonically)

20

PENSION BENEFIT GUARANTY CORPORATION:

21 MR. MARC PFEUFFER
Pension Benefit Guaranty Corporation
22 (No address provided)

23

PLAINFIELD ASSET MANAGEMENT, LLC:

24 MR. BRETT YOUNG
Plainfield Asset Management, LLC
25 (No address provided)
(Appearing telephonically)

AK/RET REPORTING, RECORDS & VIDEO, INC.

6

1 ROPES & GRAY, LLP:
MS. HEATHER J. ZELEVINSKY
2 Ropes & Gray, LLP
(No address provided)
3 (Appearing telephonically)

4 SCOTIA PACIFIC:

MS. KATHRYN A. COLEMAN
5 MR. ERIC J. FROMME
MR. RICHARD J. DOREN
6 Gibson, Dunn & Crutcher, LLP
200 Park Ave.
7 New York, NY 10166

8 MR. CHRISTOPHER D. JOHNSON
MR. KEN WILLIAM
9 MS. WENDY LAUBACH
Diamond, Mccarthy, Taylor & Finley
10 (No address provided)
(Appearing telephonically)

11

STEPHEN BUMAZIAN:

12 MR. STEPHEN BUMAZIAN
Avenue Capital Group
13 (No address provided)
(Appearing telephonically)

14

STEVE CAVE:

15 MR. WILLIAM BERTAIN
Law Office of William Bertain
16 (No address provided)
(Appearing telephonically)

17
18 THE TIMES-STANDARD:
19 MR. JOHN DRISCOLL
20 The Times-Standard
21 (No address provided)
22 (Appearing telephonically)
23
24 U.S. DEPARTMENT OF JUSTICE:
25 MR. ALAN TENEBBAUM
U.S. Department of Justice
Environment and Natural Resources Division
P.O. Box 7611
Washington, D.C. 20044
(Appearing telephonically)

AK/RET REPORTING, RECORDS & VIDEO, INC.

7

1 WATERSHED ASSET MANAGEMENT:
2 MS. ERIN ROSS
3 Watershed Asset Management
4 (No address provided)
5 (Appearing telephonically)
6
7 COURT RECORDER:
8 Janet Ezell
9
10 CERTIFIED SHORTHAND REPORTER:
11 Sylvia Kerr, CSR, RPR, CRR
12
13 * * * * *
14
15
16
17
18
19
20
21
22
23
24
25

1	I N D E X	
2		PAGE
3	Appearances	2
4	Opening Statement by Mr. Neier	26
	Opening Statement by Mr. Brilliant	48
5	Opening Statement by Mr. Greendyke	59
	Opening Statement by Mr. Krumholz	80
6	Opening Statement by Mr. Doren	83
	Opening Statement by Mr. Jordan	106
7	Opening Statement by Mr. Fiero	123
	Opening Statement by Mr. Pascuzzi	139
8	Opening Statement by Mr. Jones	147
	Opening Statement by Mr. Tenebaum	150
9	MATTHEW BRECKENRIDGE	
10	Direct Examination by Mr. Neier	183
	Cross-Examination by Mr. Krumholz	185
11	Cross-Examination by Mr. Lamb	226
	Redirect Examination by Mr. Neier	236
12	Cross-Examination by Mr. Jones	250
	Cross-Examination by Mr. Krumholz	251
13	RICHARD LAMONT	
14	Direct Examination by Mr. Schwartz	252
	Cross-Examination by Mr. Doren	266
15	Cross-Examination by Mr. Clement	305
	Redirect Examination by Mr. Schwartz	343
16		
17	EXHIBITS	
18	NUMBER	PAGE
19	DESCRIPTION	
	MMX 2 - Breckenridge Proffer	184
20	MMX 4 - Lamont Proffer	253
21	IT 111 -	202
22	IT 112 -	202
	IT 112-A	202
23		
24		
25		

1 THE COURT: All right. Go ahead.

2 MR. HOLZER: As Your Honor knows, we are

3 here on a plan confirmation of the competing plans.

4 Other matters on the docket, along with the

09:17 5 confirmations, are the motion to appoint trustee in the

6 Scopac case, which you carried. There's also a motion to
7 resolve the January 20 log payment as between Pacific
8 Lumber and Scopac that we carried over from last week,
9 and I'm not sure we're there yet.

09:17 10 MR. GREENDYKE: We are not yet.

11 THE COURT: Okay.

12 MR. GREENDYKE: But it's not because we
13 haven't thought about it. We have been focusing on other
14 things. Judge, there is also a motion to strike for the
09:17 15 proffers that we filed on behalf of Bank of New York as
16 indenture trustee last night.

17 THE COURT: You filed a motion or the
18 proffer?

19 MR. GREENDYKE: A motion to strike a
09:17 20 proffer that had been made by Marathon Finance.

21 THE COURT: Okay.

22 MR. GREENDYKE: And at the appropriate
23 time we would like to address that, and that will be
24 addressed by Mr. Krumholz.

09:17 25 MR. HOLZER: All right. And so just so

AK/RET REPORTING, RECORDS & VIDEO, INC.

10

1 everybody is clear what's going on, we have for the bench
2 there are three sets of exhibits, one set exhibits
3 proposed by the debtors, which I believe are in white
4 binders, three volumes. There's a set of exhibits
09:17 5 proposed by the Bank of New York Indentured Trustee and
6 another set of exhibits proposed by Marathon and MRC.
7 The Court was given a notebook yesterday that contained
8 the proffers. And there's, of course, duplication. All
9 the proffers in the notebook are separately included
09:17 10 among the exhibits, to my understanding, and so there's
11 some overlap there.

12 THE COURT: Which proffer are you
13 objecting to?

14 MR. GREENDYKE: First let me clarify one

09:17 15 thing. I don't think ours are here yet. They're on the
16 way. So if you're looking --

17 THE COURT: Because I've only got two
18 sets. But which proffer are you objecting to?

19 MR. GREENDYKE: It's the proffer of Sandy

09:17 20 Dean made by --

21 THE COURT: Alexandra Dean?

22 MR. GREENDYKE: Yes.

23 THE COURT: Okay. All right.

24 MR. HOLZER: So I'm not sure what to

09:17 25 suggest other than that.

AK/RET REPORTING, RECORDS & VIDEO, INC.

11

1 THE COURT: Well, I mean, I assume he's
2 going to be the second witness called, so at some time
3 prior to that we've got to have that argument but I --

4 MR. KRUMHOLZ: We understand he's the
09:17 5 first witness called, Your Honor.

6 THE COURT: Oh, he's going to be the first
7 one? So that will make it real easy. We can argue about
8 it right before we call him. But are we going to have
9 opening statements?

09:17 10 MR. HOLZER: I believe that's --

11 THE COURT: Do we have an agreement as to
12 the time and who's going to go in what order?

13 MR. HOLZER: We've been asked that
14 previously. Yes, Your Honor.

09:17 15 THE COURT: All right. So let's get
16 started.

17 SPEAKER: Do you want to do the CNA
18 and the PBGC?

19 MR. HOLZER: Yes, Your Honor. As we
09:17 20 discussed, there are three legal only plan objections
21 from non-plan sponsors, a CNA insurance, the PBGC,
22 Humboldt County. And the question is whether we take
23 those up now before opening statements or whether you

24 would like to hear the openings first.

09:17 25 THE COURT: Okay. Well, do we have -- I

AK/RET REPORTING, RECORDS & VIDEO, INC.

12

1 mean, is there a representative of Humboldt County here?

2 MR. HOLZER: I think they're on the line.

3 THE COURT: Is that true?

4 MS. ROMERO: Yes, Your Honor. Martha

09:17 5 Romero for Humboldt County.

6 THE COURT: Okay. Well, let's -- I really

7 don't care how we do it. I think we just need to get

8 started. So if you feel like these legal things ought to

9 go first, that's fine with me.

09:17 10 SPEAKER: That was the original idea, Your

11 Honor, as a courtesy to them.

12 THE COURT: Okay. Let's do it now. All

13 right.

14 MR. SCHREIBER: It may make things easier

09:17 15 and let some people drop off the line. Good morning,

16 Your Honor, Carey Schreiber from Winston Strawn. I

17 appreciate the Court's courtesy in allowing me to appear

18 pro hac before this Court.

19 There were a couple of objections with

09:17 20 respect to the MRC/Marathon plan that I'm pleased to

21 report we have resolved, leaving outstanding the more

22 substantive issues that are purported amongst the parties

23 that are here. The first one was an objection that was

24 filed by Humboldt County. Section 4.2.1 of the

09:17 25 MRC/Marathon plan provides for treatment of secured tax

AK/RET REPORTING, RECORDS & VIDEO, INC.

13

1 claims. And there are two options with respect to

2 secured tax claims. The first is to pay in full and in

3 cash on the distribution date plus a post petition

4 interest in accordance with 511 of the code. And the
09:17 5 second is to pay over time according to section 1129.
6 Humboldt County objected to the payment over time
7 requesting that they be paid either sooner or that there
8 would be certain restrictions put on their payment over
9 time. We have agreed to pay them and put language in the
09:17 10 confirmation order should our plan be the one the Court
11 approves that we would request that we pay them in
12 accordance with the option that we pay them in full in
13 cash on the distribution date.

14 And the language specifically that I've
09:17 15 been asked to read into the record would say "with
16 respect to the secured tax claims of Humboldt County, the
17 MRC/Marathon plan proponents agree that Humboldt County
18 shall receive the treatments set forth in section 4.2.2.1
19 Roman net I of the MRC/Marathon plan, providing for
09:17 20 payment of cash on the distribution date under the
21 MRC/Marathon plan, in an amount equal to the unpaid
22 portion of such allowed secured tax claim plus post
23 petition interest (at a rate to be determined under
24 applicable non-bankruptcy law).

09:17 25 The second agreement that we've reached,

AK/RET REPORTING, RECORDS & VIDEO, INC.

14

1 Your Honor, is with CNA Insurance. CNA provides workers'
2 comp for the debtors. And pursuant to section 6.6 of the
3 MRC/Marathon plan, the -- in short, for lack of a better
4 term, the reorganized entities continue the prepetition
09:17 5 workers' comp programs in full and CNA has asked us for
6 some clarifying language to resolve their objection.

7 And the language that we have agreed to
8 with CNA's counsel is as follows. And again, this is
9 language that we would, with this Court's permission, put
09:17 10 into our proposed confirmation order should our plan be
11 the plan to be confirmed by the Court. The language is
12 as follows: "Nothing in the MRC/Marathon plan shall in

13 any way impair or impact parties rights and obligations,
14 including without limitation any rights to set up or
09:17 15 recoupment under the insurance policies with respect to
16 the workers' compensation programs described in section
17 6.6 of the Marathon plan."

18 And with those two paragraphs in the
19 confirmation order, Your Honor, we believe we've resolved
09:17 20 these objections. I appreciate the Court's courtesy.

21 THE COURT: Okay. All right. Is CNA on
22 the phone?

23 MS. VAN METER: Your Honor, Ruth van Meter
24 on behalf of CNA, and that is correct.

09:17 25 THE COURT: All right. Anything else that

AK/RET REPORTING, RECORDS & VIDEO, INC.

15

1 you wanted to say?

2 MS. VAN METER: I don't have anything
3 else, Your Honor. If I may be excused.

4 THE COURT: You may be excused. All
09:17 5 right. With respect to Humboldt County, does that
6 satisfy your objection to the Mendocino Marathon plan?

7 MS. ROMERO: Yes, Your Honor, it does.

8 THE COURT: All right. I suspect you will
9 probably stay on the line.

09:17 10 MS. ROMERO: I am going to stay on the
11 line because I have filed another objection.

12 THE COURT: All right. Do we have any
13 others? Yes, sir?

14 MR. PFEUFFER: Your Honor, my name is Mark
09:17 15 Pfeuffer. I'm here on behalf of the Pension Benefit
16 Guaranty Corporation.

17 THE COURT: All right.

18 MR. PFEUFFER: I was admitted pro hac on
19 January 10th of this year. And to start out with,
09:17 20 because PBGC hasn't quite appeared in this matter before,
21 I'll just explain the Pension Benefit Guaranty

22 Corporation is a federal agency and United States
23 government corporation within the Department of Labor
24 that under Title IV of the employment retire -- the
09:17 25 employee retirement income security act ensures defined

AK/RET REPORTING, RECORDS & VIDEO, INC.

16

1 benefit pension plans sponsored by private sector
2 companies. Palco, a debtor in this case, Pacific Lumber
3 Company, sponsors the Palco retirement plan, which is a
4 covered plan under Title IV of ERISA.
09:17 5 We have filed four objections -- or rather
6 we have objected to confirmation of four of the five
7 proposed plans of reorganization. And you can find our
8 consolidated objections at Docket No. 2536. For the
9 convenience of the Court, I'll refer to the debtors'
09:17 10 three plans as the debtors' joint plan, the debtors'
11 Scopac plan, and the debtors' Palco plan, all of which
12 we've objected to confirmation of.

13 And lastly, we objected to confirmation of
14 the plan proposed by the indentured trustee. And based
09:17 15 upon ongoing negotiations with the indentured trustee, I
16 would like to move to withdraw our objection to that
17 proposed plan of reorganization without prejudice at this
18 time.

19 THE COURT: All right.

09:17 20 MR. PFEUFFER: Of the four objections that
21 we filed, I suppose I have announced withdrawal to one, I
22 will just refer to three. It will probably be easier for
23 the Court if I divided them by objection rather than by
24 debtor because the issues are the same in both. The
09:17 25 first objection concerns the debtors' Scopac plan on

AK/RET REPORTING, RECORDS & VIDEO, INC.

17

1 grounds that it fails to disclose liability to PBGC and

2 the pension plan. The second two objections concern
3 debtors' joint plan and Palco plan because of its
4 unwarranted call for substantive consolidation.

09:17 5 I would like to start with our objection
6 to the debtor Scopac plan and then follow with our
7 objection regarding the latter two debtor plans. And I
8 think it would help at the beginning because it
9 concerns -- it -- rather, the nature of our claims is the
09:17 10 predicate for both objections, so if I could take a
11 moment and explain what exactly our claims are. I'll try
12 and be as general as possible. But we filed three
13 separate claims against each of the six debtors, and each
14 one of these claims is filed jointly and separately
09:17 15 amongst all of the debtors.

16 Palco, as I mentioned, is the contributing
17 sponsor of the pension plan. And the other five debtors,
18 including Scopac, are wholly-owned subsidiaries of Palco.
19 Thus, under ERISA and the Internal Revenue Code, all six
09:18 20 of the debtors are in the same control group as that term
21 is defined under the applicable treasury regulations.
22 Again, under ERISA and the Internal Revenue Code,
23 Congress mandated that each member of the control group
24 is jointly and separately liable to PBGC and a pension
09:18 25 plan for any member's pension liabilities. These

AK/RET REPORTING, RECORDS & VIDEO, INC.

18

1 liabilities typically include -- and this is what we
2 filed our claims for -- an employer's due and unpaid
3 contributions to the pension plan, commonly referred to
4 as minimum funding contributions.

09:18 5 Secondly, pension liabilities include
6 insurance premiums owed to the PBGC. And lastly, these
7 claims include the pension plans unfunded benefit
8 liabilities. And roughly speaking, a plan's unfunded
9 benefit liabilities is the plan's current assets -- or
09:19 10 rather, the plan's benefit liabilities. In other words,

11 how much the plan ultimately has to pay out until every
12 single participant is deceased minus that plan's current
13 assets. And to give you a rough estimate of the plan's
14 unfunded benefit liabilities, at the time we filed our
09:19 15 claims it was estimated to be \$21.7 million. On top of
16 the claims for the employer contributions and premiums,
17 our outstanding claims are in excess of \$29 million.

18 Also, it's important to understand the
19 effect termination of the pension plan has on these
09:19 20 claims. ERISA provides the exclusive means for plan
21 termination. A debtor can either apply for a distress
22 termination of the pension plan, which hasn't happened in
23 this case. And the PBGC can initiate proceedings to
24 terminate a pension plan, which hasn't happened in this
09:20 25 case either.

AK/RET REPORTING, RECORDS & VIDEO, INC.

19

1 But if the plan were to terminate, our
2 plans would mature against the debtors, including Scopac,
3 which leads me to our first objection. We have the
4 debtors' Scopac plan, which I believe is at Docket 2210,
09:20 5 fails to even mention the pension plan, let alone
6 Scopac's liability for pension claims as a member of the
7 Palco control group. As such, we assert that the
8 debtors' Scopac plan doesn't meet the codes requirement
9 that a plan of reorganization must be proposed in good
09:20 10 faith. And we feel that in order to satisfy the code's
11 good faith test, debtors' Scopac plan must make clear
12 certain elements with respect to the pension plan.

13 First off, the debtors' Scopac plan should
14 make clear that under the applicable treasury regulations
09:21 15 and ERISA and the Internal Revenue Code, Scopac is a
16 member of Palco's control group, as that term is defined.
17 And it must make clear that if the pension plan does not
18 terminate in these bankruptcy proceedings, certain
19 pension obligations continue, those being the obligations

09:21 20 to make minimum funding contributions which are joint and
21 several among Palco's control group and the obligation to
22 pay PBGC insurance premiums, which are also jointly and
23 severally among the debtors as a control group.

24 More important, the PBGC asserts that the
09:21 25 debtors' Scopac plan must make clear that if the pension

AK/RET REPORTING, RECORDS & VIDEO, INC.

20

1 plan does terminate in these proceedings, which is a
2 possibility, it's an agency decision that hasn't been
3 made as of this date, the pension claims in excess of \$29
4 million, which are joint and several in nature among the
09:22 5 debtors, will become due against Scopac.

6 And as the plan is currently filed, the
7 debtors predict that Scopac's general unsecured creditors
8 will receive a full recovery and PBGC will argue that
9 this is patently absurd because the extent to which our
09:22 10 allowed claims are not awarded the priority that they're
11 due under the Internal Revenue Code and ERISA, they would
12 be general unsecured claims. The effect would be that
13 class would be flooded with our claim. And I can't say
14 for certain but it would be many millions of dollars.

09:22 15 Our priority amounts are limited under the statute to 30
16 percent of the net worth of the control group, and we
17 haven't liquidated that amount yet. But I believe this
18 debtors' Scopac plan estimated unsecured creditor claims
19 of less than half a million dollars, and that would be
09:23 20 simply absurd if the pension plan terminated.

21 So again, to recap that first objection,
22 we would argue that as its currently filed, the debtors'
23 Scopac plan fails to disclose the liability on the part
24 of Scopac for the pension plan. And in order to solve
09:23 25 this deficiency, it needs to make clear that, A, Scopac

AK/RET REPORTING, RECORDS & VIDEO, INC.

21

1 is a member of Palco's control group; and, B, if the
2 pension plan doesn't terminate, it remains liable for
3 certain pension obligations; and C, if the pension plan
4 does terminate, the pension claims become due, they're no
09:23 5 longer contingent, and they would certainly dilute the
6 unsecured creditor pool.

7 Moving along, Your Honor, I'll address my
8 last two objections. Rather, I suppose I can phrase it
9 as one objection. It's against the debtors' Palco plan
09:24 10 and the debtors' joint plan. And that concerns -- those
11 plans call for substantive consolidation. As the Court
12 is aware, substantive consolidation is a process by which
13 a court merges the assets of more than one debtor into a
14 single estate to which all holders of a claim must look
09:24 15 for a distribution. And this is an important issue for
16 PBGC, again, because our claims are joint and several
17 among the debtor, meaning, of course, that until our
18 claims are -- until we recover fully on our claims, we
19 have a right to assert a full claim against each and
09:24 20 every one of these debtors. In this judicial circuit,
21 substantive consolidation is subject to heightened
22 scrutiny because it affects the substantive rights of the
23 party.

24 In essence, a court should look to the
09:25 25 underlying purpose that the equitable -- or all

AK/RET REPORTING, RECORDS & VIDEO, INC.

22

1 creditors, rather, are treated equitable. And we believe
2 that if a substantive consolidation were granted in this
3 case, PBGC would not be treated equitably. In fact, it
4 would deprive PBGC of its statutorily granted rights.
09:25 5 And we would mention that although in this
6 circuit the standards regarding substantive consolidation
7 are not precise, courts in this circuit have made clear
8 that the practice is prohibited absent pleading proof or

18 plans are not confirmed where one party has a claim
19 that's joint and several against several individuals?
09:28 20 They're not confirmable if it calls for sudden
21 consolidation because, in effect, the substantive
22 consolidation gives every claim joint and several
23 liability and so, in essence, you're deluding that one
24 has joint and several liability? Are there cases that
09:28 25 say that?

AK/RET REPORTING, RECORDS & VIDEO, INC.

24

1 MR. PFEUFFER: Well, Your Honor, I point
2 you to two cases, one is CFI Fabricators of Utah, which
3 is a district court decision in Utah. The cite is 179 BR
4 704, and the other is in re: Northeast Dairy
09:28 5 Cooperative. That's a bankruptcy court case out of the
6 Northern District of New York. The cite is 88 BR 21.
7 And both of those cases explain why our joint and several
8 claims are affected if substantive consolidation is
9 granted. And in particular, the latter case that I
09:29 10 cited, the Northeast Dairy Co-op case, there was an
11 argument that if PBGC were granted -- or rather, if
12 substantive consolidation was granted and PBGC's -- I'm
13 sorry. Let me back up a second.

14 In that case, Your Honor, there was a
09:29 15 partial distribution made to the pension plan. And the
16 parent of the debtor, which itself was not a debtor,
17 claimed that because of PBGC's joint and several claims
18 it would enjoy an excess recovery. According to this
19 parent, a reduction was necessary. In other words,
09:30 20 substantive consolidation should apply because -- or
21 rather, or else the pension plan will recover in this
22 case 60 percent of its allowed claims while other
23 unsecured creditors will only recover, I think, 40
24 percent.

09:30 25 And in this context, the court refused to

1 reduce the pension plans claim explaining that the joint
2 and several liability imposed by ERISA was designed to
3 achieve precisely that result. And I could read from
4 that case a few lines that reiterate that point.

09:30 5 THE COURT: Okay. But do you have any
6 cases that say you can't confirm a plan if there's
7 substantive consolidation because you have joint and
8 several liability?

9 MR. PFEUFFER: No, Your Honor, I don't
09:30 10 have any of those cases before me, but I do know that in
11 order to prove that substantive consolidation is
12 warranted the debtors need to make some showing.

13 THE COURT: Right. Correct. All right.
14 Thank you.

09:31 15 MR. PFEUFFER: Okay. And that final
16 point, I'd like to just reiterate that both the debtors'
17 plan -- or rather the debtors' Palco plan and the
18 debtors' joint plan both call for substantive
19 consolidation. PBGC believes that the debtor -- the
09:31 20 debtors haven't shown cause for either and that our
21 rights would be greatly affected in either case if
22 substantive consolidation were approved.

23 THE COURT: All right. Thank you. Anyone
24 else have any preliminary arguments?

09:31 25 All right. Are we now ready to start on

1 the opening statements? Mendocino is going first for how
2 many minutes?

3 MR. NEIER: Your Honor, I'm splitting my
4 time with Mr. Brilliant who will speak on behalf of MRC.

09:31 5 I don't know how long it will be, but --

6 THE COURT: How much time are you

7 splitting?

8 SPEAKER: I think we get an hour.

9 MR. NEIER: I get an hour?

09:32 10 THE COURT: You get an hour. 40 minutes,
11 I thought that was. All right. In this regard, if we
12 can -- people can -- need to take -- if they have
13 personal problems they need to take care of, they can
14 leave the courtroom without permission to do that. All
09:32 15 right. Go ahead.

16 MR. NEIER: I should insist that everybody
17 stay here while I talk.

18 THE COURT: All right. Go ahead.

19 MR. NEIER: If we had begun on April 1st,
09:32 20 Your Honor, I would have announced a settlement among all
21 the parties.

22 THE COURT: Okay.

23 MR. NEIER: Your Honor, David Neier on
24 behalf of Marathon, Your Honor. The very last thing that
09:32 25 Marathon thought it would be doing is standing before you

AK/RET REPORTING, RECORDS & VIDEO, INC.

27

1 as a plan proponent. For Marathon, this case really
2 began when the debtors sought rescue financing about six
3 months before the petition date in July 2006. As the
4 Court knows, the debtors filed in January of 2007 with no
09:32 5 notice to Marathon and sought use of cash collateral on a
6 contested basis. Nevertheless, Marathon did step up and
7 did provide dip financing to support the debtors'
8 reorganization efforts.

9 However, it has become clear to Marathon,
09:33 10 as it has become clear to just about everybody in this
11 courtroom and everybody involved in this matter, that the
12 debtors and the noteholders are locked in a take no
13 prisoners pitch battle that will never result, never
14 result in a consensual resolution of these cases nor a
09:33 15 consensual plan. Indeed we have learned that the fight

16 that exists between the noteholders and the debtors has
17 been going on since 2005 without any let up.

18 As a result of this conflagration between
19 the debtors and the noteholders, we're faced today with
09:33 20 two extreme positions. On the one hand we have the
21 debtors who insist that equity is in the money, that this
22 asset has high value, but generates little cash due to a
23 snarl of litigation that has existed with the debtors
24 regulators that prevents them from harvesting their
09:34 25 product and thereby generating cash.

AK/RET REPORTING, RECORDS & VIDEO, INC.

28

1 They also look to the environmental
2 community as having caused them friction, and thereby
3 limiting the amount of wood that they can harvest from
4 the forest. What the debtors suggest to you now is that
09:34 5 by transforming the Redwood Forest into a vacation
6 paradise for the wealthy, creditors can be paid in full
7 at some point in the future five to eight years from now.

8 We think that's a rather radical position.
9 On the other hand, we have the noteholders who have a
09:34 10 similarly radical position. They want a liquidation of
11 their collateral with little regard to the other debtors
12 that are cases before Your Honor. That would imperil the
13 employee of the mill. They cannot survive without -- the
14 mill cannot survive without a long-term supply contract
09:34 15 from the forest. The residents of the town whose
16 residence are -- because it is a company town, all
17 employees of the debtors and their families. And many of
18 these families can count multiple generations among them
19 who have worked for this 130-year-old company.

09:35 20 Although Marathon developed a business
21 plan and attempted to broker a settlement, it was unable
22 to do so. In fact, it could basically be described as a
23 non-starter as far as the debtors and noteholders were
24 concerned. The committee and other parties have all made

09:35 25 similar attempts to try and find a middle ground in these

AK/RET REPORTING, RECORDS & VIDEO, INC.

29

1 cases, but to no avail. The result of that was that our
2 collateral was going to be severely imperiled by this
3 scorched earth battle that goes on.

4 Not only are the debtors' reorganization
09:35 5 efforts in peril by this, but Marathon's collateral, the
6 town and the mill are obviously going to be severely
7 impacted if there's not a reorganization of these cases.

8 By teaming up with Mendocino Redwood
9 Company, Marathon, though, has been able to put together
09:36 10 a plan that gives the other constituencies or mere
11 bystanders to this controversy between the debtors and
12 the noteholders another option, an option and a chance to
13 be heard to achieve the reorganization that is so
14 desperately needed in these cases.

09:36 15 The essential elements of the MRC/Marathon
16 plan are as follows: Mendocino Redwood Company will
17 contribute up to \$200 million in cash and Marathon will
18 contribute up to \$25 million in cash to a newly formed
19 entity. Contrary to the accusations of the noteholders,
09:36 20 Marathon is not receiving any consideration on account of
21 its Palco claims, nor is it receiving any consideration
22 on behalf of the Scopac equity that Palco has. That
23 equity is worthless, as far as we know.

24 At Palco, Marathon will convert
09:36 25 approximately \$160 million of its senior prepetition and

AK/RET REPORTING, RECORDS & VIDEO, INC.

30

1 postpetition debt into equity in exchange for the Palco
2 assets. And Marathon will then, in addition to the \$25
3 million, contribute the mill to the newly formed entity,
4 thereby remerging and reintegrating the forest and the

09:37 5 mill. This is not substantive consolidation. All
6 debtors are being treated separately, but post
7 effectively the mill will then be reintegrated with the
8 forest as it was before the SBE was formed for the
9 forest.

09:37 10 Marathon will also contribute the AR, or
11 the accounts receivable, and the inventory, those famous
12 law decks that you've heard a lot about, Your Honor, to
13 Newco in exchange for a note that will be valued at
14 the -- or be the market value of the AR and the
09:37 15 inventory, about \$20 to \$25 million is what we estimate.
16 Mendocino and Marathon will bring in a new, experienced
17 management team from Mendocino. Mendocino is in the
18 nearby county. It runs an operation successfully with
19 approximately the same number of acres that the debtors
09:37 20 have, about 200,000 acres. And getting that experienced
21 management team into the debtors was a critical
22 requirement for Marathon. And Mendocino amply fills that
23 requirement.

24 Your Honor, the commercial timberland and
09:38 25 sawmill operations will be reintegrated and there will be

AK/RET REPORTING, RECORDS & VIDEO, INC.

31

1 a lumber distribution business that will be added to the
2 new -- to the newly formed entity. That lumber
3 distribution business will be -- will have an extensive
4 distribution market. Mendocino Redwood Company already
09:38 5 distributes 400 million board feet in that entity. And
6 thereby, that is also a critical element of the
7 reorganization efforts of these debtors because they lack
8 a distribution and marketing system that is effective as
9 Mendocino's in reaching the marketplace.

09:39 10 And I'm sorry, but I'm not very good at
11 these projections here, so just give me a second where I
12 can catch up. And now it's gone. We'll ignore it.

13 Your Honor, Newco will achieve some \$10

14 million annually in savings from tender fees that will be
09:39 15 realized as a result of the sharing of its management
16 relationships and infrastructure with Newco. Newco will
17 be run -- and this is also a critical and important
18 aspect for us -- Newco will be run in a manner that is
19 environmentally responsible. We have seen what the
09:39 20 debtors controversies with the environmental community
21 and regulators has brought them. It has brought them a
22 lack of being able to do business in California in a
23 highly regulated market.

24 By acting in an environmentally
09:39 25 responsible manner and by having a track record, a proven

AK/RET REPORTING, RECORDS & VIDEO, INC.

32

1 track record of acting in an environmentally responsible
2 manner, we will be able to reorganize these companies and
3 successfully do business in this market. Mendocino will
4 seek forest stewardship council as part of its -- council
09:40 5 certification as part of its assumption of the
6 obligations and its environmental responsibilities going
7 forward. And that, we believe, will go a long way to
8 solving the various problems and all the controversies
9 that exist between the debtors and their regulators. In
09:40 10 addition, we will invest a total of \$7.5 million of new
11 capital into the mill. And overall, because Marathon is
12 wiping out its debt and because it's seeking --

13 THE COURT: The noteholders had at one
14 time 780 million. I don't know what the current balance
09:40 15 is.

16 MR. NEIER: You can say it's about that,
17 Your Honor.

18 THE COURT: You're going to give them 135
19 in cash?

09:40 20 MR. NEIER: 175 in cash, Your Honor.

21 THE COURT: 175 in cash. That will lower
22 it down to about 605 and you're going to write that down

23 to 300 and how much?

24 MR. NEIER: We're going to give them a new
09:41 25 note of \$325 million.

AK/RET REPORTING, RECORDS & VIDEO, INC.

33

1 THE COURT: \$325 million.

2 MR. NEIER: Secured by the same
3 collateral.

4 THE COURT: So you're writing down from
09:41 5 605 to 325, that would be \$280,000.

6 MR. NEIER: \$280 million. And then we're
7 also taking care of the \$160 million of debt. By
8 equitizing that, we realize this company is completely
9 overburdened by debt, so we're also equitizing all of
09:41 10 the -- the dip loan and the term loan that exists at
11 Palco for another \$160 million. That's the only way this
12 case -- that's the only way these companies can be
13 reorganized, Your Honor, is by eliminating the debt and
14 the crushing burden of making those debt service payments
09:41 15 that have existed for the debtors.

16 You know, obviously Marathon, like any
17 other creditor, wants to be paid in full in cash as of
18 the effective date. And especially as a dip lender, I
19 can assure you we would not have given a dip loan in any
09:42 20 other basis. However, that's not the position we are in.
21 The debtors' operations have fallen off the chart and,
22 you know, one can remember Mr. Zack Clement's famous
23 chart of the continuing spiraling down of the loss of
24 cash that's available at these companies. And when you
09:42 25 look at that, you have to realize that going forward,

AK/RET REPORTING, RECORDS & VIDEO, INC.

34

1 especially in the challenging market that is facing these
2 companies today, there's no way that the company is going

3 to be able to service the current debt load that it has.
4 THE COURT: Well, you've got to convince
09:42 5 me to confirm your plan over the objection of the
6 noteholders. You've got to convince me that they're
7 under water \$280 million.

8 MR. NEIER: That is correct, Your Honor.

9 THE COURT: Okay. Are you going to do
09:42 10 that with expert testimony?

11 MR. NEIER: That is correct, Your Honor.

12 THE COURT: All right.

13 MR. NEIER: Newco will also assume
14 responsibility for the debtors' pension plan. The town
09:43 15 of Scotia will be reorganized and residents will finally
16 be offered the opportunity to purchase their homes. B of
17 A, of course, and its participating lenders will be paid
18 in full in cash as of the effective date. All allowed
19 administrative expenses and claims will be paid in full
09:43 20 on the first distribution day.

21 The various causes of action of the
22 debtors, or at least some of those causes of action, will
23 be put into a litigation trust for the benefit of all
24 creditors that haven't been paid in full, except for
09:43 25 Marathon, of course. We think that is the outline for --

AK/RET REPORTING, RECORDS & VIDEO, INC.

35

1 and that is the essential elements of the plan of
2 reorganization that has been solicited and put before you
3 for confirmation.

4 THE COURT: As a matter of law, if I don't
09:43 5 believe that the -- if I believe the value of the timber
6 noteholders security is not \$280 million less than their
7 note, I can't confirm your plan.

8 MR. NEIER: That's correct, Your Honor.

9 What we would have to do is we would have -- if you set a
09:44 10 value, if you determine the value of the collateral that
11 the noteholders currently have, we would have to

12 essentially match that in order to confirm our plan.

13 now --

14 THE COURT: So are there provisions for
09:44 15 that in your plan or is that -- if I tell you what it is,
16 you're going to tell me what you are going to need.

17 MR. NEIER: That's correct, Your Honor. I
18 mean, they have already rejected our plan and they're not
19 going to accept our plan even if I, let's just say for
09:44 20 argument's sake, that the value was \$1 more than we put
21 in our plan and we decided to put \$1 more, that doesn't
22 turn a rejecting class into a consenting class. We have
23 impaired consenting classes for all debtors, okay, so
24 it's just a question of having fair and equitable
09:44 25 treatment, Your Honor deciding that we've given the

AK/RET REPORTING, RECORDS & VIDEO, INC.

36

1 noteholders fair and equitable treatment, and then we can
2 confirm our plan. It doesn't require resolicitation, it
3 doesn't require another confirmation hearing.

4 THE COURT: Okay.

09:45 5 MR. NEIER: Your Honor, the MRC/Marathon
6 plan has broad support and it is the only plan before you
7 that has broad support. We are the only plan that has
8 another major constituency before Your Honor that has
9 accepted the plan, namely the unofficial committee of
09:45 10 unsecured creditors. We also have the support of the
11 California State Agencies, which includes the California
12 Resources Agency, the California Department of Forestry
13 and Fire Protection, Fish and Game, Wildlife Conservation
14 Board, Water Quality Control Board, North Coast Region
09:45 15 and the State Water Resources Control Board and Governor
16 Arnold Schwarzenegger. In other words, we have the
17 support of everybody in California that regulates this
18 business.

19 We also have the support of the federal
09:46 20 agencies that regulate the debtors' operations, including

21 the U.S. Fish and Wildlife Service, the Department of
22 Interior, the National Marine Fishery Service, the
23 Department of Commerce and Congressman Mike Thompson. We
24 have the support also of various environmental groups
09:46 25 including California Trout, Conservation International,

AK/RET REPORTING, RECORDS & VIDEO, INC.

37

1 Pacific Forest Trust, Rainforest Alliance, the
2 Sustainable Conservation, Trout Unlimited. We also have
3 the support of all of the local newspapers, the Eureka
4 Times-Standard, the North Coast Journal, the Eureka
09:46 5 Reporter, the San Francisco Chronicle. We also have the
6 support of EPIC, the Environmental Protection Information
7 Center. They're one of the largest creditors in this
8 case with a \$6 million claim at Scopac and a couple
9 hundred million dollar claim at Palco. And their support
09:46 10 is critical. They've been locked in their own
11 controversy with the debtors for at least ten years.

12 We also have the support of the greater
13 Eureka Chamber of Commerce and the support of 25 families
14 owning and managing over 400,000 acres that surround the
09:47 15 debtors' property and Mendocino's property.

16 Your Honor, in terms of voting, 195 out of
17 199 unsecured creditors at the Palco debtors supported
18 our plan, and 26 out of 27 of the trade creditors at
19 Scopac supported our plan. In terms of voting, obviously
09:47 20 we voted for our own plan. We like our own plan. But we
21 have 99 percent of the trade creditors supporting our
22 plan and no other plan. They have rejected all other
23 plans. And obviously we also have Bank of America's
24 support for our plan. So we have impaired consenting
09:47 25 classes for both the Palco debtors, multiple impaired

AK/RET REPORTING, RECORDS & VIDEO, INC.

38

1 consenting classes of Palco debtors and the Scopac
2 debtors, and we're the only plan that's before you that
3 has that kind of support.

4 Now, how does our plan stack up to the
09:48 5 other plans that are before you? The debtors -- the
6 debtors have essentially two plans that don't have
7 impaired consenting classes. They have their sort of
8 plan for all debtors, which require everybody's consent.
9 They don't have our consent. And they also have their
09:48 10 Palco alternative plan, which also does not have an
11 impaired consenting class, so I don't think we need to
12 spend a lot of time talking about those plans.

13 But they have their one last plan, which
14 is the Scopac alternative plan. The Scopac alternative
09:48 15 plan can hardly be seen to have a good deal of support.
16 As far as the Scopac alternative plan is, they have one
17 impaired consenting class which is made up of four votes,
18 namely the Bank of America participating lenders. That's
19 their only impaired consenting class. And while we like
09:48 20 their support and we're glad that they voted for our plan
21 as well, we hardly think that four votes from secured
22 creditors constitutes broad support for your plan.

23 As far as our plan is concerned compared
24 to the other plans, we are putting in \$225 million in
09:49 25 cash in total in support of our plan. So \$50 million of

AK/RET REPORTING, RECORDS & VIDEO, INC.

39

1 the money that we're putting in will go towards paying
2 administrative cases and ending these bankruptcy cases,
3 paying administrative claims and ending these bankruptcy
4 cases. Compared to the other plan, the noteholder plan,
09:49 5 they have offered \$10 million to pay admin and
6 administrative expenses at the Scopac level only and they
7 have offered the unsecured creditors \$1.45 million at the
8 Scopac level only.

9 With respect to the Scopac alternative

09:49 10 plan -- and the Court has heard a lot about Maxxam making
11 contributions to the debtors -- was a \$10 million
12 contribution, but I believe that's off the table at this
13 point. In fact, Maxxam failed to file its 10K. It's
14 scheduled for delisting by Amex and has a going concerned
09:50 15 opinion for DeLoyd, so I hardly think that they're in a
16 position to help the debtors now in the debtors'
17 reorganization efforts. They have pretty much left the
18 scene.

19 So what we're left with in terms of people
09:50 20 putting in new values, it's not only important, Your
21 Honor, to lower the debt of these companies, but people
22 putting in real cash. We're putting in \$225 million, the
23 noteholders are doing a Scopac only plan, and they're
24 putting in up to \$10 million just for Scopac
09:50 25 administrative creditors and \$1.45 million, but only for

AK/RET REPORTING, RECORDS & VIDEO, INC.

40

1 unsecured creditors of Scopac, none of the other
2 unsecured creditors. And under the Scopac alternative
3 plan by the debtors, there is nothing coming in. They're
4 on their own. They have their Kingdom Home development
09:50 5 project, that's the way they're going to raise money five
6 to eight years from now.

7 In terms of a timeline, our plan -- if
8 Your Honor confirms our plan, we have to obtain the
9 regulatory approval of the state and federal agencies
09:51 10 that I mentioned earlier and then we're ready to close.
11 We're ready to close. We have the management team, we
12 have the capital committed, we don't have any financing,
13 we're ready to close. Compared to the other plans, the
14 debtors, they have to obtain not only regulatory approval
09:51 15 but some form of financing to get their plan out and then
16 they've got a five to eight year window before they start
17 paying various creditors in this case off their Kingdom
18 Home development plan. With respect to -- I'm sorry, the

19 debtors.

09:51 20 With respect to noteholders, the
21 noteholder, they're in the process of trying to sign up
22 with Stalking Horse bidder. They're going to then market
23 the assets. They're going to then seek court approval,
24 their bid procedures, they're going to then have an
09:51 25 action, they're going to let other parties do due

AK/RET REPORTING, RECORDS & VIDEO, INC.

41

1 diligence, and then they seek regulatory approval as to
2 whoever the buyer is. We don't know who that person will
3 be. And then they close the transaction. That's a five
4 to eight month window. Your Honor knows that Palco is
09:51 5 out of money and Scopac is running dry as well. Who is
6 going to support these estates? Who's going to manage
7 these estates while all of that is going on? And we
8 don't even know if the end result will be somebody who
9 can meet regulatory requirements or is an experienced
09:52 10 operator in this area.

11 With respect to the noteholders' plan,
12 they have no impaired consenting class other than
13 themselves. They are the only people supporting their
14 own plan. While we voted also for our own plan, we think
09:52 15 that's a good thing, the fact of the matter is is you can
16 hardly describe your own support as broad support among
17 the creditors. You can claim that you've met the test
18 over the bankruptcy code for impaired consenting class,
19 but that's all you can claim. You've met the bare
09:52 20 minimum requirements.

21 Combined with the lengthy timeline and the
22 management difficulties that may result from having
23 whoever wins the auction win the auction and then not
24 being able to operate the property or obtain regulatory
09:53 25 approval, we think we have the right timeline for these

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 cases because these cases are just about done.
 2 Now, the noteholders have made a bunch of
 3 unsupported allegations in their -- in their various
 4 objections to the Mendocino plan. They've claimed that
 09:53 5 somehow Marathon doesn't have standing. Well, you know,
 6 I really don't understand that. The order that
 7 terminated exclusivity gave Marathon the right to file a
 8 plan in these cases. It wasn't appealed from. Nobody
 9 asked for reconsideration of that order. After we filed
 09:53 10 our plan, this Court held a disclosure statement hearing.
 11 It approved the disclosure statement and sent out for
 12 solicitation the MRC/Marathon plan. That ruling wasn't
 13 appealed from nor was anybody asked for a
 14 reconsideration.

09:53 15 Clearly we have standing because it's
 16 already logged the case. The Court allowed us to
 17 solicit, we did solicit, we spent a great deal of time
 18 and expense putting the plan together and soliciting it
 19 and now the noteholders come in and say, oh, we don't
 09:54 20 think you have a standing. Of course we're one of the
 21 major creditor in these cases. Of course the Scopac
 22 equity is owned by Palco, so we think the argument is
 23 completely speechless.

24 And, you know, why are we pursuing a plan
 09:54 25 that reorganizes Scopac? Because it's in our best

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 interest. Our collateral is the town and the mill. As
 2 Mr. Jordan has said in this courtroom, without the
 3 forest, the mill and the town die.
 4 The indenture trustee claims that it has a
 09:54 5 security interest in some of the litigation assets of
 6 these estates. And in fact, the debtors last night --
 7 THE COURT: When is the market -- I don't

8 know what's going to happen to the assets of all of these
9 entities as a result of this bankruptcy, but wouldn't
09:54 10 whoever ends up with -- I mean, it is true that the town
11 may well die without the forest, but on the other hand,
12 if you own the forest and you don't have a mill, won't
13 someone -- I mean, whoever owns the forest have to make
14 some sort of a deal with the mill?

09:55 15 MR. NEIER: Not really. They can just sit
16 there and watch the mill starve or try to pick it up in a
17 liquidation because your trees grow. Unlike every other
18 case you've probably had, Your Honor, these assets don't
19 depreciate, they appreciate. They continue to grow.
09:55 20 It's a biological return. So the forest grows, the mill
21 dies and then they can do whatever they want.

22 THE COURT: I see.

23 MR. NEIER: They can seek other mill
24 capacity not in the town of Scotia.

09:55 25 THE COURT: All right.

AK/RET REPORTING, RECORDS & VIDEO, INC.

44

1 MR. NEIER: The indenture trustee claims
2 to have a security interest in some or all of the
3 litigation assets of Scopac. And in fact, the debtors, I
4 believe, filed an adversary proceeding last night
09:55 5 claiming that there is no such link, so that is one of
6 the things that is now before you.

7 Whatever happens with that dispute, it
8 seems to involve the Headwaters litigation, and that
9 litigation, the Headwaters litigation, is being retained
09:56 10 by the reorganized entities under our plan. And if the
11 noteholders have a lien on the proceeds of that or
12 recoveries from that litigation, they will get those
13 proceeds. And if they don't have a lien, they won't get
14 those proceeds, whatever they are. We are going to seek
09:56 15 to resolve those cases definitely.

16 The indenture trustee somehow claims that

17 they're disadvantaged by the fact that the remaining
18 unsecured claims also have a right to some of the
19 litigation trust assets. You know, there's probably some
09:56 20 \$500,000 of allowed -- this is the debtors' estimate of
21 the amount of allowed unsecured claims that will be left
22 standing at the Scopac level. So the noteholders could
23 have under our plan potentially a \$300 million deficiency
24 and they're worried about \$500 million sharing their
09:57 25 litigation trust. But in fact, they're benefitted

AK/RET REPORTING, RECORDS & VIDEO, INC.

45

1 because the litigation trust is going to include the
2 Palco litigation assets in addition to the Scopac
3 litigation assets. The noteholders don't claim they have
4 a lien on the Scopac litigation asset -- on the Palco
09:57 5 litigation assets, they're getting those, without any
6 consideration.

7 And Palco has many more litigation claims
8 than Scopac has certainly, particularly with respect to
9 parent company and director and officer liability claims.
09:57 10 The fact of the matter is that by having one litigation
11 trust instead of two litigation trustees, one at the
12 Palco level, one at the Scopac level and ultimately
13 they'll probably sue the same entity and then argue about
14 who gets the money, that's just a completely inefficient
09:57 15 way for anybody to handle litigation trust claims. By
16 combining the litigation trust claims of Palco and
17 Scopac, nobody is disadvantaged, everybody is advantaged.

18 THE COURT: Is anyone objecting to that
19 other than the noteholders?

09:57 20 MR. NEIER: No. The noteholders also
21 claim that somehow that they have a right to credit bid
22 under our plan. That's completely contrary to law. This
23 is a reorganization plan. It provides new value. We
24 gave them their 1111(B) election rights, which they
09:58 25 decline to elect. They don't have a right to credit bid

1 under our plan.

2 The noteholders have also thrown other
3 things against the wall to see what sticks. They now
4 claim that there may be some kind of antitrust issue with
09:58 5 respect to Mendocino being in a similar business to the
6 debtors. You know, Your Honor, that's a really
7 speechless argument. If you recall, the first day
8 affidavit that was submitted in this case said that one
9 of the reasons that the debtors activities were in peril
09:58 10 is because of all of the competing products that have
11 sprung up to compete with redwood for fencing and
12 decking, which is the major operation.

13 In fact, at this point with people with
14 their Trex decks and their -- and the cedar and pressure
09:59 15 treated lumber and everything else they use, just five
16 percent of the U.S. market for fencing and decking is
17 redwood at this point. So there's no antitrust issue.

18 They make some claims about classification
19 in terms of, you know, that we've created an impaired
09:59 20 class, but our impaired class are trade claims. And this
21 is a small isolated area. And you need those trade
22 creditors. Without those small mom and pop creditors who
23 are just getting paid \$500,000, you really can't operate
24 in that community. So we think we're absolutely correct
09:59 25 to create impaired consented class among the trade

1 creditors of Scopac. And I don't see why \$500,000 going
2 to those creditors should matter to them. Frankly, they
3 should support it.

4 They claim that there's artificial
09:59 5 impairment with respect to the B of A claim, but that's

6 just because they didn't win the support of B of A, which
7 the debtors and the Mendocino and Marathon both will.
8 They have a lot of arguments as opposed to value. And
9 I've gotten a note that my time is up and I'd like to
10:00 10 tell you about value, but the point is very simply that
11 on September 7, 2007 in these cases, Christopher DiMauro
12 from Houlihan, who leads the effort from Houlihan on
13 behalf of the noteholders who's been working on this case
14 since 2005, he came into your court and he said that
10:00 15 valuation of the debtors on a tax sufficient basis was
16 \$375 to \$500 million with a midpoint of \$420 million.

17 Well, now the noteholders are running away
18 from that valuation and they're going to the valuations
19 from Mr. Fleming and Mr. Daniel who both come in suddenly
10:00 20 at 600 million. And when you look at those valuations,
21 what's happened between September and March? Okay. From
22 September to March have the debtors operations gotten
23 better or worse? Has the housing crisis -- you know,
24 lumber is used for housing starts. Has housing starts
10:00 25 gone up or down? Has the credit crisis been somehow

AK/RET REPORTING, RECORDS & VIDEO, INC.

48

1 abbreviated? No. Everything has gotten worse between
2 September and March, both with respect to the debtors and
3 the market that they operated in, and yet they come to
4 this court with an increase in value. And they're trying
10:01 5 to put a bid together from their single largest
6 noteholder as a way -- as a method of establishing value
7 of \$600 million in this case.

8 But of course, if you're the single
9 largest noteholder, it's not an arm's length transaction.
10:01 10 Fair market value is based on a willing buyer and a
11 willing seller in an arm's length transaction. If your
12 secured creditor bids on the assets, he's by definition
13 an insider, okay? It doesn't establish value when he's
14 able to pay a premium and put money in his own pocket,

10:01 15 okay. It's a round trip transaction as far as he's
16 concerned. So that doesn't establish value either. The
17 way to look at these cases is to look at where the
18 noteholders have moved in their valuation, why they've
19 been inconsistent, even though the debtors operations
10:01 20 have fallen off the table.

21 And Your Honor, that concludes my remarks.

22 THE COURT: All right.

23 MR. BRILLIANT: Good morning, Your Honor.

24 Alan Brilliant on behalf of Mendocino Redwoods Company.

10:02 25 Your Honor, I'm going to just tell you a little bit about

AK/RET REPORTING, RECORDS & VIDEO, INC.

49

1 Mendocino and also about Mr. Alexander Dean, who will be
2 the first witness in the case. To make it simple, when I
3 refer to Mendocino Redwoods or any of its affiliates, I'm
4 just going to call it MRC. Your Honor, MRC was formed in
10:02 5 June 19 --

6 THE COURT: Can we get the Elmo on.

7 MR. BRILLIANT: Okay. Thank you, Your
8 Honor. Mendocino was -- MRC was formed in June 1998 to
9 acquire the redwood timberlands owned by Louisiana
10:02 10 Pacific, Mendocino County, California. As Your Honor can
11 see on the map, or at least I hope you can see on the
12 map, but Mendocino is about, you know, halfway up on the
13 map. It's north of San Francisco and it's basically one
14 county south of Humboldt County where the debtors have
10:03 15 their timberlands and their mill.

16 When Mendocino acquired their timberlands
17 from Louisiana Pacific, they also acquired an associated
18 sawmill and a lumber distribution business. Mendocino is
19 primarily owned by the Fisher family of San Francisco,
10:03 20 California. The Fishers founded the Gap, Incorporated,
21 you know, a large retail chain. I'm sure Your Honor is
22 familiar with. And the Fisher family continues to own 30
23 percent of the -- of the equity interest in the Gap. And

24 the Gap has a total market cap, it's a publicly traded
10:03 25 company of about \$15 billion.

AK/RET REPORTING, RECORDS & VIDEO, INC.

50

1 The first witness you're going to hear
2 from today, Your Honor, is Alexander Dean. And as you
3 heard earlier from the noteholders, everyone calls him
4 Sandy. That's what his friends call him and pretty much
10:04 5 everybody calls him Sandy. And he's been with MRC since
6 it was first founded. And in fact, he was the chief
7 executive of the company. He was the president of the
8 company for the first two years after it was founded and
9 he has been the chairman of the board of the company ever
10:04 10 since then. Mr. Dean holds an undergraduate degree from
11 Duke, an MBA from Stanford. And prior to joining the
12 Fishers, he worked at a number of investment management
13 firms and at Goldman Sachs.

14 Both MRC and the debtors have very
10:04 15 similar, you know, businesses. The -- they both have
16 about 200,000 acres, they're both located in relatively
17 similar parts of Northern California, and they both are
18 subject to the same regulatory and other constraints.
19 And in paragraph 21 of the proffer from Mr. Dean, we set
10:05 20 forth some of the similarities of both the redwoods
21 themselves and the mill. And you can see, Your Honor,
22 that they're very similar business operations.

23 As we said earlier, in addition to owning
24 the timberlands, MRC also owns a mill based in Ukiah,
10:05 25 California. But unlike Scopac, MRC also owns a highly

AK/RET REPORTING, RECORDS & VIDEO, INC.

51

1 successful distribution business which in recent years
2 has primarily served Home Depot, a large big box lumber
3 retailer. And as Mr. Neier said, MRC sells about 400

4 million board feet of lumber annually through its
10:05 5 distribution center. And in fact, last year MRC was Home
6 Depot's lumber department vendor of the year; very strong
7 relationship with, you know, the Home Depot, which as
8 Your Honor knows, is one of the largest retailers of
9 lumber in the country.

10:05 10 Now, MRC has some real strategic
11 advantages here, Your Honor. As a family owned business
12 that is well capitalized, MRC is not subject to having to
13 make short-term business decisions in order to generate
14 short-term cash flow. Instead, MRC is able to operate
10:06 15 its business and maximize the value of its timberlands,
16 its sawmill and its distribution over the long-term. And
17 that gives an advantage here that other parties don't
18 have. We're very oriented towards short-term harvesting
19 in order to generate short-term profits and cash flow.

10:06 20 Now, Mr. Dean is going to testify through
21 his proffer that successful operators of redwood
22 timberlands must operate a related sawmill and a related
23 processing distribution business in order to maximize the
24 long-term value of their lands. And in fact, Mr. Dean
10:06 25 testifies in his proffer that of the four major redwood

AK/RET REPORTING, RECORDS & VIDEO, INC.

52

1 timberland owners in Northern California, all but one of
2 them own their own mill and the fourth one works through,
3 you know, a third-party mill; and that that entity, the
4 fourth entity, which doesn't have an integrated mill, has
10:07 5 been forced to rely upon sales of land in order to
6 generate the type of cash flows it needs to operate
7 its -- operate its business.

8 I think Your Honor, you know, asked a very
9 astute question about what would happen if the, you know,
10:07 10 the lands were separated from the mill. You know, we
11 believe -- you'll hear, you know, from Mr. Dean in his
12 proffer believes that it would hurt the value of the

13 timberlands. But more importantly than that, the
14 noteholders would have an opportunity to take their
10:07 15 business somewhere else. And currently, you know, the
16 mill, even with 100 percent of the Palco capacity, loses
17 money. With 40 percent or a lower amount of that, it
18 won't be able to operate, you know, profitably. It just
19 won't have the volume. The mill was designed, you know,
10:07 20 to process a very significant amount of harvest, and as
21 the debtors harvest came down dramatically over the last
22 ten years. It just hasn't been getting the capacity that
23 it needs to, you know, to operate its business. And the
24 MRC has the ability to solve that.

10:08 25 In addition, Mr. Dean testifies in his

AK/RET REPORTING, RECORDS & VIDEO, INC.

53

1 proffer that timber operators must have a predictable and
2 sustainable harvest rate in order to be successful. Now,
3 when harvest rates, you know, vary the way they have, you
4 know, with the debtors, mostly coming down but also, you
10:08 5 know, varying from year to year, that creates problems
6 because with your customers, they just need to have, you
7 know, product.

8 They need to know that when they buy from
9 somebody, they have a relationship with somebody, they're
10:08 10 going to provide them with the product that they need.
11 And when you get into regulatory disputes with the state
12 or otherwise and you can't produce in a predictable and
13 sustained fashion, you end up having problems with your
14 customers and it hurts your relationships and it hurts
10:08 15 your long-term, you know, profitability.

16 In addition, when you have a variable
17 harvest rate, you're also put into a position where you
18 can't plan on your mill. You can't plan on what kind of
19 capacity you want to have, how many ships you want to
10:09 20 operate and how much money you want to invest because you
21 don't know from year to year, month to month what your

22 production is going to be. And therefore, not knowing
23 and not being able to predict your harvest rate, you
24 know, creates, you know, problems in generating long-term
10:09 25 profits.

AK/RET REPORTING, RECORDS & VIDEO, INC.

54

1 Now, Mr. Dean testifies in his proffer,
2 you know, something that I think is obvious to everyone
3 in this courtroom at this point, which is that California
4 forest industry is very highly regulated. He testifies
10:09 5 in his proffer that, in fact, it's the most regulated of
6 all the states and that California enforces its
7 regulations extremely aggressively.

8 And based on the heavy regulation and
9 aggressive enforcement of such regulations in California,
10:09 10 operators are really forced to make a decision as to how
11 they want to, you know, approach the regulation. They
12 can decide to do the bare minimum of what's required, you
13 know, by the state; or alternatively, they can try to
14 exceed the minimums with the state, get the state to buy
10:10 15 into what they're doing with the hope that in the long
16 run you have a better relationship with the state and
17 that you'll have more predictability as to your harvest.

18 Now, we know what approach, you know, the
19 debtors have taken. And when Your Honor hears the expert
10:10 20 testimony, you're going to be hearing, you know, from
21 parties based on paper appraisals and paper analysis of
22 harvest and they're going to be telling Your Honor what
23 they think if you comply with the bare minimum what the
24 most wood that can be harvested would be in the shortest
10:10 25 period of time and what kind of cash flow that might

AK/RET REPORTING, RECORDS & VIDEO, INC.

55

1 generate as a way of justifying the valuations that they

2 come up with.

3 Now, MRC, on the other hand, has chosen to
4 try to get public acceptance of their practices and
10:10 5 regulatory acceptance of the way they manage the mill.
6 And why do they do this, Your Honor? They don't do it
7 necessarily, you know, because they're nice people. They
8 are. But that's not why they do it. They do it because
9 it's good business. Because in the long run, in the
10:11 10 acceptance from the regulators in California of how
11 they're going to harvest the property gives them the
12 predictability of what they're going to harvest in order
13 to build the type of relationship they have built with
14 Home Depot. And it gives them the ability to, in the
10:11 15 long-term, maximize the value, you know, of their
16 business. Because again, they're not short-term, you
17 know, oriented.

18 And to that end, what MRC has done with
19 its business, it has eliminated traditional clearcut
10:11 20 logging on its own lands. They just don't go into an
21 area and just cut down every tree. They leave certain
22 amounts of, you know, of trees.

23 In addition, Mendocino has adopted a
24 redwood policy and they don't cut down old growth
10:12 25 redwoods that date back past 1800 or earlier. In

AK/RET REPORTING, RECORDS & VIDEO, INC.

56

1 addition, MRC has invested money to prevent sediment from
2 fouling coastal streams running through its property.
3 And all of this, Your Honor, is contained in Mr. Dean's
4 proffer.

10:12 5 And because of these very exemplary forest
6 management policies, as Mr. Neier said, Mendocino has
7 been awarded the forest stewardship council certification
8 for its forest management, which is, you know, the
9 highest level of certification that you can get. And
10:12 10 again, why did they do this? They do it because it's

11 good business, it makes sense and it maximizes cash
12 flows, you know, in the long run. You know, not because
13 they're just nice guys.

14 Now, since the beginning of 2004, MRC has
10:12 15 engaged in significant due diligence in connection with
16 the -- you know, its analysis of this company and it has
17 worked extensively with the -- you know, in analyzing,
18 you know, the debtors business operations and its
19 timberlands, and in particular what it believes, you
10:13 20 know, the debtors can harvest on a long-term basis with
21 respect to these assets. They have looked at the
22 regulatory constraints, they've looked at the operating
23 constraints. And they have, you know, sought to
24 determine what it is that, you know, can be done with
10:13 25 these lands.

AK/RET REPORTING, RECORDS & VIDEO, INC.

57

1 Your Honor, I'm being told that I'm
2 starting to -- that I have run out of time. I'm going to
3 try to wrap up very quickly.

4 THE COURT: All right.

10:13 5 MR. BRILLIANT: Your Honor, and, you know,
6 they have a special ability to forecast for this property
7 because they're right next door to these properties.
8 They operate a similar timberland and forest right next
9 door to these properties. So they have a pretty good
10:14 10 sense as to what needs to get done here and what is
11 achievable and what's obtainable with these properties.

12 And the other thing is, unlike the experts
13 here, Mendocino didn't try to just do a paper appraisal.
14 And if you look at the Dean proffer, you'll see what they
10:14 15 did is they started, you know, with the inventory and
16 they did an on the ground, so to speak, appraisal. They
17 looked at all the regulatory constraints and then they
18 looked at all the on the ground constraints, because as
19 the debtors have chewed up this forest, chewed up this

10:14 20 forest over the last few years with a desire to try to
21 cut every tree they could in order to deal with their
22 short-term, you know, cash needs. They have left slivers
23 and other problems here which in the long run has made it
24 uneconomic to harvest some of the timber.

10:14 25 So when Your Honor sits here and you're

AK/RET REPORTING, RECORDS & VIDEO, INC.

58

1 going to hear a lot about harvest rate because
2 ultimately, you know, the valuation of these timberlands
3 is going to come down to what can you harvest, how
4 quickly can you harvest and what price you're going to
10:15 5 get for, you know, the lot. So to some smaller extent
6 it's going to involve cost as well.

7 But with respect to the harvest rate, Your
8 Honor, and when you listen to the experts, take in -- ask
9 Your Honor to think about the practical constraints to
10:15 10 harvesting, both the regulatory constraints and the on
11 the ground constraints which are laid out in the Dean
12 proffer so Your Honor can really test what Your Honor
13 thinks is achievable, because at the end of the day I
14 think Your Honor, you know, hit the nail on the head.

10:15 15 You know, leaving everything else aside,
16 you know, there's really on one issue for Your Honor
17 here, you know, during this hearing, and that's what's
18 the value of the lenders' collateral. Now, Your Honor
19 approached it by, you know, what is their potential
10:15 20 write-off. I don't think that necessarily that's the
21 right way to look at it. Look at it from the other side
22 of the coin. And, you know, the question here, Your
23 Honor, is is what is being offered to them under the
24 Marathon -- the MRC/Marathon plan, is it equal to the
10:16 25 value of their collateral? And we believe that the \$175

AK/RET REPORTING, RECORDS & VIDEO, INC.

59

9 on the record that our designee as plan agent under the
10:17 10 indenture trustee's plan is former Governor Pete Wilson
11 from the State of California. We were honored and
12 delighted when he agreed to serve in this capacity upon
13 confirmation of our plan. Unfortunately, Governor Wilson
14 had prior commitments that made it impossible for him to
10:17 15 be here this week. He sends his apologies to the Court.
16 Governor Wilson is the chairman of the national World War
17 II museum and is actively involved in its development and
18 its support.

19 Months ago, prior to us contacting him and
10:17 20 dealing with him, he made plans to travel this week to
21 Washington, D.C. and New York City to meet with
22 Congressional leaders and former military leaders in an
23 attempt to encourage support for the museum. While in
24 New York, the Governor will also receive the Globe and
10:18 25 Anchor Award from the Marine Corps and Law Enforcement

AK/RET REPORTING, RECORDS & VIDEO, INC.

61

1 Foundation because of the Governor's efforts to support
2 scholarships for children of fallen marines and law
3 enforcement officers. We wish he could be here and I
4 know he does, too. I assure you his absence means no
10:18 5 disrespect to the Court nor does it indicate any lack of
6 interest or commitment to this process or the indenture
7 trustee's plan. He simply took his schedule as we found
8 it because of our conviction that he was the right person
9 for the job. We will continue to talk to and communicate
10:18 10 with the Governor and his staff to see if we can find a
11 time when it's appropriate for him to introduce himself
12 to the Court in open court on the record.

13 Judge, as you've heard from Mr. Neier
14 principally so far and from some of the other counsel for
10:18 15 Pension Benefit Guaranty Corporation and CNA, there are
16 lots of legal issues in this case. We even got a new
17 lawsuit last night disputing the amount of our claim for

1 on the record with regard to the importance of these
2 issues and how much the jobs and local economy weighs on
3 the Court's mind as it makes its decisions concerning
4 this case. Our client appreciates and respects both the
10:20 5 positions taken by the state, federal and local
6 authorities as well as the Court's concerns as expressed
7 in prior hearings.

8 Interestingly, in the next to last
9 paragraph of the statement filed by Governor
10:21 10 Schwarzenegger last Friday night where he expressed the
11 State's position, the Governor says, and I quote, "I
12 understand that the bankruptcy court must decide whether
13 the MRC/Marathon plan meets the other confirmation
14 requirements of the bankruptcy code." In that sentence,
10:21 15 he tells you that notwithstanding what he wants,
16 notwithstanding what he's asked for, you still must do
17 your job. You must still do the right thing. Your job
18 is unique among trial judges.

19 For over 20 years you've had a constant
10:21 20 parade of individuals and companies with financial
21 trouble come into court and look to you for a way out.
22 You know better than anybody in this room what it's like
23 to tell somebody face-to-face that they will lose their
24 home or their car or their job or their company. Each
10:22 25 time you have to do that, it takes a little bit out of

1 you. It pulls at your heart and you struggle between
2 what you want to do and what they want you to do and what
3 you have to do as a judge.

4 And you tell that person, I'm sorry, I
10:22 5 understand you, I sympathize with your situation and as a
6 person, I wish I could help. But because of the oath

7 that you took on July 31st, 1987, you say, "I have to
8 apply the law, and the law says creditors have rights,
9 too. The bankruptcy code won't allow me to do what you
10:22 10 want me to do and I have to follow the law." It's that
11 commitment to the law that the Governor acknowledged when
12 he wrote you that letter and filed that pleading. And
13 it's that commitment to the law that we ask you for
14 today.

10:22 15 As I said, I think there's several things
16 that get in the way of a court being able to give
17 Marathon, Marathon supporters, including the State of
18 California what they are asking for in this case. Those
19 three things are separateness, value, and the mill. With
10:23 20 regard to separateness, the Marathon plan is trying to
21 blend two separate and distinct cases, just as these two
22 counsel tables here where David Neier sits and I sit are
23 separate tables. They are not together. We talk to each
24 other, we joke with each other. Those tables aren't
10:23 25 together; Mr. Neier and I aren't together. We have a

AK/RET REPORTING, RECORDS & VIDEO, INC.

65

1 business relationship. We have a professional
2 relationship. We're not the same, we're not blended,
3 it's one not one table; it's two tables.
4 We say, as Mr. Neier alluded to you
10:23 5 earlier, that Marathon has no standing to that makes
6 Scopac to stay. And then Mr. Neier says, well, we didn't
7 object to the disclosure statement. Well, in the
8 disclosure statement here he said, everything that
9 happens in the disclosure statement is without prejudice
10:23 10 to any confirmation objection that we might have. And
11 our confirmation objection is they don't have standing to
12 do what they want to do.

13 Indeed the UCC, the Unsecured Creditors
14 Committee in their brief, before Mr. Neier's admission
10:24 15 this morning to the Court that they have no equity, the

16 committee pointed it out. Page 15, paragraph 31 in the
17 committee's brief they said, "because creditors (such as
18 the indenture trustee) are impaired under the
19 MRC/Marathon plan and receive only partial consideration
10:24 20 on account of their claims, there is no value remaining
21 for debtors equity interest." The whole premise of the
22 Marathon plan is that the timberlands, the commercial
23 timberlands, are worth \$430 million.

24 And as everybody talked about before me,
10:24 25 the claim of the noteholders are well over \$700 million,

AK/RET REPORTING, RECORDS & VIDEO, INC.

66

1 no matter what the lawsuit says. If there's any value
2 left in the commercial timberlands above the \$430
3 million, it belongs to the noteholders as creditors of
4 the Scopac case and not to Palco as the equity --
10:24 5 potential equity holders and not to Palco's creditor
6 Marathon. The attempt to force this Marathon plan on
7 Scopac and the noteholders is contrary to the law for
8 several reasons, contrary to the separateness principle
9 for several reasons.

10:25 10 First, the absolute priority rule prevents
11 that from happening. Nothing, not even control, should
12 go to equity if that's the claim that Marathon has as
13 Palco creditors, unless the indenture trustee and the
14 unsecured creditors in the Scopac case are paid in full.

10:25 15 Second, a plan orchestrates an illegal
16 substantive consolidation. You know, as well as I do,
17 and I think the Pension Benefit Guaranty Council tried to
18 allude to it a little bit earlier, case law with regard
19 to substantive consolidation is a lot different today
10:25 20 than it was in the '90s. In the '90s bankruptcy courts
21 substantively consolidated joint venture cases all the
22 time because that's what everybody wanted and no one
23 objected. And then the Owens-Corning case came along and
24 said, wait a minute, you have got to think about this.

10:25 25 You know, if you're going to prejudice somebody who got

AK/RET REPORTING, RECORDS & VIDEO, INC.

67

1 into this deal on the basis of separateness, you can't
2 always do it just willy-nilly. You have to think about
3 it and you have to carry every burden to show that
4 there's no prejudice. That line of thought is
10:26 5 underscored by the Fifth Circuit in the Wells Fargo
6 versus Sommers case that came out in 2006. It came out
7 of the Southern District of Texas from Judge Brown's
8 court where she had found subject to consolidate a couple
9 of cases before her. The cite is 444 Fed 3rd 690.

10:26 10 The third point is, and Mr. Neier has
11 already beat me to the punch on this, we believe the plan
12 deprives us of our right to credit bid. And yes, he's
13 right, this is not a prepetition presale, but one aspect
14 of 1129(B) is you can make this fit as the 3653(K) says
10:26 15 where we would have our lien obtained and our right to
16 credit bid.

17 In the Marathon plan, there's only one
18 bidder and there's only one price. And we don't have --
19 we're deprived of our right to credit bid. Not only do
10:26 20 they not give us a fair value for the collateral that
21 they're trying to buy from us, in effect, they're not
22 giving us the ability to keep our liens on the remaining
23 property, which is the Headwaters litigation. They're
24 asking us to share whatever proceeds are with other
10:27 25 creditors. And it may be a small amount, but they are

AK/RET REPORTING, RECORDS & VIDEO, INC.

68

1 taking the lien away and they're taking our collateral
2 away. That's deprivation of the rights that we would
3 otherwise be entitled to as a secured creditor.

4 Now I go back to value. This is the point

10:27 5 that Mr. Brilliant talked about. The committee says in
6 their papers that we had our chance to propose a viable
7 plan. Marathon says \$430 million is the value and that
8 our experts have changed their opinion based upon the
9 chart that he showed you with Mr. DiMauro's testimony,
10:27 10 even though prior testimony or opinions of value given by
11 Mr. DiMauro were given arguably in the dark without the
12 benefit of current meaningful information from the
13 debtors that was available at the time.

14 All the while, we've had continuing
10:27 15 expressions of interest. You recall the Nature
16 Conservancy in this court many times watching these
17 proceedings, and others, for amounts substantially in
18 excess of the MRC value.

19 If you look at what the witnesses are
10:28 20 going to tell you about value, the theoretical value the
21 witnesses are going to tell you, the debtors at the high
22 water mark at about \$943 million for the commercial
23 timberlands. MRC is at the bottom line, the low-ball
24 offer for \$430 million. Our experts, two of them, are in
10:28 25 the range of \$588 to \$622 million. As everybody has told

AK/RET REPORTING, RECORDS & VIDEO, INC.

69

1 you, we no longer have to talk about theoretical values.
2 We no longer have to concern ourselves or focus on this
3 low-ball value MRC is giving you. We have a
4 noncontingent hard offer from Scotia Redwood Foundation,
10:28 5 Incorporated and affiliated with the financial
6 corporation for \$603 million.

7 And I can hardly believe what I heard
8 Mr. Neier tell you, that for some reason that hard offer
9 of \$603 million is not worth \$603 million because of
10:29 10 motive. Like the proposal of the plan by Marathon isn't
11 predicated upon or driven by motive to recover the losses
12 that they're going to incur because of a very poor
13 business decision to make rescue lending to the Palco

14 debtor prepetition. The whole reason why they're here is
10:29 15 to recover the losses that they've incurred because of
16 the bad business decision they made to get involved.

17 And the only way to make their plan work
18 is to reach over to our table and take value from our
19 table and drag it across, just like you're dragging
10:29 20 something on a computer screen, to their table so that
21 they can recover a long-term basis some of their losses.
22 That's what's happening here.

23 We are bringing the Scopac estate \$173
24 million more dollars than MRC is bringing to the court
10:29 25 and to the estate. The real value is telling you why

AK/RET REPORTING, RECORDS & VIDEO, INC.

70

1 Marathon and MRC's \$430 million is not correct and why
2 you really don't even have to worry about all of this
3 theoretical stuff anymore because we have a hard offer
4 that's right in the middle.

10:30 5 The third point I want to talk to you
6 about is the mill. And the mill is really kind of an
7 interesting topic. And I know it's very important to the
8 Court and I know it's important to the estate. Marathon
9 and MRC have marketed its plan and they showed you the
10:30 10 list of all the people in California, from Trout
11 Unlimited to the Governor of California that are
12 interested in their plan and favor their plan.

13 And we've been talking to people in
14 California, too. They have marketed their plan to the
10:30 15 world as the only confirmable plan that provides for the
16 mill. They have conducted meetings in Humboldt County,
17 they have talked to people in Sacramento, they have
18 talked to the press, as we have, and they say that their
19 plan saves the mill and that the indenture trustee's plan
10:30 20 does not. In their words, Marathon and MRC say that
21 unless their plan is confirmed, the mill will shutdown
22 and all the jobs will be lost. That's what they're

23 telling people.

24 I woke up Sunday morning in Houston before

10:31 25 I drove down here to get ready for trial and I read the

AK/RET REPORTING, RECORDS & VIDEO, INC.

71

1 Houston Chronicle. And in the editorial section of the

2 paper was a political cartoon and it had a picture of the

3 Democratic presidential candidate with that candidate's

4 arm around a mule. The candidate had a gun in his hand

10:31 5 pointing at the mule and in fact the caption said "unless

6 I get my way, the mule gets shot." It's a joke, it's

7 satire. This is not a joking matter and this is not

8 satire and I don't mean to equate to it. But in effect,

9 Marathon is living out this cartoon with all of us by

10:31 10 saying unless it gets its way, unless its plan gets

11 confirmed it's going to kill the town and all those jobs.

12 But the result of that is it's not in

13 their best economic interest. The logic of an investor

14 would be to do everything possible to preserve the value

10:31 15 of its investment, albeit a bad one, in the town and in

16 the mill so that if something happens like you confirm

17 our plan, the indenture trustee's plan, we're not going

18 to close the mill down because the most logical customer

19 for the forest is that mill that's right next-door.

10:32 20 Because when the mill next-door buys logs from the forest

21 next-door, there's not as much transportation cost, and

22 the margin for profits are small.

23 So it doesn't make any sense economically,

24 financially for somebody to ship something way far off to

10:32 25 be milled into lumber and sold because the costs are low.

AK/RET REPORTING, RECORDS & VIDEO, INC.

72

1 So the almost symmetrical partners, logical partners are

2 the ones right together. So it makes sense for them to

3 keep the mill open and not let it go down in their own
4 economic interest.

10:32 5 We have every reason to believe that if
6 you confirm our plan that MRC will participate in the
7 sale process. The indenture trustee and noteholders
8 would welcome MRC's participation in such a sales
9 process. And assuming that a going concern lumber mill
10:33 10 is worth more than one that is shut down, why would the
11 senior secured creditor, Marathon, not preserve the value
12 of its investment. Neither the indenture trustee nor any
13 of the noteholders has any claim at the Palco level. We
14 have no standing to do anything in Palco.

10:33 15 So in the end, whatever happens to Palco
16 is up to no one other than Marathon. They have complete
17 economic control. As they've said, Maxxam has pretty
18 much backed out. They have complete authority and
19 complete responsibility to do whatever is necessary to
10:33 20 preserve the value of their investments and having to
21 preserve those jobs and preserving that town. If the
22 mill and town are shut down, it will always be Marathon's
23 choice and not the noteholders' choice. And the Court
24 should see this coercion for what it is.

10:33 25 Now let's talk a little bit more about

AK/RET REPORTING, RECORDS & VIDEO, INC.

73

1 some of the legal issues. I've already told you that
2 Marathon's plan must be crammed down on the noteholders.
3 To do so, the plan must be fair and equitable and it must
4 give us the due equivalent of our claims. We think, as I
10:33 5 told you, the plan deprives us of a right to credit bid
6 and is therefore not fair and equitable. It doesn't
7 comply with 363 and it doesn't comply with 1129(B).

8 The plan also deprives us of our liens on
9 the Headwaters litigation primarily and it does not give
10:34 10 us sufficient value. They told you in answer to your
11 questions they're going to give us some cash and some

12 notes. The notes have a negative amortization and a very
13 speculative conclusion in terms of whether or not we're
14 ever going to get to the end in terms of payments. And
10:34 15 we're also not real sure about what the starting point is
16 going to be on the amount of the note based upon their
17 ability to adjust the amount of the note for cash.
18 Because of the negative amortization and the
19 speculativeness, we think that the note and the plan that
10:34 20 proposes the note is not feasible.

21 We also think the plan violates Graystone
22 because it separately classifies our deficiency claim for
23 general unsecured and then it treats us much worse than
24 the general unsecured. It both discriminates unfairly of
10:34 25 a yes vote that they would not have gotten if we had been

AK/RET REPORTING, RECORDS & VIDEO, INC.

74

1 lumped together with the general unsecured creditors.
2 Their purpose for the separate classification is
3 improper, particularly when you recall this is not a
4 debtor plan, this is an interlobular plan. And that
10:35 5 interlobular plan takes everything from my client, the
6 indenture trustee and the noteholders' control, value and
7 property rights to favor the creditors in the Palco
8 estate. The plan effectuates substantive consolidation.

9 And another thing in regard to thinking
10:35 10 about what happens if you go forward with the Marathon
11 plan, because of the substantive consolidation issue,
12 because of the way these cases were structured and these
13 investments were made, particularly with regard to the
14 Scopac noteholders, a ruling in favor of Marathon could
10:35 15 impact the financial market's use towards granting credit
16 in similar circumstances. The Court needs to consider
17 the effect of such a ruling on the market.

18 Finally, as they alluded to in their
19 arguments, the plan risks violation of antitrust law.
10:35 20 I'm not talking about lumber now and I'm not talking

21 about what somebody makes their redwood deck out of.
22 It's a feasibility objection, number one. And number
23 two, it's an objection with regard to 1129(A)1 as to
24 whether or not the plan as proposed applies with the law
10:36 25 or runs the risk of running afoul of the law which is

AK/RET REPORTING, RECORDS & VIDEO, INC.

75

1 distant second. We're talking about section 7, and the
2 reason why we raise this is because the combination of
3 Scopac and MRC, the forest, Scopac, MRC, would combine
4 the second and third largest owners of redwood in the
10:36 5 United States and evolve it into the largest holder of
6 redwood forest in the United States. And we think that
7 such a combination creates a substantial risk that the
8 Federal Trade Commission and the Department of Justice
9 will seek to enjoin such transfer. Those are the reasons
10:36 10 why the Marathon plan is not confirmable and should not
11 be confirmed over our objection.

12 Let's talk about the debtors' plans for a
13 little bit. We currently have pending before you a
14 motion to deny confirmation of the joint plan because it
10:37 15 cannot be crammed out. It still cannot be crammed out.
16 Nothing has changed, nothing is different. We've been
17 waiting. Mr. Neier brought it up. We feel the same way.
18 We agree.

19 Our motion also asks that you deny
10:37 20 confirmation of the Palco alternative plan because it
21 fails to satisfy 1129(B)10. They have not gotten the
22 affirmative vote of any impaired class; and therefore it
23 cannot go forward for confirmation. We reurge our motion
24 with regard to both of those plans at this time.

10:37 25 The remaining plan by the debtors is the

AK/RET REPORTING, RECORDS & VIDEO, INC.

76

1 Scopac alternative plan. In this plan they also have to
2 cram down the indenture trustee noteholders. This plan
3 proposed by the debtors is a partial dirt for debt plan.
4 As you know, partial dirt for debt cases indicate that
10:37 5 these situations deserve the utmost judicial scrutiny and
6 discretion and caution based on the inherent risk of
7 theoretically battling land for the purpose of
8 transferring only part of the collateral incurred for the
9 satisfaction of the entire debt.

10:38 10 All of these cases balance in whether --
11 I'm talking about Scopac plan or whether I'm talking
12 about Marathon's plan, you need to look as the judge at
13 what the noteholders have now and the risks associated
14 and the value associated with collection now. Contrasted
10:38 15 with what somebody wants to give you, whether it's a
16 substitution of different collateral or whether it's part
17 of the collateral or it's notes and cash, whatever it is,
18 and that's the substitution part. And you need to weigh
19 not only the value of what's being switched out, but what
10:38 20 the relative risk is of collection of what's being
21 switched out.

22 It doesn't take a lot of math to figure
23 out that if somebody gives us arguably three quarters of
24 what we are entitled to for the whole debt, that there's
10:38 25 a lot more risk associated with that than it would be if

AK/RET REPORTING, RECORDS & VIDEO, INC.

77

1 we had the whole thing.
2 By the same token, reflecting on
3 Marathon's plan, a speculatively repayable note is not
4 the whole value of the forest that we otherwise would
10:39 5 have had initially. Such a transfer -- going back to
6 Scopac -- for a part of the collateral does not give the
7 equivalence of rights the noteholders currently enjoy.
8 For that reason, it's impermissible and the plan is not
9 confirmable. My point is more clearly made by the spread

10:39 10 of values given by the parties that you'll hear from the
11 witnesses, debtors 943, the low-ball value of 430 by MRC,
12 and our value is in the middle and the hard bid made by
13 the financial corporation affiliate.

14 After all this time we have two hard
10:39 15 offers; one low one and one of 603 that just came in
16 yesterday. And we're still \$350 million off of the
17 debtors' theoretical value of what they think all of this
18 property is worth. Why this incredibly high value being
19 propounded by the debtors? We say, and have always told
10:39 20 you, that we think that they're breaching a fiduciary
21 duty to us. We continue to believe that they're
22 breaching their fiduciary duty to us.

23 The value for the timberlands is off the
24 chart and unreasonable. And we think it's clear evidence
10:40 25 that the real value of the forest is in the neighborhood,

AK/RET REPORTING, RECORDS & VIDEO, INC.

78

1 furnished by our experts, somewhere around 600 and the
2 hard bid that's being brought to you by one of the
3 noteholders.

4 The risk inherent in the Scopac
10:40 5 alternative plan, it's too speculative for us and it
6 should be too speculative for you. So we're down to
7 three plans now, hopefully: The debtors' plan, the
8 Marathon plan and our plan. The debtors' Scopac plan is
9 predicated on these absurdly high values and offers
10:40 10 nothing, not even cooperation, not even a sales process
11 for purposes of trying to take care of the Palco mill.
12 Our plan offers timber to supply the mill and cooperation
13 with regard to a sales process to the extent that MRC or
14 Marathon or both want to participate in our sales
10:40 15 process.

16 The Marathon plan inappropriately offers
17 small value, but it does deal with Palco and at the cost
18 of hundreds of millions of dollars to the noteholders.

19 And it has the added burden of legal impediments that
10:41 20 cannot be ignored and we say cannot be overcome. It's
21 interesting to note that the Marathon brief describes the
22 value which is with regard to the IT plan. I'm referring
23 to page 69, paragraph 146 of their brief. Most of the
24 things that they discuss have either been achieved or
10:41 25 within reach of being achieved. Number one, and I quote,

AK/RET REPORTING, RECORDS & VIDEO, INC.

79

1 "indenture trustees proposed the auction process does not
2 require a league bidder." We have a bidder. We have a
3 hard bidder now that could be a league bidder in the end.
4 Number two, "the auction process does not set a price
10:41 5 beyond which the indenture trustee will agree to refrain
6 from placing the credit in." The offer that you will see
7 that we will place in evidence will say that that league
8 bidder will agree not to exceed its bid, to stand pat on
9 its cash bid and not credit its holders.

10:41 10 And third, "the IT plan has no provision
11 for funding operations during market." I think our plan
12 already says that. I think our plan has provision for
13 the plan agent to borrow money with the help and
14 assistance of several of the large noteholders to make it
10:42 15 through the gap here, whether it's to pay off priority
16 creditors or administrative creditors or even Bank of
17 America at some point.

18 Clearly when you read that brief, you can
19 sense from the way they speak about our plan that MRC
10:42 20 wants to participate in indenture trustee's sales process
21 if their plan is not confirmed. We ask the Court to let
22 this process happen under our plan because we believe
23 that Marathon will keep its word to California and do the
24 right thing to keep the mill open, even if its plan
10:42 25 doesn't get confirmed.

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 In conclusion, I thank the Court for its
2 time, for its attention. I'm going to turn the podium
3 over briefly now to my partner, Richard Krumholz, who
4 will briefly address the Court on our pending trustee
10:43 5 motion. Thank you, Judge.

6 MR. KRUMHOLZ: Thank you, Your Honor. I
7 will try to keep this brief.

8 THE COURT: Do you want us to turn off the
9 Elmo?

10:43 10 MR. KRUMHOLZ: Sure. Your Honor, as
11 Mr. Greendyke has told you, we believe that the only plan
12 that satisfies the confirmation -- that's been -- that
13 satisfies the standards for confirmation under section
14 1129 of the bankruptcy code is the one submitted by the
10:43 15 indenture trustee. We are confident that the evidence
16 that you will hear will lead to no other conclusion,
17 frankly.

18 Now, with that said, if the Court denies
19 confirmation, we believe that the evidence will
10:43 20 overwhelmingly establish that a trustee should appoint
21 pursuant to the indenture trustee's motion to appoint a
22 trustee. That's for two purposes obviously, to preserve
23 the value of the debtors' assets for the benefit of the
24 debtors' creditors and to prevent the continued
10:44 25 deterioration and impairment of the timber noteholders'

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 collateral, a collateral interest in which only they
2 hold.

3 Now, I mentioned a moment ago that the
4 evidence will be overwhelming. What have we done in that
10:44 5 regard over the last few weeks to develop this evidence?
6 And this is important because if the Court chooses not to
7 confirm any of the plans before you, despite obviously

8 our contention that the IT plan should be confirmed, then
9 it must know that the record will be replete for purposes
10:44 10 of appeal or otherwise, that a trustee was appropriate
11 and proper in this circumstance.

12 And I would suggest to you that this is
13 exactly the kind of case that courts routinely refer to
14 trustees. Why? Because the irreversible and undeniable
10:45 15 conflicts of interest that exist and because management
16 has shown themselves, by their own admission, to be
17 unqualified to monitor and manage the assets that are at
18 issue in these cases.

19 So what evidence am I talking about?
10:45 20 These Palco and Scopac have the same CEO, have the same
21 CFO, have the same general counsel, and for the most
22 relevant periods during this case, had the same vice
23 president. Despite these conflicts, they had substantial
24 transactions between the companies. Now, normally there
10:45 25 would be processes put into place to assure that those

AK/RET REPORTING, RECORDS & VIDEO, INC.

82

1 kinds of conflicts do not lead to the very results that
2 we've seen here. But unfortunately, what we have learned
3 is that the independent managers that were supposedly the
4 back stop, so to speak, in connection with all of these
10:45 5 conflicts of interest, were not provided the very basic
6 and critical information that they needed in order to
7 make wise decisions on behalf of Scopac. As a result,
8 and pursuant to the wealth of the case law that supports
9 the appointment of trustee in these circumstances, that
10:46 10 alone provides the Court with reason enough to appoint a
11 trustee.

12 Also, it doesn't stop there. As Mr. Neier
13 indicated, there's no question, I don't believe, and it's
14 certainly been admitted to in deposition that the
10:46 15 officers of Scopac and Palco have failed each and every
16 week, each and every month, each and every quarter, to

17 provide meaningful projections of what those businesses
18 would do in terms of cash flow, in terms of revenue and
19 otherwise.

10:46 20 And as Mr. O'Brien, the CEO testified not
21 long ago, the lack of reliable projections is a signal,
22 it demonstrates the lack of control and the lack of
23 understanding of the business on the part of management.
24 And that's how you measure management according to
10:47 25 Mr. O'Brien, the CEO of both of these companies. So

AK/RET REPORTING, RECORDS & VIDEO, INC.

83

1 under the case law, Judge, this is exactly the classic
2 situation in which a trustee should be appointed.

3 Now, at the pretrial, the Court was urged
4 to deny confirmation of the debtors' alternative plan.
10:47 5 Nothing has changed in terms of that plan. The evidence
6 at this hearing will establish that none of the debtors
7 plans is confirmable. But to the extent that none of
8 those plans is confirmable, there's no question that at
9 this stage in the case, we must have the appointment of
10:47 10 the trustee.

11 Now, one of counsel asked a question, how
12 is this going to be paid for? And those -- the money has
13 already been committed to in connection with the IT plan,
14 and certainly that is something that is expected under
10:47 15 any sort of trustee motion.

16 So with that context, Your Honor, in the
17 alternative to confirming the IT plan, we would request
18 that the motion for a trustee be granted in all respects.

19 THE COURT: All right.

10:48 20 MR. DOREN: Good morning, Your Honor.
21 Richard Doren on behalf of Scotia Pacific, L.L.C. In a
22 letter dated to this Court last week, Governor Arnold
23 Schwarzenegger wrote, "The California's majestic redwood
24 forests are among its most precious natural assets.
10:48 25 Historian Kevin Starr once said that "the redwood tree

1 could almost stand alone as a symbol of California found
2 and lost, lost and found." And as someone born and
3 raised in Northern California, I can confirm the place in
4 the hearts of all Californians that these trees hold,
10:49 5 both because of their natural beauty and because of their
6 place in the state's history and the state's economy.

7 We are here today to determine the future
8 of a rare asset, 210,000 acres of redwood timberland.
9 The creditors do not just want the payment of their
10:49 10 debts, they want control of the timberlands. And that
11 speaks volumes about the unique and precious asset we are
12 discussing. The plans advanced by Marathon, the New York
13 hedge fund and Mendocino Redwood Company, run by an
14 investment banker, and the professional bond investors
10:49 15 who own the timber notes do exactly what you would expect
16 such shrewd investors to do, they seek to make outside
17 gains with as small an investment as possible. But they
18 both do this by assigning tailored and unjustified low
19 values to Scopac's assets.

10:50 20 Your Honor, this morning I would like to
21 address the evidence from three perspectives. First, I
22 would like to talk about the timberlands themselves and
23 the history that brings us here today. Second, I will
24 address the creditors' competing plans and the evidence
10:50 25 addressing their confirmability. And third, I will

1 discuss Scopac's plan and the evidence that establishes
2 its confirmability. And ultimately, the evidence will
3 show that while imperfect, it is Scopac's plan that
4 should be confirmed by this Court.

10:50 5 Now, before turning to the body of my

6 argument, I just want to take a moment to comment on
7 Mr. Krumholz's argument regarding the trustee motion. It
8 should be pointed out, Your Honor, that the independent
9 managers had 47 meetings in the year 2007, virtually
10:50 10 every week, sometimes twice a week, sometimes twice a
11 day. They had the advice of counsel, counsel brought to
12 the extent there were serious administrative or financial
13 issues between Palco and Scopac. The evidence will show
14 that they were brought to the independent managers. And
10:51 15 on a day-to-day basis it will be seen that the management
16 teams of Scopac and Palco worked together to work through
17 the operational issues between the two entities.

18 At the end of the day, Your Honor, in the
19 original indenture, the bond holders were well informed
10:51 20 and accepted the fact that people would be wearing two
21 hats within Scopac and Palco, and the independence of the
22 two entities has been respective. Let's turn now to
23 point one.

24 Pacific Lumber Company has been in
10:51 25 business continually since the 1860's. Until late in the

AK/RET REPORTING, RECORDS & VIDEO, INC.

86

1 last century timber harvesting in California was
2 essentially unregulated. The historic photos of loggers
3 on giant stumps on denuded hillsides are from the earlier
4 era. Regulation began in 1972 and increased over the
10:52 5 next several decades. And by the late 1980s, Palco was
6 the only timber company left in Northern California with
7 significant old growth redwood. And as a result, it
8 became a target of environmental activists and regulators
9 who sought to preserve the old redwood trees.

10:52 10 The evidence will show that by the 1990s
11 Palco was so tied up in regulatory red tape that it was
12 effectively barred from harvesting its own land,
13 including the Headwaters forest. Because of this, Palco
14 had to sue the state and the federal governments to

10:52 15 regain its ability to do business. In 1996, Palco
16 reached a global resolution with the state and federal
17 governments through what we know as the Headwaters
18 agreement. And the transactions set out in the
19 Headwaters agreement were completed in March 1999.

10:52 20 Now, as part of the Headwaters agreement,
21 the state and federal governments purchased several
22 tracts of land from Palco. And Scopac agreed the
23 concrete steps to protect the environment and to ensure
24 the healthy, productive and sustainable uses of its
10:53 25 forests. Scopac agreed to a 50-year habitat conservation

AK/RET REPORTING, RECORDS & VIDEO, INC.

87

1 plan. To this day it is the most comprehensive and far
2 reaching HCP in the timber industry.

3 It provides for environmental monitoring,
4 it provides for erosion control programs, and it sets
10:53 5 forth specific guidance for harvesting practices as well
6 as protecting the habitats for rare and endangered
7 species, species including the coho salmon, the northern
8 spotted owls and the marbled murrelets the Court has
9 heard so much about over the last year and some months.

10:53 10 And Scopac has taken its obligations under the HCP to
11 heart. The company has 65 employees, many of whom are
12 scientists and other professionals who were drawn to
13 Scopac specifically to be a part of implementing this
14 historic agreement.

10:54 15 Now, as part of the HCP, Scopac agreed to
16 protect about 66 -- or 6640 acres. On this map you can
17 see them outlined in green. These acres contain
18 thousands of acres of virgin and old growth redwood.
19 These areas have become known as the Marbled Murrelet
10:54 20 Conservation Areas or MMCAs. Now, Scopac's harvesting
21 methods today are made of thinnings, selective harvests
22 and clearcuts. But the clearcuts are not like those at
23 the turn of the century. They are smaller areas, they

24 are subject to strict environmental controls and the HCP
10:54 25 requires a variety of trees to be left in place for

AK/RET REPORTING, RECORDS & VIDEO, INC.

88

1 habitat and for regeneration.
2 These clearcuts qualify as variable
3 retention harvests under state regulations. Now, this is
4 not to say, Your Honor, that there have not been issues
10:55 5 since 1999. It took Scopac time to implement its
6 processes under the HCP, and more fundamentally, as you
7 will hear in the testimony, the Regional Water Quality
8 Control Board has imposed restrictions over and above
9 those in the Headwaters agreement. It is the position of
10:55 10 Scopac and Palco that those constitute breaches of the
11 Headwaters agreement and they have brought suit against
12 the state agencies to recover the damages that result
13 from lost harvests.

14 That is one of the assets of the Scopac
10:55 15 estate. Nonetheless, Scopac continues to work with the
16 Regional Quality -- Regional Water Quality Control Board
17 on a day-to-day basis and has succeeded in freeing up
18 thousands of additional acres through watershed analysis
19 for harvest.

10:55 20 At the end of the day, the Headwaters
21 agreement and the HCP should work from Scopac's
22 perspective to actually improve the business and improve
23 foreseeability. When properly implemented, the
24 agreements benefit the company by providing a structure
10:56 25 to work within and a defined regulatory framework for

AK/RET REPORTING, RECORDS & VIDEO, INC.

89

1 decades to come.
2 Now, where do the noteholders fit into
3 this sequence of events? Well, the noteholders took

4 their notes six months before the HCP closed in 1999,
10:56 5 fully understanding the completion of the HCP was
6 imminent and that the terms were being finalized. And of
7 course, many of those bonds have changed hands since with
8 the investors knowing full well about these agreements
9 involving the property.

10:56 10 Now, since the bonds were issued, Scopac
11 has had to harvest enough timber to generate enough cash
12 to make interest payments to the noteholders. This came
13 to mean that Scopac had to harvest trees uneconomically,
14 using expensive methods such as helicopter logging. And
10:57 15 by January 2007, Scopac could no longer cut enough trees
16 to make the payments and it filed for bankruptcy
17 protection.

18 It has been said that crisis equals
19 opportunity. And for Scopac, there is no doubt that this
10:57 20 is a crisis. It is also clear, though, that the
21 noteholders in Marathon see it as an opportunity. So let
22 me take a few minutes to turn to point two and discuss
23 the competing plans. And let's start with the creditors,
24 with Marathon's plan.

10:57 25 Marathon has no claim against Scopac but

AK/RET REPORTING, RECORDS & VIDEO, INC.

90

1 it does have a plan to take the timberlands. And
2 Marathon and its co-plan proponent, Mendocino Redwood
3 Company, have done a nice job of building a public
4 relations tailwind behind their plan. And the Court has
10:57 5 received several statements in support of it, including
6 that from Governor Schwarzenegger. The Court may even
7 hear testimony this week from some Scopac employees
8 saying that they too wish there could be a plan that kept
9 the mill and the forest together.

10:58 10 And there is no doubt that in a perfect
11 world, the mill and the timberlands would be kept
12 together. And that's why Scopac and Palco put a joint

13 consensual plan before this Court that would do exactly
14 that. But just as Scopac's consensual plan cannot be
10:58 15 crammed down on creditors, neither can Marathon's plan be
16 crammed down on Scopac, Palco or anyone else in this
17 courtroom.

18 The consideration proposed by Marathon for
19 the sale of all assets of Scopac and Palco is not fair
10:58 20 and it is not reasonable. Marathon and MRC are paying at
21 most, at most, \$387 million; \$225 million in cash and
22 \$162 million in claims, which we heard Mr. Neier say
23 today was actually \$135. In exchange, they receive a
24 value well in excess of \$1 billion. Moreover, the \$1
10:59 25 billion in value does not include any of the items that

AK/RET REPORTING, RECORDS & VIDEO, INC.

91

1 this Court has heard debated for the last six months. It
2 doesn't include the MMCAs, it doesn't include the Redwood
3 Preserve Community potential and it doesn't include the
4 Headwaters litigation.

10:59 5 Evidence will be presented that even if
6 this Court were to set aside the possibility of a
7 preserve development, even if this Court were to leave
8 out the MMCAs and even if this Court were to ignore the
9 value of the lawsuit against the State of California, the
10:59 10 Scopac timberlands alone have a value of \$943 million.
11 Add to that the value of the mill and the town assets,
12 and as they stand in Scotia today, without further
13 investment or modification, the assets of the debtors
14 well exceed \$1 billion.

10:59 15 Now, Marathon cannot be permitted to walk
16 away with that value for \$225 million in cash and \$135
17 million in claims. Now, where does this \$1 billion
18 valuation come from? You've already heard some
19 discussion about it, so let's talk about it.

11:00 20 The debtors will present evidence from
21 three experts, Dr. Iles, Dr. Reimer and Mr. Yerges from

22 KPMG. These three independent experts combine forces to
23 determine the fair market value of the Scopac
24 timberlands. Every valuation expert that takes the stand
11:00 25 will tell you that the cornerstone of an accurate

AK/RET REPORTING, RECORDS & VIDEO, INC.

92

1 valuation is an accurate timber inventory. Now, in 2001,
2 Scopac updated its inventory through timber cruisers at
3 12,000 different locations throughout the property. Each
4 year since it has updated its inventory based on harvest
11:00 5 and growth. Now, usually an appraiser will take that
6 inventory and simply make their appraisal, as several did
7 in this case.

8 But Scopac went several steps further.
9 Scopac brought in Dr. Iles, a renowned biometrician who
11:01 10 has performed and validated timber inventories all over
11 the world. And Scopac asked him to design a process to
12 check that inventory. The evidence will show that
13 Dr. Iles designed a test to identify 96 statistically
14 significant different sites throughout the property. He
11:01 15 sent timber cruisers out into the woods to take
16 measurements in each of those areas. And then he sent a
17 second group of check cruisers out to a subset of those
18 areas to recheck the data.

19 Still not satisfied, he then went back
11:01 20 into the woods with his team, cut down 250 trees and
21 actually checked the trees themselves against the
22 measurements on the ground against the measurements that
23 they took while the trees were standing. And Dr. Iles
24 found that Scopac's timber inventory was not only
11:02 25 accurate, but conservative by 2.4 percent.

AK/RET REPORTING, RECORDS & VIDEO, INC.

93

1 Now, at this point Dr. Reimer came in.

2 Dr. Reimer has spent over 35 years modeling timber
3 harvests on hundreds of millions of acres throughout the
4 world. Over the last 24 years Dr. Reimer has developed
11:02 5 and refined a spacial deterministic model which is an
6 important form model, Your Honor, that we're going to
7 hear a lot about in this trial, that has been licensed by
8 state agencies and some of the largest timber companies
9 in the world for their work in projecting harvests.

11:02 10 And Dr. Reimer's model, above all, is
11 unequally suited to Scopac's property because while most
12 models involve what is called a linear mathematical
13 process, Dr. Reimer's had the ability to examine the
14 property spatially. In other words, Dr. Reimer's model
11:03 15 can evaluate the relationships between different plots,
16 their ages, their species, the rate at which each plot is
17 growing and the relevant cause of harvest for a
18 particular plot given their grade or their age. And
19 Dr. Reimer's model takes into account all of the
11:03 20 regulatory restrictions and constraints that you will
21 hear about, including owl circles, including screen
22 buffers and every other nuance of harvesting restriction,
23 including the Regional Water Quality Control Board
24 limitations.

11:03 25 And using that model and the validated

AK/RET REPORTING, RECORDS & VIDEO, INC.

94

1 timber inventory, Dr. Iles projected a sustainable
2 harvest that maximizes net cash flow over the next 50
3 years. And make no mistake, this is the test Dr. Reimer
4 used. He performed over 200 different scenarios to find
11:03 5 the right kind of combination of harvests to create a
6 sustainable and profitable forest, one in which stands
7 are harvested at times and with methods that are
8 appropriate and that makes sense given the volume and the
9 value of the trees involved. And most importantly, at
11:04 10 levels that will sustain the forest over the long-term.

11 Now, Mr. Yerges at KPMG coordinated
12 closely with Dr. Reimer as he did those harvest
13 calculations. Mr. Yerges is a valuation specialist who
14 has spent decades valuing the complex assets, including
11:04 15 timberlands. Mr. Yerges took Dr. Reimer's projections
16 and performed a discounted cash flow analysis. Now, in
17 doing so, Mr. Yerges sought out all potentially relevant
18 information. The evidence will show that in
19 establishing, for example, his discount rate, he
11:04 20 evaluated the weighted average cost of capital in forest
21 product companies generally. He looked to the returns on
22 timber rates. He looked to investor survey results from
23 TEMO's and he looked at the internal rates of return on
24 comparable transactions. And from that he established
11:05 25 his discount rate after taking into account the

AK/RET REPORTING, RECORDS & VIDEO, INC.

95

1 particular circumstances of the property at issue.
2 In evaluating pricing, he looked at
3 publicly available pricing data from the California State
4 Board of Equalization, the same price data that's used in
11:05 5 sales between transactions between Scopac and Palco. And
6 that data shows that over the last 33 years, there has
7 been average real growth in redwood pricing. In short,
8 Mr. Yerges searched out each potentially relevant piece
9 of data and plugged it into his formula. He also
11:05 10 conducted a comparable sales analysis to double-check the
11 validity of his discounted cash flow. And with all these
12 factors in place, Mr. Yerges concluded that the
13 timberlands as a whole, without the MMCAs and setting
14 aside nothing for a potential preserved community are
11:05 15 worth \$943 million. And if 21,700 acres were set aside
16 for a redwood preserved property, the value would still
17 be \$856 million.
18 Now, how does Marathon avoid this, the gap
19 between their offer price and this valuation? Well, they

11:06 20 have an expert, too, named Mr. Lamont who runs his own
21 calculation. He was asked to do that earlier this year
22 and he generated in two months time what it took
23 Mr. Yerges months to do. And Mr. Lamont came up with a
24 value of \$430 million, less than half of the value of
11:06 25 Scopac's valuation team, and that included the MMCAs.

AK/RET REPORTING, RECORDS & VIDEO, INC.

96

1 Now, Mr. Lamont has been working as Marathon's consultant
2 in 2007. When Mendocino Redwoods came in in December
3 2007, they gave Mr. Lamont their model for valuation of
4 the Scopac lands.

11:06 5 In January 2008, Mr. Lamont changed hats
6 and became an independent third-party expert, asked for
7 the first time to value the property. And based on his
8 valuation, Marathon and MRC would walk away, lock, stock
9 and barrel, with all of Scopac and all of Palco for \$387
11:07 10 million. His value, by the way, is within a few million
11 dollars of the value that Mr. Dean tells the Court it
12 should apply the forest.

13 So where does the difference come from in
14 terms of means of calculation? Well, Mr. Lamont
11:07 15 concludes that a reasonable purchaser would harvest at a
16 level substantially below what Dr. Reimer's conservative
17 projections estimate. And in reaching that conclusion
18 Mr. Lamont essentially adopted MRC's model and MRC's
19 suggested harvest levels.

11:07 20 Next, he used depressed pricing data as
21 his baseline for redwood pricing and then projected out
22 zero growth into perpetuity, despite the fact that there
23 has been actual real growth over the last 33 years.

24 And finally, in establishing his discount
11:08 25 rate, he agreed that based on recent transactions in the

AK/RET REPORTING, RECORDS & VIDEO, INC.

97

1 northwest a rate of 6 percent may be appropriate, but
2 then he added a full percent to that because the property
3 is located in California. Again, as did Mr. Dean. Now,
4 the evidence will show that Marathon's valuation of the
11:08 5 timberlands is indefensibly low.

6 Let's turn now to the noteholders' plan.
7 The noteholders' plan addresses only Scopac and it does
8 so by immediately putting all of Scopac's assets up for
9 auction. The noteholders will credit bid the current
11:08 10 value of their notes, roughly \$800 million, and their
11 intention is to take the forest. Now, what value did
12 they attribute to the timberlands? Well, the evidence
13 will show, Your Honor, that it depends on when you talk
14 to them.

11:09 15 When this case was filed, the noteholders
16 took the position that they were over secured. Last fall
17 before Marathon and MRC had joined forces, Mr. DiMauro of
18 Houlihan Lokey testified that the value of Scopac's
19 productive timberlands was in a range of either \$290 to
11:09 20 \$375 million or \$375 to \$460 million, depending on your
21 assumptions.

22 Now, unfortunately, Mr. DiMauro is
23 otherwise occupied and won't be joining us for trial, but
24 we will be hearing some of his colleagues at Houlihan
11:09 25 Lokey explain the difference between the position then

AK/RET REPORTING, RECORDS & VIDEO, INC.

98

1 and the position now.
2 Now, in January 2008 Marathon came forward
3 with its plan to pay the noteholders \$500 million; \$175
4 million in cash and notes with a face value of \$325
11:09 5 million. So in January, the noteholders announced that
6 they had offer letters from three bidders that set a
7 floor value for Scopac's assets of \$603 million. And of
8 course, since that's an opening offer we can only assume

9 it's a floor and the price can only go up from there.

11:10 10 The noteholders then brought in
11 Mr. Fleming to value the timberlands. Mr. Fleming has
12 been valuing timberlands since the 1970's and he uses an
13 Excel spreadsheet. He chooses to use a ten-year
14 projection period rather than a 50-year projection period
11:10 15 that other experts in this case will use, and he applies
16 a discount rate of some 9 percent. And at this point
17 Mr. Fleming came forward with his opinion that the value
18 of the timberlands was about \$605 million.

19 And so today the noteholders present the
11:10 20 Court with a value that is higher than the amount offered
21 them by Marathon but still low enough that they can
22 capture the entire property through a credit bid with the
23 value of their notes. It is the perfect Goldilocks
24 valuation. The evidence will show that neither the value
11:11 25 offered by Marathon, nor the various values offered by

AK/RET REPORTING, RECORDS & VIDEO, INC.

99

1 the noteholders is accurate or credible.

2 Let's turn now to Scopac's proposed plan
3 for reorganization. As the debtor with a fiduciary
4 responsibility to maximize value for both creditors and
11:11 5 equity, Scopac went out and hired independent experts and
6 asked them to help the company maximize the value of its
7 assets for all stakeholders. We've already talked about
8 the team that valued the timberlands. There are three
9 other elements of value that we should touch upon.

11:11 10 First, the MMCAs. Dr. Bill Mundy is an
11 economist who has worked in and around timberlands and
12 other rural properties for decades. Dr. Mundy assisted
13 Scopac in two represents. First, he looked at the MMCAs,
14 the marbled murrelet conservation areas, and offered
11:12 15 suggestions on the best way to obtain full value for
16 those precious acres. The Court will recall that the
17 MMCAs are made of six areas totalling 6640 acres. The

18 evidence will show that the these acres contain the
19 greatest remaining concentration of old growth redwood in
11:12 20 private ownership anywhere in the world.

21 They're home to a variety of rare and
22 endangered species and are protected from any significant
23 commercial harvesting until the HCP expires in 42 years.
24 Dr. Mundy equates them to the natural equivalent of a
11:12 25 Rembrandt or a Monet. And we know that the State of

AK/RET REPORTING, RECORDS & VIDEO, INC.

100

1 California and Governor Arnold Schwarzenegger do as well.
2 Dr. Mundy has looked at significant preservation
3 purchases throughout the country and throughout
4 California. And you'll hear other witnesses testify that
11:12 5 there is a robust conservation market in California. And
6 Dr. Mundy will testify that the MMCAs have significant
7 value.

8 Dr. Mundy reviewed other recent sales of
9 California ancient and old growth redwood which, as you
11:13 10 would expect, several of which were part of the
11 Headwaters transaction. And he concluded that as
12 conservation properties, the MMCAs have a value of
13 \$60,000 an acre, and that this price can likely be
14 achieved within a few years with a sale to the state or
11:13 15 federal government, a foundation or wealthy individuals
16 anxious to assure the preservation of these natural
17 wonders.

18 Now, neither the noteholders or Marathon
19 attach any real value to the MMCAs. The noteholders
11:13 20 value them as harvestable timber, just timber you can't
21 harvest for 42 years. So in their projection, they
22 assume they will be cutting them in 42 years. They
23 discount it back and they assign a value to the entire
24 6600 acres of about \$16 million. Mr. Lamont simply threw
11:13 25 them in to his harvest forecast, assigned them a no cut

1 designation and so they barely make a ripple.
2 Let's turn now to the redwood preserve,
3 the second element of value we haven't discussed. In
4 addition to the MMCAs, Dr. Mundy also suggested the
11:14 5 consideration of a preservation community. Your Honor
6 may recall that the development of -- the possibility of
7 a development was discussed in the first plan submission
8 in September when in its roughest conceptual stage it was
9 described as 160-acre ranches throughout a 21,000 acre
11:14 10 area of the property. That caused quite a stir in the
11 county and we heard them.

12 And Dr. Mundy brought in Keith Gurnee, a
13 land planner who specializes in conservation
14 developments. Mr. Gurnee has worked throughout
11:14 15 California, including in and around Humboldt County for
16 over 30 years. He has completed many projects in
17 Humboldt County including those involving rezoning of
18 forest lands and he currently has projects ongoing for
19 the city of Eureka.

11:15 20 Now, the light isn't great, but this is
21 the concept that Mr. Gurnee and Dr. Mundy have developed.
22 The idea would be that there could be two clusters of
23 homes in two areas in the property that take up about 500
24 of the 21,700 acres. The balance of the property would
11:15 25 be left and managed -- in timber management for the

1 owners of these parcels. They would have an undivided
2 interest in the remaining property.
3 In this way, something like 98 percent of
4 the property remains in timberlands, satisfying the
11:15 5 county's desire to have the lands of Humboldt County
6 remain in timber management and to keep the fiber basket,

7 as they call it, in place, while still unlocking the
8 higher and better use and the greater value of these
9 areas on the edge of the properties adjacent to towns.

11:16 10 Now, obviously this is a concept and this
11 project is still subject to much discussion with the
12 county. It would require amendments to the HCP. But
13 based on its decades of work in Humboldt County, and as
14 many projects involving areas of endangered species
11:16 15 throughout the State of California, Mr. Gurnee believes
16 that this project has a good chance of ultimately being
17 approved and Dr. Mundy believes that such a project would
18 have great value.

19 Dr. Mundy believes that 133 home sites in
11:16 20 this rare environment could sell for \$5 million each. If
21 one of the MMCAs were included, the price point would
22 rise to \$6 million. The total net cash flow predicted by
23 Dr. Mundy for these projects would be about \$970 million
24 over the next nine years.

11:17 25 Here again, neither the noteholders nor

AK/RET REPORTING, RECORDS & VIDEO, INC.

103

1 Marathon place much value, at least publicly, in the
2 possibility of this project. The noteholders offer
3 Mr. Kieser to tell us no one with \$5 million would want
4 to have a home amongst the redwoods. I believe he said
11:17 5 something about them being thrice cut, weed infested,
6 steep slopes that no one would want to be near. Well,
7 Mr. Kieser went out in a helicopter and looked over the
8 entire timberland. Mr. Mundy took these photos from
9 within the constraints and from the ground of what would
11:17 10 be the development land. You can see the Pacific Ocean
11 out here and the Eel River coming out. Needless to say,
12 both the noteholders and Marathon present plans which
13 give them both the MMCAs and the 21,700 acres as part of
14 the assets they take.

11:17 15 As we mentioned previously, there is

16 currently litigation pending between Scopac and various
17 state agencies related to the Headwaters agreement.
18 Mr. Lungston from FTI will present testimony estimating
19 the damages caused to Scopac and Palco jointly at over
11:18 20 \$600 million, and the damage to Scopac individually being
21 in excess of \$300 million. Both the noteholders and
22 Marathon want to take this litigation through their
23 reorganization plans.

24 Your Honor, let's take a moment to touch
11:18 25 on the joint consensual plan proposed by debtors.

AK/RET REPORTING, RECORDS & VIDEO, INC.

104

1 Included in the disclosure statement is the joint
2 consensual plan through which Scopac and Palco propose
3 that the noteholders share in the timberlands, the MMCAs,
4 the proposed development and the lawsuit through a 49
11:18 5 percent interest in a new jointly owned entity. The
6 noteholders rejected this offer and instead asked this
7 Court to confirm a plan that would give them all of
8 Scopac's assets for an \$800 million credit bid.

9 Scopac, however, has a fiduciary duty to
11:19 10 equity as well as its creditors and it cannot stand by
11 and let its assets be taken in violation of the absolute
12 priority rule. Therefore, Scopac proposes a plan which
13 provides the noteholders with 90 percent of the
14 timberland, which Mr. Yerges values at \$856 million, a
11:19 15 value that in and of itself provides the noteholders with
16 a substantial equity cushion. Scopac's equity holders,
17 in turn, would retain 21,700 acres, about 10 percent of
18 the total acreage, as well as the MMCAs. Scopac then
19 could try and realize the value that the noteholders have
11:19 20 been offered but rejected and that you'll hear the
21 noteholders and Marathon mock through this proceeding.

22 Scopac would also retain the Headwaters
23 litigation, which in significant part, would permit it to
24 recapture some of the value that it has lost as a result

11:20 25 of the state violations of the Headwaters agreement. In

AK/RET REPORTING, RECORDS & VIDEO, INC.

105

1 short, Your Honor, the only plan that allocates assets
2 fairly and that can be confirmed is the plan proposed by
3 Scopac.

4 One last comment. We heard several asides
11:20 5 about how Maxxam has exited the scene. Well, as
6 indicated in the disclosure statement, the debtors and
7 Maxxam have pursued exit financing for the alternative
8 plans. The debtors are pleased to represent that as of
9 yesterday, they have received a promising written
11:20 10 proposal for \$150 million that will be subject to
11 significant attention in the coming days in the hope that
12 the proposal will become an exit financing commitment.
13 And we will keep the Court apprised of our progress.
14 Thank you for your time, Your Honor.

11:21 15 THE COURT: All right. Anybody else going
16 to make -- Mr. Jordan.

17 MR. JORDAN: And I believe the committee
18 is going to also make one.

19 THE COURT: All right.

11:21 20 MR. JORDAN: I don't know what order John
21 prefers we go in.

22 MR. FIERO: Well, you're a plan proponent.

23 THE COURT: He's just a plan supporter.

24 MR. FIERO: He's just a plan supporter.

11:21 25 All right.

AK/RET REPORTING, RECORDS & VIDEO, INC.

106

1 MR. PASCUZZI: Your Honor, the California
2 State Agencies would have about a 15 minute opening.

3 MR. JONES: I also have a short opening.

4 THE COURT: Okay. Go right ahead.

11:21 5 MR. JORDAN: I'm not going to be very
6 long. I'm certainly not going to repeat what -- because
7 we are so closely aligned in most respects to Scopac, I'm
8 not going to repeat what Scopac counsel has clearly
9 demonstrated in connection with what this case is truly
11:21 10 about.

11 First of all, I will acknowledge that the
12 Palco debtors plan, as we prior represented to this
13 Court, is without an impaired consenting class. We also
14 in that respect agreed that we will not address or argue
11:22 15 the confirmation aspects of any Palco plan, but I do want
16 to address how we got there. I certainly want to address
17 how it may be that a plan -- it may be that we do
18 ultimately have a plan to discuss in connection with this
19 entire case.

11:22 20 First of all, we will also acknowledge
21 that we had throughout this case the entire inability to
22 induce anyone to negotiate a plan term with Palco as a
23 debtor. The noteholders told you in March 2007 that they
24 wanted the timber, they intended to foreclose and you did
11:22 25 get a glimpse of what they called was an offer in

AK/RET REPORTING, RECORDS & VIDEO, INC.

107

1 September when they said substantial cash down and 90
2 days to pay the balance or thereabouts. Maybe it was 120
3 days. Likewise with Marathon, Marathon has done a good
4 job of pursuing a loan to own strategy. That's clearly
11:22 5 what they've been doing. Marathon was a six month old
6 lender when this case was filed because we couldn't work
7 out the very first renewal of the Marathon loan. It took
8 us seven months with Marathon to negotiate a dip, a dip
9 which had very stringent, difficult terms and which will
11:23 10 have a serious impact on our ability to conclude a plan,
11 except for as what was announced the potential for the
12 exit financing being put together prior to what I would
13 call closing time of this particular process.

14 Finally, with respect to the Unsecured
11:23 15 Creditors Committee, we never had a single negotiating
16 session. Multiple lawyers on behalf of both debtors
17 invited those sessions, they never came to be. And we
18 told the Court that it was no surprise to us some time
19 ago that we would likely not have a consenting class.
11:23 20 Your Honor, I will simply point out to the Court, I don't
21 know that you've seen it, but this 350 or longer
22 ten-point typed page document that was sent to the
23 unsecured creditors was accompanied with a one page --
24 appropriately a one-page comment by the creditors saying
11:24 25 "please vote against the Palco plan." I suspect, Your

AK/RET REPORTING, RECORDS & VIDEO, INC.

108

1 Honor, that it should be no surprise to anyone that in
2 that process, we received no significant votes. Couple
3 that with what the Court found in this case, and that was
4 in a fight with its lenders in the beginning.
11:24 5 Incidentally, we had paid interest plus principal down to
6 \$715 or so million since 1998. There have been
7 substantial payments made. But we found ourselves in an
8 incredibly declining market, a market that was driven by
9 both housing, complicated by many, many other factors.
11:24 10 And Your Honor, I will just point out
11 this. We -- I believe one of the items in evidence that
12 you'll see was an article that was in the Wall Street
13 Journal, the impact of what is happening in the timber
14 business has hit dairy farms and all of those types of
11:24 15 industries that use sawdust. Sawdust has now quadrupled
16 in value because no one is cutting lumber. Sawdust is,
17 as oil, now \$100 a ton when it was \$25 -- I'm sorry, \$250
18 a ton prior. The type of market that we discovered was
19 going to complicate this Chapter 11 is no one -- I can't
11:25 20 pick on the noteholders, I can't pick on Marathon or the
21 committees with respect to that, but I can pick on
22 someone else in this respect.

23 Part of the reason we got here, Your
24 Honor, is a twofold, I think events the Court should
11:25 25 observe. First is the Headwaters litigation. One of the

AK/RET REPORTING, RECORDS & VIDEO, INC.

109

1 reasons that cash flows are as they are is we have never
2 produced and we're continually prevented from producing
3 what the Headwaters agreement entitled us to produce.
4 Now, what did that result in? And this is what I think
11:25 5 is the --

6 THE COURT: I mean, there are lots of
7 bankruptcies that have litigation that they want to
8 preserve for -- as an asset and don't want to get
9 foreclosed on while they're doing that. I mean, isn't
11:25 10 that pretty much -- I mean, this is a big case, but lots
11 of little cases have that situation, so you just propose
12 a plan that adequately protects the secured debtor and
13 then you go on about doing your litigation.

14 MR. JORDAN: Well, yes. If that were my
11:26 15 point, I guess I would agree that I've seen debtors come
16 in saying, Judge, I have a great lawsuit, give me time to
17 sue them and I'll prove to you that I can take care of
18 the problem. That certainly is not my point. In fact,
19 you might note that --

11:26 20 THE COURT: No, I don't think that you can
21 reasonably expect that you're going to get time to sue
22 them and prove up that that's the value in your company.
23 But if you -- as long as you adequately protect the
24 creditors, you can propose and confirm a plan that does
11:26 25 that if you have the money to do that. I mean, the

AK/RET REPORTING, RECORDS & VIDEO, INC.

110

1 question is whether or not you've got to come up with the
2 money to support the adequate protection while you're

3 suing.

4 MR. JORDAN: Yes.

11:26 5 THE COURT: Or can you wait until the end
6 of the lawsuit.

7 MR. JORDAN: Well, and if I get to the
8 point that I can argue about the Palco ultimate plan and
9 I can represent to the Court that we have those
11:26 10 ingredients that might make that plan a doable plan, Your
11 Honor, and I'm going to get there very quickly so you can
12 hear where I'm going.

13 THE COURT: Go ahead.

14 MR. JORDAN: Let me readdress the
11:27 15 Headwaters litigation. I didn't mean to suggest to you
16 that the Headwaters litigation is something the Court
17 should take into context -- I think into consideration of
18 the context of value, but I say it for this reason.
19 Number one is we haven't produced like the Headwaters
11:27 20 said we were supposed to produce. So what resulted?
21 What resulted was, of course, litigation. But what
22 resulted from that? Most strikingly in this case there
23 are no environmental claims against my client Palco or my
24 debtors who we are effectively joined at the hip because
11:27 25 they own the timber, Scopac. We are good stewards of the

AK/RET REPORTING, RECORDS & VIDEO, INC.

111

1 environment. No matter what these -- the political
2 statements that have been made to the Court, no matter
3 how it is spun, the term environmentally responsible
4 manner. Those claims don't exist.

11:27 5 And I promise you if they were there, you
6 would have heard about them over and over and over again,
7 and you haven't because we are good stewards. We are in
8 litigation, we are in a bad market, we are in
9 circumstances that caused these problems to become
11:28 10 exaggerated, but it wasn't because we weren't stewards.
11 Those pictures you saw are actual animals that we have

12 preserved, actual forests that we have preserved, all
13 complying with what is importantly, Your Honor, a matter
14 that in the future someone else is going to need to prove
11:28 15 to you that they can do so.

16 I made the comment, though, Your Honor,
17 that in respect to these proceedings, how we have gotten
18 here seldom is a confirmation hearing, first of all, ever
19 this contested. If three plans with three people who are
11:28 20 excluding each other, and by the way, just think about
21 this. The noteholders say the Marathon plant can't be
22 confirmed. Marathon says the noteholders plan can't be
23 confirmed. The noteholders and Marathon says the Scopac
24 plan can't be confirmed. MRC says the Palco plan can't
11:28 25 be confirmed. Palco says that MRC and noteholders can't

AK/RET REPORTING, RECORDS & VIDEO, INC.

112

1 be confirmed. And Scopac finally says MRC noteholders
2 can't be confirmed. Can't be confirmed, not that it's a
3 bad idea but that the valuations and the method by which
4 they are attempting to convince this Court, evaluations
11:29 5 will not meet the restrictions of the code and that it
6 can't be confirmed.

7 I say that for two observations. One is
8 that seldom will these type of proceedings ever result in
9 a fully contested proceeding to judgment because they're,
11:29 10 first of all, very seldom brought. They are usually
11 announced that today we typically would be announcing
12 them in the hard fought battles we have reached
13 conclusions so that we don't do this. Secondly is there
14 have been major cases started, very few of them ever
11:29 15 result in a judgment because in the process that is
16 implemented, which is where we are, compromise comes.

17 An finally, Your Honor, that's why I
18 suggest that it is not closing time. We might be ugly
19 now, but when we get to the point of closing time, we may
11:29 20 be a lot prettier than people are assuming for a number

21 of reasons. That was a country and western song or I
22 don't remember what that is, Your Honor. But it brings
23 me to this conclusion, and that is to ask the Court to
24 invoke the California rule. You have told these parties
11:30 25 several times in the last few months, you have said,

AK/RET REPORTING, RECORDS & VIDEO, INC.

113

1 there is a rule in California, new rule, and I have just
2 learned in a seminar, and those judges out there get to
3 tell the parties what they are thinking. We ask, on
4 behalf of Palco, that that occur in this case. At the
11:30 5 appropriate time you will call that shot at the
6 appropriate time because I want to, I guess, quickly jump
7 to this issue of value and valuation.

8 Your Honor, value drives this case; value
9 of the timberlands, value of the timberlands development
11:30 10 for timber production, value of the timberlands as a
11 business model for a new business model, the value of
12 Palco's assets which we are tied at the hip to those
13 redwood trees because we won't function without it and
14 Palco's assets which are the town we have developed and
11:30 15 steward and live in to continue the process of all of the
16 productions of both of these assets, all tied to this
17 issue of value. The debtors' responsibility is tied to
18 the value.

19 If there's equity in these assets, and we
11:31 20 have plenty of evidence that there's equity, the lawyers
21 of the debtors, and you have commented in the past that
22 what does the debtors lawyer do when we have real experts
23 saying there's equity, who do we pursue? Well, the only
24 thing I can tell the Court that we have done is we have
11:31 25 represented as the only fiduciary to the estate.

AK/RET REPORTING, RECORDS & VIDEO, INC.

114

1 Creditors have a fiduciary to its constituency. The
2 noteholders are fiduciaries to no one and Marathon is a
3 fiduciary to no one, even though we have paid all those
4 constituencies to prosecute their competing plans. We
11:31 5 are fiduciaries to the administrative claimants, the
6 secured claimants, the unsecured claimants, the estate
7 and equity interest if there's equity.

8 If you would tell us later that there is
9 no equity, just assuming that were the case, that does do
11:31 10 one thing, it carves out interest holder or equity from
11 that fiduciary obligation and we can pursue that process
12 as that goes forward. We don't think you're going to get
13 there because I think when you look at the merits of the
14 valuation testimony, you're going to discover that having
11:32 15 one of the unique assets located in the world is
16 something that has a -- the task is difficult, but it has
17 a method by which the Court appropriately can get to the
18 actual valuation.

19 So I want to very briefly give the
11:32 20 Court -- I have copies for counsel, but I know they know
21 the case as well -- two cases, and I've marked them --
22 I've marked the Bank of America La Salle case at page
23 1423. And I've marked the Protective Committee case,
24 both Supreme Court cases, at 1174 and 1177. And I want
11:32 25 to discuss very quickly, Your Honor, where I think the

AK/RET REPORTING, RECORDS & VIDEO, INC.

115

1 Court is duty bound to go. Because the parties are going
2 to give you this basic evidence, I'd like to first
3 address Protective Committee. Everyone knows Protective
4 Committee as the case that defines settlement, yet there
11:32 5 are two parts of the case. The first part of the case,
6 the most significant and as it relates to this particular
7 case, although it does say that if a -- well, more
8 important to the merits of Protective Committee on the
9 non-settlement aspect, that is how do you settle a case

11:33 10 in bankruptcy, is the merits of the case.

11 In Protective Committee, very quickly,
12 there was a company that more or less invented a method
13 of shuttling containers of cargo between Florida and
14 Puerto Rico quickly because of the method they had
11:33 15 employed, had not patented, competition took over, they
16 were very successful but then very quickly unsuccessful.
17 They had to come back into bankruptcy court with a new
18 business plan and a new business model that actually
19 modified their equipment, modified the roots, modified
11:33 20 the place. In other words, changed the way business
21 could be done in order to survive.

22 The bankruptcy court, over their
23 objection, confirmed the plan of the secured creditor
24 and, I believe, of the trustee. This was a Chapter Roman
11:34 25 11 case. But at page 1174, the Court makes two

AK/RET REPORTING, RECORDS & VIDEO, INC.

116

1 observations. The first observation the Court talks
2 about the fact that "against this backdrop we must
3 examine the information that the trial court had
4 accessing the future prospects of TMT," and I won't read
11:34 5 the entire quote that I have marked at 1174. I'll allow
6 the Court to go there when it gets time. But I do want
7 to make this observation. Now on page 1177, "it was
8 evident that certain specific and predictable alterations
9 would have to be made in the equipment and operations of
11:34 10 the company in order to meet foreseeable operations in
11 the market. The trial court shut its eyes to these
12 important developments and in so doing ignored the
13 cardinal principle of proper evaluation."

14 The Supreme Court goes on to hold at the
11:34 15 bottom of the page, "because only past earnings were
16 relied upon in this case in determining the value of the
17 debtor as of one concern, we reverse and remand the Court
18 of Appeals with directions to remand the district court

19 to hold new hearings without in any way prejudicing the
11:35 20 issue. It is possible that when the compromise discussed
21 in part 2," and that's their own opinion about how do you
22 comprise a case, which everyone cites this case for, "of
23 this opinion are reconsidered. And when the company is
24 properly valued by taking into account its future
11:35 25 prospects, the company will be found not to be insolvent.

AK/RET REPORTING, RECORDS & VIDEO, INC.

117

1 Such a finding would permit stockholders to participate."
2 So this case talks about the first method that the Court
3 has to deal with, and that is, you have to understand
4 that the debtor you have is not one of historical
11:35 5 proportions, but of where it's going to go otherwise,
6 which is a significant part of the value, completely
7 ignored by both the noteholders or totally discounted by
8 the noteholders and by the Marathon plan.

9 The second observation I want to make to
11:35 10 Your Honor is the Bank of La Salle opinion, which I have
11 marked at page 1423. Your Honor, that talks about so you
12 take expert testimony, what else do you do? And La Salle
13 is often quoted for the idea that a market test is
14 required, and that's true. But I want to be certain the
11:36 15 Court had the benefit of those, of the quotes on 1423 and
16 1424 because what you have in this case are several
17 things that I think benefit the Court in this respect.

18 You do have a market test because La Salle
19 said that it is not necessarily preferable for a market
11:36 20 test to be in auction because exclusivity is, in fact, in
21 a sense, an auction. But what I want to point out to the
22 Court when you get to the values, you have now expert
23 testimony and then you, in fact, lifted exclusivity to
24 test the market and look what you got. You got from 400
11:36 25 minus million to 1.2 billion from the exclusivity testing

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 of the market. And then you got, most interestingly,
2 today in the hearing we find out that in order to get
3 Stalking Horse, the noteholders have brought in their
4 majority bond holder, the bond holder that owns most of
11:37 5 the bonds, I don't believe it's a majority. But the bond
6 holder that owns most of the bonds who now has made, as
7 it was described by Marathon, a pocket to pocket offer.

8 And so, Your Honor, it is -- it is going
9 to be a difficult task. It was a difficult task for us
11:37 10 to come to grips with where we were in value, it's going
11 to be a difficult task because you've given all the
12 players a very fair opportunity to tell me what the real
13 value is by lifting exclusivity and allowing all the
14 market matters to come to bear. And you have Marathon
11:37 15 trying to low-ball at \$400 million, \$500 million,
16 whatever it actually comes out to when you determine what
17 it is when you see how the long-term notes they want to
18 attribute value to.

19 You have the noteholders suggesting they
11:37 20 just sort of happened to get an offer right at where the
21 value of what they now claim, not what they claimed when
22 they wanted exclusivity lifted, which was \$442 million
23 average, but what they now claim it is, and you have us
24 with a dollar amount which we have always said is what we
11:37 25 believe to be the correct dollar amount.

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 All of this to come down to this
2 conclusion, Your Honor, and I'll sit down. In order for
3 the parties to know where these plans can result, in
4 order for us to know where if we obtain the extra
11:38 5 financing that we are aggressively seeking can be applied
6 in the context of what obviously would have to be a
7 compromise or a compromise and revote so that we have the

8 affirmative votes of the parties involved, however that
9 comes down, we believe the Court should not be influenced
11:38 10 by the practical and political arguments. It just
11 surprises me that we have the noteholders went out and
12 hired the past Governor because Marathon has a letter
13 from the current Governor of who wants what.

14 The politics setting aside, you have an
11:38 15 asset whose value is going to be determined in this
16 hearing in some fashion. You have two cases that tell
17 you how you get there. And although I believe that you
18 have done everything that you could do to give all of us
19 the opportunity to prove value, all of us should come to
11:39 20 you with a legitimate basis by which value is to be
21 determined. We have offered you effectively nothing.

22 You have between \$400 million and \$1.2 billion to decide.
23 I will suggest that it will fall within
24 that range. My client truly believes, but we are tried
11:39 25 to the hip of the valuation of the timber. And without

AK/RET REPORTING, RECORDS & VIDEO, INC.

120

1 that, and I'll close with this comment on two things.
2 Without the ability to assure continued operations, and I
3 wanted to suggest this, the noteholders said, well, of
4 course, we would consider the mill and the employees and
11:39 5 those issues, Judge, we have the timber and we need a
6 mill.

7 Well, the facts are that there are other
8 mills available. The facts are that if the noteholders
9 really were sensitive to that issue, they would have
11:39 10 resolved that by providing it in their plan. And the
11 facts are the truth is that all you have to do as a
12 timber holder is watch your timber grow and just tell the
13 mill or whoever might want to buy that mill, if it's not
14 you at a cheap price, we're not really going to sell you
11:40 15 our lumber because we own it and we're not interested in
16 selling it to you. So the mill is not just at risk, it

17 will have no chance of success if the noteholders divide
18 up that process and there's no arrangement with respect
19 to the mill.

11:40 20 But then I flip to the other side because
21 I can pick on the noteholders for a minute, but then I
22 look at what Marathon has done. Just look at the
23 litigation trust at what they have provided. In the
24 litigation trust, first of all, they say that the
11:40 25 noteholders, who is this massive deficiency claim of

AK/RET REPORTING, RECORDS & VIDEO, INC.

121

1 hundreds of millions of dollars, we're going to
2 separately classify you and then we're going to carve out
3 of the litigation trust the Headwaters agreement. Well,
4 it's not odd to me that the State of California is here
11:40 5 saying we love Marathon because Marathon has said we're
6 going to settle it quickly and cheaply.

7 Well, that does accomplish a lot of
8 political purposes. But the noteholders then who are --
9 would be otherwise, if not separately classified, be 99.9
11:41 10 percent of the unsecured debt, they're now not
11 represented on a litigation trust, they're all three
12 unsecured creditors. And although they are apparently in
13 some form a beneficiary of that, they carve out what we
14 believe is the most significant aspect of the case and
11:41 15 preserve it for Marathon and its use, attributing
16 effectively no value to it.

17 Each aspect of each one of these cases
18 have such dramatic self dealing that the Court, I think,
19 will never get to the point of being able to sort out
11:41 20 these problems and the multiple -- the exponential
21 defects that exists in just these two plans, who by the
22 way, are telling you neither are confirmable. So I mean,
23 there's certainly no consensus that confirmation is for
24 anybody's plan.

11:41 25 In that same vain, Your Honor, I'll

1 conclude simply by saying that the Palco debtors believe
2 that progress can be made. I'll remind the Court that we
3 tried to get you to take the bait in January and you
4 didn't. And likely, it was -- it was a process that had
11:42 5 to develop where we are. We believe this case will not
6 compromise ever without an indication of value.

7 We also believe that it could be, and we
8 suggest to the Court to please consider invoking the
9 California rule. And at the point that it might be
11:42 10 appropriate for the Court to give an indication of where
11 it's going to avoid what we said back in January, it's,
12 Judge, the worst circumstance for all of us. And the
13 one -- only one of the players survive with is we all
14 show up with non-confirmable plans.

11:42 15 Everybody says that's true today. You
16 don't have any consensus that anybody has a confirmable
17 plan. And if all parties show up with a non-confirmable
18 plan, because the Court is not authorized to draft its
19 own, the Court may have limited, which is disastrous
11:43 20 results for everyone in the process except potential
21 noteholders who simply want their timber. So I would ask
22 the Court to keep in mind when you -- as this process
23 develops, as possibly we get prettier, that you let us
24 know, the parties know, what you are considering in
11:43 25 connection with the value and valuation testimony.

1 And I'm going to conclude with this, that
2 it looks to me that we would not be finished this week,
3 so I'm not suggesting to the Court that this week is the
4 answer, but at the place where you feel comfortable that
11:43 5 you have -- you have circumstances about value in mind,

6 we would certainly welcome the Court's comments from the
7 bench. Thank you, Your Honor.

8 THE COURT: All right. The committee is
9 next.

11:43 10 MR. FIERO: Good morning, Your Honor.
11 John Fiero for the committee. For more than 20 years the
12 people of Humboldt County have been mired in the conflict
13 that the partisans and press have often referred to as
14 the timber wars. These wars have pitted the Pacific
11:44 15 Lumber Company against a broad spectrum of environmental
16 concerns and the State of California. The environmental
17 concerns found themselves fighting against Palco and the
18 State. Finally the State found itself defending against
19 claims brought by Palco and lawsuit claims from
11:44 20 environmentalists seeking to ensure that the State's
21 logging laws were enforced.

22 Many of the people in businesses
23 represented by committee were caught in the crossfire of
24 the timber wars. Tied to the company for their
11:44 25 livelihood and fearful of any perceived threat to their

AK/RET REPORTING, RECORDS & VIDEO, INC.

124

1 jobs and economic well-being, the company preyed on their
2 fears and used them to generate public support for the
3 company.

4 I'm sure the Court remembers how Pacific
11:44 5 Lumber used the company's purchasing department to obtain
6 66 joinders in support of the debtor's opposition to the
7 venue motion. This was an opposition that wasn't on file
8 and that none of the 66 joining parties had even read.
9 I'm sure the Court also remembers how George O'Brien told
11:45 10 the Court from a conference room in Scotia at the
11 company's offices that he had more than 30 interested
12 parties with him listening to the venue proceedings by
13 speakerphone. This was the power of the company at the
14 height of the timber wars when its propaganda machines

11:45 15 still worked and the prospect of a new beginning was too
16 remote to even hope for.
17 The events of the last 15 months have made
18 some things clear to all but the hardiest of the
19 partisans in the timber wars. First, Palco cannot
11:45 20 continue under its current leadership and ownership
21 because those groups clearly do not know how to make a
22 profit from the sawmill. Palco and Maxxam can talk all
23 they want about the funds they have invested in the mill,
24 but that doesn't change the fact that Palco and Maxxam
11:45 25 have proven incapable of operating it profitably. The

AK/RET REPORTING, RECORDS & VIDEO, INC.

125

1 losses of Palco are staggering and none of the lay-offs
2 or other tricks, such as the creation of the Scopac log
3 deck, have been able to mask this. Second, despite of
4 having a team of almost 65 foresters and scientists, many
11:46 5 of them with advanced and college degrees, the current
6 operations of Scopac show that there is only so much
7 timber that can legally and economically be removed from
8 the forest each year. And that amount of timber is well,
9 well below the amount needed to service the timber note's
11:46 10 \$714 million principal amount.

11 Now, for the first time since the
12 Headwaters agreement's overblown promise of 50 years of
13 stability for Humboldt County, there has been a paradigm
14 shift that marks at least a ceasefire in the timber wars.
11:46 15 For the first time in a very long time, and due in no
16 small part to the decision of the United States trustee
17 to form a committee that included the interest of both
18 loggers and environmentalists, there is a new paradigm of
19 interest focused on a new beginning for Humboldt County,
11:46 20 a reorganization of Pacific Lumber and Scopac supported
21 wholeheartedly by a realignment of former combatants.
22 Specifically, Mendocino Redwood Company
23 and Marathon Structured Finance have joined together to

24 propose a plan that would reorganize these businesses in
11:47 25 a way that makes sense to the overwhelming majority of

AK/RET REPORTING, RECORDS & VIDEO, INC.

126

1 unsecured creditors, environmentalists, other redwood
2 timberland owners, county, state and federal officials
3 and both major local newspapers in Eureka, California.
4 This alliance is unprecedented, Your Honor.
11:47 5 The MRC/Marathon plan is not some term
6 sheet or unilateral letter of intent or preliminary
7 expression of interest. It is a detailed viable strategy
8 for operating an integrated redwood forest and mill
9 company in the most highly regulated county in the nation
11:47 10 at a time when Douglas Fir prices make that species
11 uneconomic to log and redwood prices are down
12 significantly from those seen just six months ago when
13 the noteholders own witness, Chris DiMauro of Houlihan
14 Lokey, told the Court that the forest was worth between
11:47 15 \$375 million and \$460 million.

16 The MRC/Marathon plan is backed by cash,
17 \$225 million of it to be invested overall and \$175
18 million of it to be paid over to the indentured trustee
19 on the plan's effective date. The MRC/Marathon plan is
11:48 20 not subject to due diligence or other conditions.

21 The MRC/Marathon plan is not speculative
22 like some crazy notion that celebrities and the super
23 rich are going to spend as much as \$10 million or more to
24 buy a home site and then build a home in the middle of a
11:48 25 working forest with its dirt roads and lack of nearby

AK/RET REPORTING, RECORDS & VIDEO, INC.

127

1 amenities. The MRC/Marathon plan is also rational. With
2 its focus on cooperation with regulators and adherence to
3 the responsible principals required of those earning the

4 certification of the forest stewardship council.

11:48 5 Finally, these newly aligned groups see
6 the MRC/Marathon plan as fair. With a reasonable
7 aggregate cash payout to unsecured creditors of \$10.6
8 million, plus an interest in a litigation trust with a
9 pre-funding of its expenses.

11:49 10 Lastly, and perhaps most importantly, the
11 MRC/Marathon plan comes with an assumption of the
12 company's pension liabilities which could total as much
13 as \$29 million, according to the PBGC. Preventing the
14 diluted effect of this potentially huge unsecured claim
11:49 15 was something that the committee valued highly. The
16 degree of support by unsecured creditors for the
17 MRC/Marathon plan is almost impossible to overstate.
18 Among the unsecured creditors of Palco, the votes were
19 195 to 4. Among non-deficiency unsecured claimants of
11:49 20 Scopac, the votes were 26 to 1.

21 The committee recognizes, Your Honor, that
22 this isn't just a popularity contest. In order to
23 confirm the MRC/Marathon plan, the Court will have to
24 find as a an evidentiary matter that the values put
11:49 25 forward by MRC and Marathon are the most convincing.

AK/RET REPORTING, RECORDS & VIDEO, INC.

128

1 The committee is already engaged in this
2 analysis with the help of its timber valuation
3 consultants. Based upon a complete review of the
4 appraisals, attendance at every valuation witness's
11:50 5 deposition and a review of the proffers, the committee
6 puts no faith in the valuation proposed by the debtors
7 and Maxxam. The debtors have adopted a building block
8 approach to their valuation.

9 This sounds logical, but if the underlying
11:50 10 blocks are unfirm, then the structure will collapse, and
11 that is what will happen here. The ground floor of the
12 debtor's valuation work is built on the work of Dr. Ken

13 Iles, a Canadian biometrician with no special redwood
14 background who sought to test the accuracy of Scopac's
11:50 15 existing timber inventory.

16 Dr. Iles determined that within a 67
17 percent degree of confidence and a plus or minus 13
18 percent margin of error he could say that the Scopac
19 timber inventory was accurate. During his deposition,
11:50 20 Dr. Iles admitted that these broad swings of possible
21 error were not industry standard which requires a margin
22 of error of five percent and a 95 percent degree of
23 confidence.

24 The evidence will also show that
11:51 25 Dr. Donald Reimer, another Canadian with no particular

AK/RET REPORTING, RECORDS & VIDEO, INC.

129

1 redwood experience, then took the Scopac inventory and
2 adjusted it upward by 2 percent, even though Dr. Iles did
3 not recommend that the inventory be adjusted upwards.
4 From this newly inflated base, Dr. Reimer sought to
11:51 5 project the growth of the forest over the next 50 years
6 along with the amounts that would be available for
7 cutting in those years. The tool that Dr. Reimer used to
8 make these projections was a software program of his own
9 making called Options. The evidence will show that
11:51 10 Dr. Reimer had to run 200 different scenarios on Options
11 before concluding that he had arrived at the one that
12 adequately maximized Scopac's cash flow.

13 The evidence will also show that Scopac
14 has been the licensee of the Options program for some
11:51 15 period of years prior to the bankruptcy but had not seen
16 fit to use it for its own harvest. Scopac chose instead
17 to rely on the human beings on Jeff Barrett's staff to
18 determine what to cut and when.

19 Finally, the evidence will show that even
11:52 20 if Options is not exactly akin to a black box, it is not
21 a reliable forest harvesting scheduler because it has no

22 way to optimize the output to prevent, for instance, the
23 software from selecting parcels for harvesting which are
24 too small, too scattered or otherwise too expensive to
11:52 25 harvest.

AK/RET REPORTING, RECORDS & VIDEO, INC.

130

1 The debtors then passed this information
2 on to James Yerges of the accounting firm KPMG.
3 Mr. Yerges is neither a forester nor a licensed real
4 estate appraiser and he does not follow the uniform
11:52 5 standards of professional appraisal practice which all
6 licensed appraisers must follow. Moreover, he is utterly
7 inactive in the practice of commercial timberland
8 appraisal for active timberland investors. He's from
9 Washington State and he has no redwood experience to
11:52 10 speak of.

11 The evidence will show that his appraisal
12 contains the following cardinal errors. Mr. Yerges
13 blindly accepts scores of assumptions and information
14 provided by the debtor with no background against which
11:53 15 to test their reasonableness. For instance, he bases his
16 cash flow projections on a harvesting model that is
17 optimistic and unrealistic, one which anticipates
18 wholesale conversion of the forest for a redwood mono
19 culture and which projects a management scenario that
11:53 20 requires an utter suspension of disbelief when tested
21 against the current management practices of Scopac and
22 its peers in the industry.

23 Mr. Yerges projects optimistic increases
24 in redwood prices to occur forever into the future when
11:53 25 in fact prices have fallen in recent years. Mr. Yerges

AK/RET REPORTING, RECORDS & VIDEO, INC.

131

1 converts future cash flows into present value by using a

2 discount rate that is unrealistically low. That does not
3 account for the acute regulatory risk that any astute
4 investor would recognize in cultural California, risks
11:53 5 that the debtor acknowledges in their suit, claiming that
6 the regulators have caused their business to fail.

7 Mr. Yerges attempts to use comparable
8 sales from other timberlands to arrive at an independent
9 value estimate, but he uses sales of properties in other
11:54 10 states with different species and much more lenient
11 regulatory environments. And some of these are not even
12 sales, but just listings. Some are as small as 449
13 acres. Only two are over 100,000 acres, and the largest
14 since 2000 is just one-third the size of Scopac's, more
11:54 15 than 200,000 acres.

16 Mr. Yerges commits multiple errors in his
17 report, errors which he admits to but which further
18 impugn the credibility of his work. Mr. Yerges concludes
19 with a value that in per acre terms would constitute the
11:54 20 highest value timberland sale in the history of North
21 America for a property its size, which is patently absurd
22 given the economic, regulatory and social context of the
23 Scopac timberlands.

24 Mr. Yerges, by committing these errors,
11:54 25 has demonstrated that his taking on of this assignment

AK/RET REPORTING, RECORDS & VIDEO, INC.

132

1 for the debtor constitutes a violation of the competency
2 provision of the uniform standards of professional
3 appraisal practice and its further provisions prohibiting
4 appraisers from issuing misleading appraisals.

11:55 5 The debtors add to their mountain of
6 dubious expert opinion evidence the testimony of Dr. Bill
7 Mundy and Keith Gurnee. It is the responsibility of
8 these two gentlemen to convince the Court that the super
9 rich want to buy home sites in the middle of active
11:55 10 logging operations 250 miles north of San Francisco, even

11 though neither Eureka nor Scotia nor Fortuna nor Ferndale
12 nor Garberville or any other town in Humboldt County is
13 currently known as a destination on par with Carmel,
14 Vale, Aspen, Sun Valley, Big Sky or Jackson Hole.

11:55 15 We also are to believe that private
16 residential development in the midst of a commercial
17 timberland operation is a compatible use and would be
18 desirable by both residential users and the owners of the
19 commercial timberlands. The committee is not convinced,
11:55 20 Your Honor, and the Court should not be convinced either
21 as this evidence is so speculative as to be implausible.

22 Finally, the debtors will present the
23 evidence of yet another accounting professional, Thomas
24 Lungston, to describe the damages that Scopac and Palco
11:56 25 could claim in their suit against the State of California

AK/RET REPORTING, RECORDS & VIDEO, INC.

133

1 pending in Fresno.

2 Mr. Lungston will not attempt to assess
3 the merits nor will he offer any evidence of the
4 likelihood that the debtors will prevail in this action.
11:56 5 Because such evidence will not come before the Court and
6 reasonably could not be relied upon even if it were
7 offered, no value at all can be attributed to this
8 lottery ticket.

9 Consider also the evidence to be presented
11:56 10 by the indenture trustee on the question of the value of
11 the forest. James Fleming, the indenture trustee's
12 appraiser, will testify that he used an Excel spreadsheet
13 to arrive at his value based upon his determination that
14 the Scopac timberlands can support cutting at the rate of
11:56 15 81 million board feet over the next ten years and then
16 jump to 100 million in the terminal year which results in
17 a corresponding EBIDTA increase from \$46 million per year
18 to \$60 million per year in perpetuity. Yet he will also
19 admit that his projection of available timber is not

11:57 20 based on any rational economic model for the management
21 of the forest and contains no effort to assess whether
22 the proposed cut level would be the most profitable way
23 to extract value from the forest.

24 Finally, he will admit that despite the
11:57 25 many protestations of the indenture trustee regarding the

AK/RET REPORTING, RECORDS & VIDEO, INC.

134

1 need for access to the debtors GIS database, Mr. Fleming
2 did not use any GIS database information whatsoever in
3 his attempt to present an informed opinion to the Court.

4 I know you remember, Your Honor, the
11:57 5 repeated hearings we had about access to that GIS
6 database and the debtors -- and the indenture trustee's
7 assurance that this was key information. Mr. Fleming did
8 not use it at all.

9 Mr. Fleming makes no attempt to apply
11:58 10 comparable sales analysis to the appraisal problem, yet
11 this is generally the most widely accepted method in
12 existence. The result is an unsubstantiated estimate
13 that overstates the market value of the debtors
14 timberland. Fleming's overly simplistic and optimistic
11:58 15 harvest projections are at the heart of the indenture
16 trustee's valuation evidence.

17 Glenn Daniel of Houlihan Lokey, the
18 indenture trustee's other valuation expert, is not an
19 independent timber professional. He has not valued
11:58 20 timberlands in the last 20 years. He has never even
21 visited Scotia. He knows almost nothing about Scopac's
22 timber inventories, harvest projections or regulatory
23 limitations except what Mr. Fleming and the other
24 consultants working for the indenture trustee have told
11:58 25 him.

AK/RET REPORTING, RECORDS & VIDEO, INC.

135

1 Perhaps most concerning, though, Your
2 Honor, is that he blindly relied on Fleming's harvest
3 projects and thereby incorporated their flaws. As noted
4 by others, Daniel also did not have time to come to the
11:59 5 valid independent valuation conclusion that this Court
6 would expect. He only had two weeks to do the job and he
7 was pressured into it by Chris DiMauro and senior
8 executives at Houlihan who dropped a draft report in his
9 lap, prepared by the same people who were working as
11:59 10 financial advisors to the indenture trustee and were
11 involved in the prior DiMauro valuation.

12 Mr. Daniel then relied on these same
13 people as his team to prepare his report. Under these
14 circumstances, Mr. Daniel's valuation is simply not
11:59 15 credible. And the people who prepared it clearly had a
16 target in mind. Not surprisingly, they hit it.

17 The indenture trustee has also advised the
18 Court that it expects to present a purported stalking
19 horse bid to the Court during this confirmation hearing.
11:59 20 The committee now knows that it would be an affiliate of
21 Biel Bank, which is believed to be the largest holder of
22 the timber notes that will step forward. This is nothing
23 more than a disguised credit bid by a noteholder, and the
24 Court should recognize it as such. Because a credit bid
12:00 25 need not bear any relationship to the real value of the

AK/RET REPORTING, RECORDS & VIDEO, INC.

136

1 forest and does not promote reorganization, the Court
2 need not rely on any such offer when determining the
3 value of the forest.

4 This brings us, Your Honor, to the value
12:00 5 that Marathon and MRC attribute to the forest in their
6 plan. This valuation strikes the committee as the most
7 credible because there is nothing theoretical about it.
8 This makes it very different from the debtors valued

9 conclusions built on the opinions of Canadian and
12:00 10 Washington based experts who are not experienced in
11 redwood or expert in California's unique regulatory
12 environment. This also makes it different from the
13 opinion of Mr. Fleming who chose not to consider the
14 information contained in the company's GIS database and
12:00 15 who built his model without the benefit of this crucial
16 information. Unlike the opinion of Mr. Fleming, the
17 MRC/Marathon plan is based on a real offer, backed with
18 cash and not subject to contingencies beyond the
19 confirmation of the MRC/Marathon plan.

12:01 20 Notably, and as it was shown to you
21 before, the value dovetails with that put forward by
22 Mr. DiMauro back in September. What could destroy this
23 new paradigm of aligned interests and rekindle the dying
24 embers of the timber wars? Only two things, Your Honor.
12:01 25 The first would be Maxxam retaining a stake in the

AK/RET REPORTING, RECORDS & VIDEO, INC.

137

1 ownership or management of these debtors. Let there be
2 no mistake, it was the opportunity to rid the county of
3 its most notorious corporate citizen that helped bring
4 this unprecedented alliance together.
12:01 5 The other risk would be uncertainty. And
6 that is what the indenture trustee's plan offers because
7 it is not a plan at all. It is a roadmap to a sale. At
8 that sale, no one knows what will happen or who will buy.
9 Under the indenture trustee's plan, the sale process will
12:01 10 be run by Houlihan, its own financial advisor.
11 Mr. DiMauro of Houlihan testified in his deposition in
12 advance of this confirmation hearing that he believed the
13 indenture trustee's sale process would take from five to
14 seven months from beginning to end.
12:02 15 And what is to happen to the employees of
16 Palco and the residents of Scopac -- or I'm sorry, of
17 Scotia during this interim? Is it reasonable to expect

18 that Marathon will blindly fund the losses at the mill
19 and town to preserve their livelihoods and way of life?
12:02 20 And what if the worse happens? What if five to seven
21 months pass and the indenture trustee's sale ends up
22 being nothing more than a foreclosure sale? What if Biel
23 Bank, in effect, credit bids their lien interest and
24 takes over the forest? This would be the worse possible
12:02 25 outcome because it would just compound the uncertainty

AK/RET REPORTING, RECORDS & VIDEO, INC.

138

1 for the county and its inhabitants.
2 Surely Biel Bank would not be a long-term
3 holder of the forest. We believe they said as much in
4 their depositions speaking about their uncertain timing
12:02 5 for exit. Biel Bank has no special forest background or
6 expertise. If Biel Bank were to become the owner, no one
7 who works in the redwood business in Humboldt County
8 would have any way of predicting the future. How could
9 they invest in their businesses? How could the residents
12:03 10 of Scotia decide whether or not they should buy their
11 homes?
12 This is not what reorganization is
13 supposed to accomplish. And this is a primary reason why
14 the unsecured trade creditors of Scopac rejected the
12:03 15 indenture trustee's plan by a vote of 28 to 2, even
16 though it purported to pay them 100 cents on the dollar.
17 In contrast, the MRC/Marathon plan got 195 accepting
18 votes from Palco's unsecured creditors. By dollar
19 amount, 99.95 percent of all of Palco's non-insider or
12:03 20 unsecured creditors accepted the MRC/Marathon plan. And
21 Scopac by dollar amount, 99.55 percent of the Scopac
22 trade claimants accepted the MRC/Marathon plan.
23 And what, Your Honor, of the 66 creditors
24 for whom the debtors filed joinders in opposition to the
12:04 25 motion 13 months ago, how did they vote on the plans that

1 are now on file? Well, Your Honor, 28 of the 66 voted on
2 the debtors' plan and 26 of them voted to reject it. 6
3 of them voted on the indenture trustee plan and all six
4 of them voted to reject it. 31 of them voted on the
12:04 5 MRC/Marathon plan and 30 of them voted to accept it. 21
6 of them voted on the Palco alternative plan and all 21 of
7 those joining parties voted to reject it. 6 of them
8 voted on the Scopac alternative plan and all 6 of them
9 voted to reject it.

12:04 10 For all of these reasons, Your Honor, the
11 committee is proud to recommend to the Court that it find
12 the MRC/Marathon plan to be the best solution to a
13 problem that has vexed Humboldt County for more than 20
14 years and vexed this Court for more than a year.

12:05 15 THE COURT: Thank you. The State of
16 California is next.

17 MR. PASCUZZI: Thank you, Your Honor.
18 Your Honor, we're here to urge the Court to confirm the
19 MRC/Marathon plan. You heard a lot about Friday
12:05 20 afternoon the Governor filing a statement in support of
21 the MRC/Marathon plan on behalf of the State of
22 California. We also filed a brief on behalf of our
23 agencies, or our clients, the California State Agencies,
24 that supports the MRC/Marathon plan and discusses the
12:05 25 legal framework of the environmental regulation of the

1 debtors' operations. That brief points out some of the
2 feasibility problems with the debtors alternate plans and
3 the inherent risks we believe that the indenture trustee
4 plan presents. Your Honor, I want to make a couple of
12:05 5 what I believe are crucial points for the Court in the
6 confirmation trial.

7 A couple issues you're going to be dealing
8 with, you've heard, are value and environmental
9 compliance. Your Honor, as you know, we've been active
12:05 10 in the case to make sure that the environmental laws of
11 the State of California come out unscathed. And we were
12 very concerned at the beginning of the case that the
13 debtors filed it here to perhaps try and find a court
14 that might be less sympathetic to our interest in
12:06 15 upholding the environmental laws.

16 But this Court has never wavered in ruling
17 that bankruptcy was not going to restructure the
18 environmental laws of California or the United States.
19 We believe that's a correct statement of the law. So in
12:06 20 looking at the plans before the Court, there's one plan
21 that not only says it's going to uphold the laws of
22 the -- the environmental laws, it also demonstrates how
23 it will do so with a track record of making a profit, and
24 that is the MRC/Marathon plan.

12:06 25 Your Honor, California Public Resources

AK/RET REPORTING, RECORDS & VIDEO, INC.

141

1 Code section 4513(B) talks about legal timber harvesting
2 levels, which is going to be a key component in the
3 valuations. And it says, quote, "The goal of maximum
4 sustained production of high quality timber products is
12:06 5 achieved while giving consideration to values relating to
6 recreation, watershed, wildlife, range and forage,
7 fisheries, regional economic vitality, employment and
8 aesthetic enjoyment."

9 As you've heard, the debtors of the
12:07 10 noteholders argue that the MRC/Marathon plan undervalues
11 the property, low-ball. We want you to know that we do
12 not believe that is the case. We believe that the
13 evidence will show that the MRC/Marathon plan and their
14 group has complied with California law, the section I
12:07 15 just read to you, and considered not just how much timber

16 they can get off the property in the short-term, but the
17 long-term sustainability of the timberlands taken into
18 consideration the growth of the forest, the effect of
19 harvesting on the watershed, the effective harvesting on
12:07 20 endangered species and employment and the economic
21 vitality of the region. That's what the law says you
22 have to do. And we think the evidence will show that the
23 others have valued the land without considering the
24 entire environmental picture but focusing on maximum
12:08 25 harvesting in the short-term.

AK/RET REPORTING, RECORDS & VIDEO, INC.

142

1 The other plan proponents might suggest
2 that if the regulators had their way, there would be no
3 logging at all or the least amount possible, but that's
4 not the case. The law says in the section I just
12:08 5 mentioned to you, you have to take into consideration
6 employment and the economic vitality of the region.

7 Your Honor, the Court asked at the
8 beginning when Mr. Neier was up here on behalf of
9 Marathon what's the difference between the noteholders
12:08 10 claim and the value of the collateral that the Marathon
11 plan is talking about? And I believe the number \$280
12 million was put. But the way I see it, I'm not sure the
13 gap is so large. The MRC/Marathon plan gives the
14 noteholders \$500 million. The noteholders say the value
12:08 15 of their collateral is \$600 million and they have
16 letters, expressions of interest in the 500, mid 500
17 ranges. So the difference really is not \$280 million,
18 it's more like \$50 to \$100 million.

19 I want to respond to one comment made by
12:09 20 counsel for Palco. He implied or insinuated that we're
21 here to support the MRC/Marathon plan because there have
22 been promises from them that they'll dispose of or get
23 rid of the so-called Headwaters or Fresno litigation. I
24 want to assure the Court that there have been no

12:09 25 promises, there have been no agreements, there have been

AK/RET REPORTING, RECORDS & VIDEO, INC.

143

1 no representations other than they will take a fair and
2 reasonable look at it. That is not why we're here
3 supporting the MRC/Marathon plan.

4 Your Honor, in our brief we identify a
12:09 5 couple of issues with the Marathon/MRC plan based on the
6 jurisdictional provisions that we have problems with.
7 Actually, all the plans have overbroad retention of
8 jurisdiction provisions. The point is that the plans
9 cannot create jurisdiction in the bankruptcy court where
12:09 10 none exists otherwise. So the environmental matters,
11 including the Fresno or Headwaters litigation should be
12 resolved in the appropriate non-bankruptcy forum and the
13 confirmation order should provide.

14 We think the confirmation order should
12:10 15 also have some language to make sure everyone is clear
16 about the prior approvals by the state and federal
17 regulators. I think the federal agencies are asking for
18 the same thing. I think we can deal with those issues
19 with counsel, and if not, we'll raise them at closing.

12:10 20 Moving on to the indenture trustee plan,
21 Your Honor, it has two inherent risks that cause us
22 concern. As you've heard, there's no long-term solution
23 for the mill. You've heard some temporary solutions,
24 some possibilities, some speculation but nothing certain.
12:10 25 Second, we don't know who the buyer will be. You've

AK/RET REPORTING, RECORDS & VIDEO, INC.

144

1 heard identified potential purchasers like the nature
2 conservancy. And the nature conservancy could be a
3 favorable buyer to the State, but there is a risk that a
4 financially driven buyer comes in looking to get as much

12:10 5 timber off the property in the short-term as possible,
6 and that gets back to environmental law compliance. And
7 while the indenture trustee plan said they will comply
8 with the law and a buyer will have to comply with the
9 law, the reality is if you have a buyer that is
12:11 10 inexperienced in the California timber industry, and
11 primarily a financial buyer looking for short-term
12 profits instead of long-term sustainability, we won't
13 have environmental compliance in the long-term.

14 That won't be something this Court will
12:11 15 have to deal with, but it will be something the state and
16 federal regulators will have to deal with in the future.
17 And when there's an alternative with the Marathon/MRC
18 group that understand these long-term sustainability
19 concepts, we prefer that.

12:11 20 Your Honor, turning to the debtors' plans,
21 I think the only plans on the table are the alternate
22 plans. These plans transfer all the assets to the banks
23 and the noteholders except for the preserved project
24 lands and the Fresno or Headwaters litigation.
12:11 25 Regardless of what happens to the timberlands and the

AK/RET REPORTING, RECORDS & VIDEO, INC.

145

1 mills, we have the same issue as under the indenture
2 trustee plan. Who knows who will own the timberlands,
3 who knows what will happen with the mill.

4 The preserve project, Your Honor, is
12:12 5 mentioned in our brief. We have serious concerns about
6 the feasibility of that project and we don't think the
7 debtors will put on sufficient evidence to meet the
8 feasibility standard of 1129 that the preserve project
9 has a reasonable probability of success. And the
12:12 10 debtors' experts don't show there's a reasonable
11 probability of success. What they do is talk about it as
12 a concept. And I think counsel for Scopac actually used
13 that word in his opening.

14 They might be able to do it, and if they
12:12 15 do do it, there might be the values that they say are
16 there. That's best described as a visionary scheme that
17 doesn't meet the feasibility standard of 1129.

18 In getting back to environmental
19 compliance, again, their plan says they will comply with
12:12 20 environmental laws, they'll get all the approvals they
21 need, but what they're really talking about is an
22 admitted change in the regulatory scheme. Our brief
23 shows that the habitat conservation plan and related
24 environmental permits were all designed with one common
12:12 25 owner of all of the lands and primarily timber harvesting

AK/RET REPORTING, RECORDS & VIDEO, INC.

146

1 activities in mind, not multiple owners with residential
2 housing. So we're talking about major changes to the
3 existing regulatory scheme, admittedly amendments to the
4 HCP that will require years of scientific study,
12:13 5 environmental impact reports, public hearings, probably
6 some lawsuits from environmental groups along the way and
7 millions of dollars spent not only by the debtors, but
8 also by the taxpayers of the State of California.

9 And we believe, Your Honor, when there is
12:13 10 a much more feasible alternative like the Marathon/MRC
11 plan that also meets the goals of Chapter 11, that's the
12 way the Court should go.

13 In conclusion, Your Honor, we believe the
14 evidence will show that the MRC/Marathon plan
12:13 15 appropriately values the assets given the legal
16 requirements to comply with environmental laws which
17 includes harvest levels that meet the critical goal of
18 ensuring sustainable high quality timber production over
19 the long-term while protecting the watershed and wildlife
12:13 20 and economic vitality of the region. Thank you.

21 THE COURT: Thank you. Yes, sir. I think
22 this is the last opening statement.

23 MR. TENEBBAUM: Your Honor, I have a very
24 short one.

12:14 25 THE COURT: We'll let you go next then,

AK/RET REPORTING, RECORDS & VIDEO, INC.

147

1 Mr. Tenebaum. Go ahead.

2 MR. JONES: Thank you, Your Honor. Evan
3 Jones on behalf of Bank of America. Your Honor, we're
4 not here to urge the Court to confirm a particular plan.
12:14 5 We have negotiated with all of the constituencies or all
6 the proponents and all of them treat our clients
7 reasonably well. Your Honor, I would note that Corpus
8 Christi is a much more exciting town than I realized when
9 I first started coming here. You can wake up on any
12:14 10 given morning and see you've got ten or 12 pleadings
11 relating to the hearing that day.

12 And I did learn last night that apparently
13 the noteholders believe that they don't need to pay us
14 our default interest. They rely on the Entz-White case,
12:15 15 which at an appropriate time, Your Honor, we'll suggest
16 is based on an old version of the definition of
17 impairment was changed by the legislation specifically in
18 reaction to that and that there are a lot of post 1988
19 cases that say we do get our default interest. But Your
12:15 20 Honor, that's not before the Court today. I think even
21 the noteholders would acknowledge that the Marathon plan
22 which they say artificially impairs us because it
23 proposes to pay us our default interest does have other
24 impaired classes voting for it, and so we'll deal with
12:15 25 that issue at another day, if we need to. We support

AK/RET REPORTING, RECORDS & VIDEO, INC.

148

1 each of the proponents here and we'll deal with that
2 another time.

3 Your Honor, what we really want to urge
4 the Court, though, is what we mentioned on a number of
12:15 5 occasions, that it's time to get this case resolved.
6 Your Honor, I would suggest that it's going to be a
7 disaster for everyone in this room, and I use that phrase
8 advisedly, if we walk away from here without a confirmed
9 plan.

12:16 10 We do have a motion pending for a Chapter
11 trustee. Your Honor, I respectfully suggest that if
12 we don't get a plan confirmed, frankly we may be looking
13 at a Chapter 7 for one or more of these cases. I learned
14 today I'm a minor party, I don't get a chair at the table
12:16 15 and there's only one lawyer in the room for my client,
16 but this case is burning value quickly. And so, Your
17 Honor, I'd like to second comments that were essentially
18 made by both Mr. Neier and Mr. Jordan.

19 Mr. Neier, he didn't put it in exactly
12:16 20 these words, but he essentially said, Your Honor, if you
21 tell us the value is something different than what our
22 plans says, we're going to have to try to and fix it. He
23 hasn't given you a blank check, but he's made it clear
24 that his client is looking to this Court for guidance.
12:16 25 Your Honor, Mr. Jordan says the same thing. He describes

AK/RET REPORTING, RECORDS & VIDEO, INC.

149

1 it as invoking the California rule, and I think he's
2 talking about in California a lot of the judges are
3 prepared to give tentative rulings on motions.

4 THE COURT: Right.

12:17 5 MR. JONES: Your Honor, as a California
6 lawyer, I note that that's often helpful, but the most
7 effective use that I've seen by a Court was when I was in
8 Ohio in a case. I put my case on the in morning, the
9 Judge called us in to chambers at lunch and he turned to
12:17 10 my opponent and said, you can put your case on this
11 afternoon but he's going to win, you may want to think

12 about negotiating over lunch. And Your Honor, believe it
13 or not, we got it done.

14 Now, Your Honor, again, I don't care which
12:17 15 plan it is. And I'm not going to say, but I suspect the
16 Court may conclude that there are some things about each
17 of these plans that need to be moved around, changed,
18 cleaned up a little to confirm any of them. What I'm
19 here for, Your Honor, is to very strongly urge the Court
12:17 20 to use that power, box these people about the ears, get
21 them to fix their plans in whatever way the Court finds
22 so at the end of these hearings -- and it's clear to me
23 we should be finished by tomorrow given the time we've
24 taken on openings -- but whenever we finish them, I sure
12:18 25 would like us to walk out of here with a confirmed plan.

AK/RET REPORTING, RECORDS & VIDEO, INC.

150

1 And if the Court needs to take people into chambers and
2 help them get there, I would strongly urge the Court to
3 do that. Thank you, Your Honor.

4 THE COURT: Mr. Tenebaum.

12:18 5 MR. TENEBBAUM: Thank you, Your Honor. We
6 filed some comments and limited objections on the various
7 plans on behalf of the federal wildlife agencies and the
8 Department of Interior and Department of Commerce.
9 First, as to the comments, the federal wildlife agencies
12:18 10 have reviewed the various plans and we also had
11 presentations on the plans in California from each of the
12 plan sponsors and proponents, and we do thank them very
13 much for making a trip out there. It was very helpful.

14 Based on the review of the plans and the
12:18 15 presentation, the federal wildlife agencies do believe
16 that the Mendocino/Marathon plan is the one that is most
17 consistent with the existing habitat conservation plan.
18 The other plans, as has already been noted by the State,
19 have various uncertainties as to whether they will end up
12:19 20 being consistent with the habitat conservation plan. I'm

21 sure Your Honor will be hearing more about that during
22 the course of the proceeding.

23 Now, while this comment of the federal
24 wildlife agencies is not -- it's not a general objection
12:19 25 to the other plans, we are making the comment to the

AK/RET REPORTING, RECORDS & VIDEO, INC.

151

1 extent that the Court determines that it's relevant to
2 the Court's analysis to some of the issues before it such
3 as valuation, feasibility, and the public interest and
4 compliance with non-bankruptcy law.

12:19 5 Let me turn then very quickly, briefly to
6 the limited objection, the limited legal objections that
7 we stated in our filing. Most -- all of these are really
8 requests for clarification of all the plans. They apply
9 to all of them, and our statement about the Mendocino
12:20 10 Marathon plan is conditioned on modification of that plan
11 to incorporate the suggestion for clarification that we
12 did make in our filing.

13 And we don't believe that these should be
14 controversial in any way. I'm just -- they're all
12:20 15 designed to make sure that as the plans are not forbidden
16 by non-bankruptcy law and thus would be in violation of
17 1123 -- 1129(A)3 of the bankruptcy code which requires
18 that debtors may not propose plans that are quote
19 "forbidden by law."

12:20 20 I'm just going to mention two of the
21 requests for clarification, two of the most important
22 ones of those. The first is that we think the plans all
23 need to be clarified so there's no misunderstanding that
24 nothing in the plans authorize any transfer of land
12:21 25 covered by the HCP or any of the permits prior to

AK/RET REPORTING, RECORDS & VIDEO, INC.

152

1 obtaining any applicable regulatory approval for such
2 transfer. And the other clarification that's
3 particularly important that I wanted to mention up front
4 is that for any of these plans that any disputes
12:21 5 involving the environmental obligations or regulatory
6 approval for transfer of properties or the amendment or
7 issuance of permits, that those should be resolved in the
8 applicable non-bankruptcy forum.

9 I'll refer the Court to our filing for the
12:21 10 others. I think there's three other request filings that
11 we have in there. And we'll ask that they be addressed
12 as appropriate at the end of the hearing. Thank you very
13 much.

14 THE COURT: All right. Anyone else? All
12:22 15 right. We're going to now break for lunch. And it's now
16 11:21 so we'll say 1:30, 1:30. Is that reasonable?

17 SPEAKER: It's 12:20.

18 THE COURT: It's 12:20, so 1:30, that
19 gives you an hour and ten minutes. Hopefully that will
12:22 20 work. Thank you. We'll leave the telephone on.

21 (A recess was taken for lunch.)

22 MR. JORDAN: Your Honor, we're still
23 stocking the courtroom.

24 THE COURT: Okay.

01:30 25 SPEAKER: There's a big line at security.

AK/RET REPORTING, RECORDS & VIDEO, INC.

153

1 Judge, I want to let the Court know that we've been told
2 that Mr. Dean is the first witness; is that correct?

3 THE COURT: And you have an objection to
4 his proffer?

01:30 5 SPEAKER: We have an objection to --
6 that's right, to his proffer.

7 THE COURT: Okay. We'll start with that.

8 SPEAKER: Mr. Dean and his counsel are, I
9 believe, downstairs at security.

01:31 10 THE COURT: Can we start arguing about
11 who's going to make the argument about the admissibility
12 of Mr. Dean's proffer?
13 MR. KRUMHOLZ: I am for the indenture
14 trustee, Your Honor.
01:31 15 SPEAKER: Your Honor, if you would wait
16 until Mendocino counsel is here.
17 THE COURT: Mendocino is not here yet?
18 SPEAKER: Well, they're on the security
19 line. It's a long, long line.
01:31 20 MR. KRUMHOLZ: Judge, while we're waiting,
21 we can get kind of a housecleaning issue.
22 THE COURT: It doesn't involve anybody
23 else but yourself?
24 SPEAKER: We're here. Your Honor, we're
01:32 25 here.

AK/RET REPORTING, RECORDS & VIDEO, INC.

154

1 THE COURT: Well, we still don't have part
2 of the debtors that are not here. They're getting here.
3 They're coming in the door.
4 MR. KRUMHOLZ: The only issue is a copying
01:32 5 issue.
6 THE COURT: A copying issue?
7 MR. KRUMHOLZ: A copying issue with
8 respect to the hard copy.
9 THE COURT: If you have a question about
01:32 10 the hard copies and the disc copies, what?
11 MR. KRUMHOLZ: We have discs, CDs ready to
12 go. The problem was when they were sent out yesterday to
13 the copy center that was recommended by Pitney Bowes,
14 they came back and the quality is so poor we're not
01:32 15 comfortable giving them to anybody, including using them
16 ourselves, so we're having to redo those.
17 THE COURT: Okay.
18 MR. KRUMHOLZ: And we're bringing in

19 multiple copies so we can get through it as quickly as we
01:32 20 can. It shouldn't delay anything but I wanted to apprise
21 the Court of what's going on.
22 THE COURT: Okay. Not a problem. All
23 right. I think we have enough of everyone here that we
24 can at least go ahead with the issue about the proffer of
01:33 25 Mr. Dean. Go ahead.

AK/RET REPORTING, RECORDS & VIDEO, INC.

155

1 MR. KRUMHOLZ: Thank you, Your Honor.
2 Richard Krumholz on behalf of the indenture trustee.
3 Last night and this morning I was trying to figure out
4 how I can best communicate to the Court the situation
01:34 5 they're in and the importance of the motion that we have
6 now filed and set this morning. At 2:30 a.m. on Saturday
7 morning we received for the first time an expert report,
8 in essence, that was provided as a proffer of Mr. Dean.
9 Mr. Dean, of course, is the chairman of Mendocino and has
01:34 10 been involved in evaluating the plan and obviously a
11 co-proponent of the Marathon plan and has gone to great
12 lengths to tell us how much he knows about Scopac and
13 Palco because he's been involved since 2004 in doing
14 various due diligence in 2006 and later now in January
01:34 15 2008.

16 And what's striking about this expert
17 report is how comprehensive it is with respect to just
18 about every expert opinion you can possibly imagine that
19 could be at issue in this case. So for the first time
01:35 20 we're going to see what is, in essence, an expert report
21 contending the most comprehensive set of opinions that we
22 have seen as to every issue the Saturday before we start
23 trial on Tuesday, and well after the deposition of a
24 supposed simply fact witness that we took long ago.
01:35 25 Now, as you read through this 64-page

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 proffer, what you quickly realize, as Mr. Brilliant
2 pointed out today, that he provides us with a number of
3 very substantive opinions as to value. The maximization
4 of the value of the timberlands, supposedly how the
01:35 5 benefits of what he plans to do will benefit the
6 timberlands, the environmental regulations and opinions
7 regarding those environmental regulations, the supposed
8 probable future market prices for timber to support those
9 valuation opinions, the supposed costs associated with
01:36 10 harvesting and selling timber to support the value
11 opinions.

12 And then he continues with his contention
13 regarding profitability, both long-term, short-term and
14 whether it's important and why. And then of course he,
01:36 15 as Mr. Brilliant says, comes forward with an appraisal,
16 an appraisal that they consider to be somehow more
17 believable or credible given his knowledge of the area.

18 All of these opinions, without a report at
19 all for us to look at without any documents that he
01:36 20 supposedly reviewed or relied upon to look at and review.
21 Now, it wouldn't be so bad if, you know, we were just
22 trying our best and willy-nilly trying to get to a trial
23 without a discovery plan. But what is particularly
24 egregious in this circumstance is that Mr. Lamb and I in
01:37 25 February of this year, pursuant to your particular orders

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 when we first showed up in this case, negotiated at
2 length an agreement that we proposed to all of the
3 parties that are sitting here today proposing a plan.

4 And that agreement has been attached to
01:37 5 our motion as Exhibit A and Exhibit B. And Jamie, can
6 you go ahead and put the discovery agreement on the
7 monitor. If you can highlight that first sentence,

8 Jamie, and call it out so we can actually see it.

9 It says -- and this, by the way, is from
01:37 10 David Neier, counsel for Marathon and it's to Craig
11 Druehl, of course, who I understand is the counsel for
12 Mendocino. And what you see in the very first sentence,
13 it says "the indenture trustee, committee, Mendocino and
14 Marathon are in general agreement with the e-mail of
01:38 15 Richard Krumholz," that's me, "that is attached hereto."
16 And you see that little proposed discovery plan envelope
17 in the top left-hand corner, that's the attachment. And
18 so if we can go to Exhibit B of that document, which is
19 the actual agreement.

01:38 20 This is what was agreed to and what
21 everybody was supposedly living by. "On March 14, the
22 designation of all experts in exchange of reports
23 containing a fair summary of their opinions, all opinions
24 and the basis for saying." We never received that for
01:38 25 this witness on March 14. We didn't receive it the next

AK/RET REPORTING, RECORDS & VIDEO, INC.

158

1 week, the next week, the next week. We finally received
2 a proffer, and we have had no ability to cross-examine
3 this witness on any of the issues that he's -- that he
4 now has opinions about. We have had no ability to review
01:38 5 any of the mountains of evidence that he supposedly has
6 that support these contentions.

7 In fact, last night I had to spend, while
8 we were preparing for trial, a list of references to
9 documents he supposedly has reviewed and relied upon.
01:39 10 And this is just what I could get through by the end of
11 last night. And none of that have I seen. And to be
12 honest with you, even if I did, we would need experts to
13 go back and look at these and tell me why -- what the
14 opinions mean and what the bases mean so we could have an
01:39 15 intelligent cross-examination of this gentleman.

16 So the reality is that I have never seen a

17 more egregious abuse of the discovery process in the
18 context of a case like this. It's trial by ambush, it's
19 trial at the 11th hour and it's the most comprehensive
01:39 20 set of opinions and testimony of any witness in this
21 whole courtroom that you'll hear the entire week, the
22 entire week. Now --

23 THE COURT: Is Mr. Dean being offered as
24 an expert witness?

01:40 25 MR. HALE: Your Honor, he's being offered

AK/RET REPORTING, RECORDS & VIDEO, INC.

159

1 to testify about the value that he did, the facts that he
2 did, his experience with his -- with his company, what he
3 did to model, what he did to value the timberlands. He's
4 being offered to testify in the basis of his experience,
01:40 5 Your Honor.

6 MR. KRUMHOLZ: I think that's a yes.

7 MR. HALE: He's testifying as a plan
8 proponent in this case, Your Honor. It is not an opinion
9 in this case. He has an offer on the table to invest
01:40 10 hundreds of millions of dollars into the business. It's
11 not a hypothetical appraisal, it's not some theoretical
12 model. He's testifying about what he did, the facts of
13 what he did, what's appropriate in what he did and why
14 what he did is accurate.

01:40 15 THE COURT: When did you identify him as a
16 witness?

17 MR. HALE: Your Honor, he's been
18 identified a long time ago. He was deposed on March the
19 12th. And in fact, in his deposition he referenced the
01:40 20 valuation models, he talked about the models, they were
21 produced shortly thereafter, within two or three days is
22 when they were scheduled to be produced. The indenture
23 trustee didn't sign a protective order, so they weren't
24 produced for a while but there's over 25 valuation models
01:41 25 that were produced.

1 THE COURT: All right. Finish your
2 argument.

3 MR. KRUMHOLZ: Your Honor, the bottom line
4 is you can't just say he is offered as an expert or not.
01:41 5 If he has opinion testimony, he is to testify as an
6 expert witness in every court that I know of in the
7 United States, federal, state or otherwise. Throughout
8 his proffer there are opinions about all the issues that
9 I described a few moments ago and about every issue. And
01:41 10 these are not just quote "facts," these are absolute
11 opinions. And yes, there can be lay witnesses who have
12 opinions about which they are qualified to render, that
13 they are testifying experts and they have to comply with
14 deadlines like these.

01:41 15 And it's clear what happened here. This
16 is a gentleman who has been involved long before March
17 14. They had a choice then and there to have him provide
18 us with their expert opinions. They should not be
19 rewarded for that strategy and his opinions should be
01:41 20 struck. If he wants to talk about facts like what we do
21 as Mendocino, like he does in his first half of his
22 report, why they're qualified to run this thing, his
23 knowledge of environmental regulations, his compliance
24 with them, the awards that he said he has gotten in that
01:42 25 regard, all of those things are facts.

1 What's not a fact -- what are not facts
2 are value. What are not facts are harvest rate, the best
3 harvest rate. What are not facts is whether or not
4 integration is the best way to do that. None of those
01:42 5 are facts, those are opinion evidence about which no

6 layperson -- I certainly wouldn't know one way or the
7 other, and that's the definition under 702 of an expert,
8 is it helpful to a layperson in providing -- or is it
9 common knowledge.

01:42 10 This is not that sort of thing. This is a
11 maybe a fact witness, but he certainly has been offered
12 as an expert with expert opinions and you just can't
13 label him a fact witness and then somehow bootstrap a
14 bunch of opinions at the last minute. It is truly trial
01:43 15 by ambush. And if you had gone through the process by
16 which Mr. Lamb and I negotiated it --

17 THE COURT: Let's take the -- where is the
18 most egregious statement in the proffer that you're
19 considering to be expert testimony?

01:43 20 MR. KRUMHOLZ: The values, the 55 billion.

21 THE COURT: What page?

22 MR. KRUMHOLZ: We can go through it if
23 you'd like, Your Honor.

24 THE COURT: Just pick out the worst one.

01:43 25 MR. KRUMHOLZ: One of the worst ones is

AK/RET REPORTING, RECORDS & VIDEO, INC.

162

1 that he's come up with this 55 million -- I mean, 55
2 million --

3 THE COURT: Where is it?

4 MR. KRUMHOLZ: That is the harvest rate
01:43 5 that he wants to apply.

6 THE COURT: Where is that?

7 MR. KRUMHOLZ: I'll try to find it
8 quickly, Your Honor. And which was referenced in the --
9 it's on paragraph 75 on page 31.

01:43 10 THE COURT: All right. On page 31.

11 MR. KRUMHOLZ: That's one of them.

12 THE COURT: Okay. Page 31, paragraph 75.
13 What -- "further capturing these and other constraints
14 led us to acreage based analysis described above. So it

01:44 15 is our understanding of the effective constraints that
16 limit the harvest of 55 million feet for the first ten
17 years."

18 MR. KRUMHOLZ: It says "the bottom line is
19 that under Palco, ten million can be operated at higher
01:44 20 than 55 million working for a short amount of time. A
21 higher rate is not sustainable and will not maximize
22 long-term profits." There are four or five opinions in
23 that one statement.

24 MR. HALE: Your Honor, while we're on that
01:44 25 subject, I'll just respond. That's in the disclosure

AK/RET REPORTING, RECORDS & VIDEO, INC.

163

1 statement. And secondly, he was specifically asked about
2 the 55 million board feet was specifically discussed at
3 Mr. Dean's deposition. Page 115: "What harvest level
4 does the model assume?" Talking about Mr. Dean's model
01:44 5 valuation. "In what period?"

6 Question: "In the near term."

7 Answer: "55 million feet."

8 Question: "And how did you arrive at that
9 number?"

01:44 10 THE COURT: I'm not sure exactly how we --
11 I understand your enthusiasm to respond and I'm going to
12 give you a chance to respond, but I don't think it's fair
13 to just jump up right when he's talking and say, okay, we
14 questioned him on this.

01:45 15 MR. HALE: Fair enough.

16 THE COURT: So do you have another one?

17 MR. KRUMHOLZ: Well, yeah. There are
18 literally dozens in this proffer, Your Honor. And what I
19 would request is instead of taking this gentleman first,
01:45 20 I would suggest that they call someone else and that you
21 have an opportunity to read it and see what I'm talking
22 about because for me to go page by page and show you
23 every single --

24 THE COURT: I read this last night,
01:45 25 actually, so I've had the chance to read it. I mean, he

AK/RET REPORTING, RECORDS & VIDEO, INC.

164

1 is obviously the plan proponent and he's the gentleman
2 that's most qualified to testify about what Mendocino
3 thinks it can do with this acreage.

4 MR. KRUMHOLZ: He did say what their plans
01:45 5 are. There's a difference between saying we're going to
6 harvest 55 million board feet and saying that that's all
7 you can do optimally and that's the only thing that's
8 sustainable or that will lead to a long-term profit.
9 Those things are opinion, it just is.

01:46 10 THE COURT: They're opinions, but that is
11 not the kind of an opinion that -- first of all, he runs
12 a redwood company, so I can't imagine that you didn't
13 expect that they weren't going to ask him how much he
14 thought they could get off of the acreage. I mean,
01:46 15 whether it's binding or not, I don't know that it's
16 opinion evidence like an expert, but I think there are
17 independent reasons why they have to have this guy say
18 what he thinks he's going to do, etcetera.

19 MR. KRUMHOLZ: Well, that's a fair point.
01:46 20 So in the deposition my partner asked him: "Has MRC had
21 a valuation done of Scopac timbers?" And the answer was
22 no. I mean, we can only do so much. He was not offered
23 as an expert at the time of his deposition. He was
24 offered under the laundry list of 1129(A).

01:46 25 THE COURT: Well, I'm not going to

AK/RET REPORTING, RECORDS & VIDEO, INC.

165

1 consider him as an expert today. I'm going to consider
2 him as the chairman of the board of that company
3 testifying what he believes his plan provides.

4 MR. KRUMHOLZ: Well, you can say he's an
01:47 5 expert or not and what we call him and label him, he
6 cannot provide these opinions. That's under the federal
7 rules. And Your Honor, frankly, I believe that under
8 those rules it would be reversible to do so.

9 THE COURT: You know, there are opinions
01:47 10 that can -- you know, opinions of value, for instance.
11 Well, you know, the debtor somehow gets to give their
12 opinion of value in a bankruptcy case. Other than that,
13 experts are supposed to give opinions as to that. Now,
14 this is not the day. Although I mean, I'm not sure -- I
01:47 15 mean, you have also an objection to their standing to
16 even present this plan on your portion of it. And I'm
17 not certain if they believe their standing is based on
18 their fact that they have a security interest in the
19 stock or the height, the nature of these two businesses
01:48 20 being tied together or what it is, but -- I don't know.
21 I don't know how that relates.

22 MR. KRUMHOLZ: The truth is if you live
23 through this process, Judge, what you know is they hid
24 behind the law. And the real question is are you going
01:48 25 to allow them to do it? That's really what it comes down

AK/RET REPORTING, RECORDS & VIDEO, INC.

166

1 to because they have known for a very long time that they
2 were going to call this guy with these opinions. And you
3 saw the other expert reports. This report is more
4 comprehensive in terms of those opinions at issue in this
01:48 5 case than any others. And under the federal rules, it
6 has absolutely been prejudiced. There's no excuse. And
7 under -- and at 1488, the Fifth Circuit has spoken on
8 these issues.

9 THE COURT: All right. Now, your
01:48 10 response.

11 MR. HALE: Your Honor, we understand that
12 he's being offered as a fact witness for exactly what you

13 said.

14 THE COURT: The microphones that are near
01:49 15 you can also pick you up, but you're right, that normally
16 you'd come to the microphone.

17 MR. HALE: Your Honor, I'm Bryan Hale from
18 Goodwin Procter representing the Mendocino Redwood
19 Company. First, we appreciate what Your Honor has said,
01:49 20 he is being offered as a fact witness for exactly what
21 you said, which was testifying about his analysis, how he
22 runs the company and what he intends to do with the plan
23 if he buys the operations. He's being offered as a plan
24 proponent, and Your Honor is correct for seeing that.

01:49 25 As to Mr. Krumholz's statement that at his

AK/RET REPORTING, RECORDS & VIDEO, INC.

167

1 deposition he somehow testified incorrectly or misled the
2 witnesses, they have selectively quoted a portion of the
3 deposition in which Mr. Dean was talking about a meeting
4 that he had had back in December or early January. And
01:49 5 if you read the entire transcript, which I have a copy
6 of, Your Honor, that confusion is further flushed out.
7 And in fact, we tell the debtors and the indenture
8 trustee that the valuation models are coming. Later in
9 his deposition there is a direct question on page 108
01:50 10 line 5.

11 "So is there somewhere inside MRC, is
12 there a valuation analysis that establishes a value from
13 which you relied in proposing the plan?"

14 Answer: "Yes."

01:50 15 Mr. Lamb: "Is that the model we talked
16 about earlier?"

17 Counsel, Mr. Brilliant: "Yes, the model
18 we talked about earlier that's coming."

19 The answer: "More than one model but,
01:50 20 yeah, there's lots of modeling that's been done, yes."

21 All of that modeling was produced. We had

22 25 valuation models that was produced, we never heard
23 another word out of the indenture trustee or the debtor
24 about another deposition. They were free to ask him
01:50 25 about his model. They pointed out earlier, they talked

AK/RET REPORTING, RECORDS & VIDEO, INC.

168

1 about harvest levels and harvest level inputs into the
2 model. And further, they want to argue it was all trial
3 by ambush, it's all in the disclosure statement, 55
4 million board feet was covered in the disclosure
01:50 5 statement. All of these business plans were talked about
6 in the disclosure statement. So Your Honor, you can
7 correctly perceive --

8 THE COURT: Do you-all have an expert that
9 also testifies as to 55 million board feet or whatever?

01:50 10 MR. HALE: Well, there is an valuation
11 expert that Mr. Lamont is going to testify about, but his
12 hypothetical valuation was based on a series of schedules
13 and harvest plans and things like that, which is a
14 different -- which is a different number than Mr. Dean's
01:51 15 number.

16 MR. KRUMHOLZ: Not only that, just so
17 we're on the same page here, when you're taking a fact
18 witness deposition after the deadline to designate an
19 expert, you're not interested necessarily in opinions he
01:51 20 may or may not have regarding value, what you're trying
21 to find out is what he's proffered for, which is the 1129
22 list. We shouldn't be guessing at experts. That's why
23 rule 26 is very clear on these issues and that's why we
24 entered into this agreement.

01:51 25 THE COURT: I don't know why you wouldn't

AK/RET REPORTING, RECORDS & VIDEO, INC.

169

1 be interested in his opinion of value just because he's a

2 fact witness. I suspect that -- I mean, the absurdity of
3 that position is if he had said that he believed the
4 forests were worth \$700 million, there's no way we can
01:51 5 confirm this plan; isn't that true? If he's trying to
6 bring it in through Dean they didn't think it's worth
7 that.

8 MR. KRUMHOLZ: Judge, what I'm suggesting
9 to you is this, that the whole idea behind rule 26 and
01:52 10 behind these types of agreements that we have reached is
11 so that we have an understanding of what a witness is
12 going to say or not. And we had a very short period of
13 time to prepare for this trial obviously. And in doing
14 so, we should have been given the opportunity to see the
01:52 15 opinions and to cross-examine fully on those opinions if
16 that was where they were going with this witness.

17 When I have -- and to your point as to the
18 debtors. There is a long line of cases that we're all
19 familiar with inside and outside of bankruptcy that you
01:52 20 can testify to the value of your own property. If I own
21 a car, I can testify about that value whether I'm
22 qualified or not. That's just the truth of the matter.

23 THE COURT: Right.

24 MR. KRUMHOLZ: Daubert doesn't even apply.
01:52 25 That is a far cry from this situation.

AK/RET REPORTING, RECORDS & VIDEO, INC.

170

1 MR. HALE: Your Honor, Mr. Dean is
2 testifying about the plans that he put together, his
3 valuation, the assumptions, why his harvest schedule is
4 right, why his methodology is correct and why that's the
01:52 5 best thing to do and that's what he's done.

6 THE COURT: And I don't know that these --
7 his testimony will be sufficient to convince me that
8 there's proper evidence as to expert opinions that he's
9 attempting to give. I don't know what opinions he's
01:53 10 planning to give. And we can argue about what that --

11 those opinions are at a later date, whether they have
12 satisfied their burden. But I think that -- I mean, I
13 didn't find anything -- I mean, in looking through this
14 declaration, I didn't find anything offensive from the
01:53 15 standpoint of the kinds of things that a plan proponent
16 would always testify to.

17 MR. NEIER: Your Honor, David Neier on
18 behalf of Marathon. We are going to put on expert
19 testimony as to valuation from Mr. Lamont. We have other
01:53 20 experts on valuation that will testify in rebuttal.

21 THE COURT: So I'm going to overrule the
22 objection in any event. And -- but on the other hand, I
23 agree with you that this is not an expert witness, so I
24 won't consider his opinion as an expert witness opinion.

01:53 25 MR. KRUMHOLZ: Now, the only other request

AK/RET REPORTING, RECORDS & VIDEO, INC.

171

1 I have in light of Your Honor's ruling is that we want a
2 chance to depose him on these issues and we would ask
3 that he -- his testimony --

4 THE COURT: You can do that tomorrow
01:54 5 morning, if you want to. I won't be here if you want to
6 do that. But you're not ready to cross-examine him, is
7 that what you're saying?

8 MR. HALE: Your Honor, all these documents
9 were --

01:54 10 MR. KRUMHOLZ: Absolutely, that's what
11 we're saying. We have been ambushed and we're prejudiced
12 by it and we would like to have the opportunity to at
13 least depose him during trial tonight and then if they
14 want to put him on tomorrow, fine.

01:54 15 MR. HALE: Your Honor, the valuation
16 models have been produced and in their hands, over 25
17 different models.

18 THE COURT: Do you have another witness?

19 MR. NEIER: The plan proponents have to go

01:54 20 first, Your Honor. I mean, talk about ambush.
21 MR. HALE: They know that we've been going
22 first and they have had the Dean proffer --
23 MR. NEIER: Your Honor, if they want to
24 call their witnesses, we'll have them call their
01:54 25 witnesses.

AK/RET REPORTING, RECORDS & VIDEO, INC.

172

1 THE COURT: Hold on. His proffer is now
2 admitted. Okay. Now, the question is when are we going
3 to cross-examine him? Is anyone here ready to
4 cross-examine him other than the timber noteholders?
01:54 5 MR. HALE: And surely Your Honor --
6 THE COURT: Was the debtor going to
7 cross-examine Mr. Dean?
8 MR. LAMB: Yes, we are.
9 THE COURT: All right. Let's start there.
01:55 10 MR. LAMB: We are prepared in part to
11 cross-examine him, but I have to agree, the deposition
12 that's been taken of this witness was not taken of a
13 proposed expert witness.
14 THE COURT: Well, he is not an expert
01:55 15 witness.
16 MR. LAMB: I understand that. And we can
17 proceed under that understanding.
18 MR. HALE: Your Honor, all the statements
19 are in the disclosure statement. They've had the
01:55 20 document production for a month. They never mentioned
21 another peep. They knew he would be a witness. We don't
22 take another deposition. There's just not any basis for
23 it.
24 MR. KRUMHOLZ: I can respond.
01:55 25 THE COURT: I don't think that the harm in

AK/RET REPORTING, RECORDS & VIDEO, INC.

173

1 calling him for cross-examination tomorrow is that great,
2 so if -- I mean, if there is a problem with that,
3 somebody needs to tell me right now what harm that would
4 be. Was Mr. Dean planning on staying here tomorrow? Can
01:55 5 he stay here tomorrow?

6 MR. HALE: He is, Your Honor.

7 THE COURT: All right. So is the debtor
8 prepared to cross-examine him today?

9 MR. JORDAN: Your Honor, if he's going to
01:55 10 be deposed, I don't want to be --

11 THE COURT: Do we have any other
12 witnesses?

13 MR. HALE: Your Honor, they've had their
14 opportunity to depose him. He has already been deposed
01:56 15 once.

16 MR. KRUMHOLZ: He has not been deposed on
17 that issue.

18 MR. HALE: We talked about harvest models.
19 We've talked about harvest scheduling. We've talked
01:56 20 about valuation models in his deposition.

21 THE COURT: I understand that. They think
22 they need to depose him. We've got a morning tomorrow
23 they could depose him if they want to. Do we have other
24 witnesses that you can present at this time? Don't you
01:56 25 have other expert witnesses that you can go forward with?

AK/RET REPORTING, RECORDS & VIDEO, INC.

174

1 MR. NEIER: Your Honor, our next witness
2 will be Matt Breckenridge.

3 THE COURT: All right.

4 SPEAKER: Your Honor, there are other
01:56 5 housekeeping matters to attend to. My partner Ken Brown
6 will address the Court now on --

7 THE COURT: All right.

8 MR. JORDAN: May I also suggest this

9 unless someone has a different suggestion. We can do the
01:56 10 deposition in our offices tomorrow, but I need to know
11 start times and --
12 MR. KRUMHOLZ: How about tonight?
13 THE COURT: Or you can start it tonight.
14 I don't have a problem with that.
01:56 15 MR. KRUMHOLZ: Starting at 8 o'clock and
16 we'll go as late as we need to, absolutely.
17 THE COURT: You can go over and start that
18 deposition.
19 MR. JORDAN: Okay.
01:57 20 THE COURT: That's probably not true.
21 What is your housekeeping then?
22 MR. BROWN: Good afternoon, Your Honor.
23 This is Ken Brown for the committee. You've heard a
24 couple of times in the opening statements a reference to
01:57 25 a bid, a stalking horse bid that's been made by Biel,

AK/RET REPORTING, RECORDS & VIDEO, INC.

175

1 which is, from what we understand, one of the
2 noteholders. In fact, we think it's the noteholder that
3 holds the largest share of the notes. And we got the
4 quote "bid" last night at around 11 p.m. for the first
01:57 5 time and have just now today had a chance to review it.
6 We -- I believe I speak for MRC, Marathon and the debtors
7 along with the committee when I say that we all want to
8 depose Mr. Biel. And I believe there is not a
9 controversy over our right to depose him.
01:57 10 During the lunch break I approached
11 Mr. Gerber for the noteholders and asked if Mr. Biel
12 could be brought to Corpus Christi in light of the fact
13 that all the lawyers were here and we could have a chance
14 to depose him tomorrow. And Mr. Gerber said, no, he
01:58 15 would be made available in Dallas but not in Corpus
16 Christi. It just seems to me given the time pressures
17 that we're all under here and the dramatically greater

18 expense to the estate of flying a bunch of lawyers out to
19 Dallas tomorrow to take this guy's deposition, that it
01:58 20 makes a whole lot more sense to bring Mr. Biel here for a
21 few hours of deposition. And we respectfully ask you to
22 exercise some of your powers to get Mr. Biel here rather
23 than force everybody to Dallas.

24 MR. GERBER: Your Honor, Toby Gerber for
01:58 25 the indenture trustee. I don't represent the bidder.

AK/RET REPORTING, RECORDS & VIDEO, INC.

176

1 The bidder's actual name, I believe, Your Honor, is
2 Scotia Redwood Foundation, Inc. It's an affiliate of the
3 Biel Bank family. The witness who will be produced at
4 the request -- we received a request in the middle of the
01:59 5 night last night for his deposition, is Mr. Jacob
6 Cherner. He's available in Dallas or Plano tomorrow
7 morning. He's available in Dallas or Plano the rest of
8 the week at the convenience of the parties. But I don't
9 represent him. I don't know that you can force a
01:59 10 third-party witness to come down to Corpus to have the
11 deposition taken. If the Court would like me to request
12 that be the case, I'll be glad to request it.

13 THE COURT: Well, would you request it.

14 MR. GERBER: Certainly, Your Honor.

01:59 15 THE COURT: I'm not going to force him to
16 come down. I don't think we can do that. But if you
17 would request it, it certainly would make sense to do it
18 while we're here.

19 MR. GERBER: I don't disagree with that,
01:59 20 Judge, I just don't have the power to force anybody to
21 show up.

22 THE COURT: We can schedule it around the
23 Southwest flights.

24 MR. GERBER: Okay. Thank you, Your Honor.

02:00 25 MR. BROWN: Your Honor, just one other

1 thing. The individual who signed the bid letter is
2 Andrew Biel, it's not Cherner, so I think everybody wants
3 to talk to Andrew Biel, not Mr. Cherner. Mr. Cherner, I
4 believe, has already been deposed and Andrew Biel is the
02:00 5 signatory to the letter and it's important that he --
6 MR. GERBER: No, Mr. Biel is not the
7 signatory to the letter, Your Honor. The signatory to
8 the letter is Scotia Redwood Foundation, Inc. The
9 president of that company is D. Andrew Biel. If they
02:00 10 want to find the best witness and not simply harass
11 Mr. Biel, they will ask for -- it's Mr. Cherner who
12 Scotia Redwood would produce.
13 MR. BROWN: Well, there's also the other
14 thing --
02:00 15 THE COURT: Hang on. Who is the person
16 that's the most knowledgeable at the foundation to answer
17 questions about the bid?
18 MR. GERBER: Mr. Cherner, Your Honor.
19 THE COURT: Okay. Well, I think they can
02:00 20 designate whoever they want, if that's what you want.
21 But then if you wanted to depose Mr. Biel, I mean, that
22 could be done, but I suspect that what we're trying to do
23 is find out the most information about the bid, then the
24 person they designate probably would be the appropriate
02:01 25 person.

1 MR. BROWN: I guess the other thing we're
2 kind of mystified about, we did a country wide search for
3 this entity, Scotia Redwood Foundation and didn't find
4 anything.
02:01 5 MR. GERBER: I'm sorry. If Mr. -- if
6 counsel is testifying about some search he did, I don't

7 know.

8 THE COURT: No, I just -- but if there

9 is --

02:01 10 MR. BROWN: Is there such an entity?

11 THE COURT: I don't know if it's important

12 or not. If it's important how this was developed, then

13 maybe you can get some information.

14 MR. GERBER: I'm sure we can give them

02:01 15 that information without the necessity of a deposition.

16 Is that all you need?

17 THE COURT: I think they want to depose

18 the author.

19 MR. BROWN: The only comment I would have,

02:01 20 Your Honor, and this is a bid, I think it's important

21 from everybody's standpoint, I think the noteholders are

22 going to rely on it heavily in their presentation in

23 terms of the real world value, purported real world value

24 before us. I think Your Honor can exert some pressure

02:02 25 if -- to have the individual come here by just precluding

AK/RET REPORTING, RECORDS & VIDEO, INC.

179

1 evidence unless he comes and allows himself to be

2 deposed.

3 THE COURT: Well, they haven't offered any

4 evidence.

02:02 5 MR. BROWN: They have offered the bid.

6 MR. GERBER: No.

7 THE COURT: I don't have their documents

8 yet.

9 MR. BROWN: Well, they referred to it in

02:02 10 their opening statement. It would be improper for them

11 to refer to it in their opening statement if they weren't

12 going to offer it into evidence.

13 THE COURT: I understand that. We have

14 also referred to any number of officials who have

02:02 15 supported one particular plan or another and I don't know

16 how we get those in unless everybody agrees to it. They
17 are statements of support, they are not a party of
18 interest in this case, they're just statements. They're
19 not evidence in this case until somebody takes the stand
02:02 20 or until it's been offered and admitted.

21 So I mean, there are a lot of stuff that
22 we talk about in bankruptcy cases, and I don't know that
23 we're getting anywhere right now. So I think that if you
24 want me to meaningfully consider the Biel Bank offer, or
02:03 25 whatever it is, then you need to make the people

AK/RET REPORTING, RECORDS & VIDEO, INC.

180

1 available for a reasonable deposition and get that done,
2 and whatever other information there might well be. I
3 mean, obviously I'm not giving them a carte blanche to
4 ask for anything they want, but if the makeup of the
02:03 5 organization that is making the offer is an important,
6 well, then perhaps you can give them some information
7 about that, too.

8 MR. GERBER: Your Honor, counsel has asked
9 for a few items in addition and no one has objected to
02:03 10 that. And we have agreed to -- I have contacted
11 Mr. Cherner, he's available in Dallas. You've asked me
12 to contact him to bring him to Corpus Christi. I will
13 make that contact and recommend that he come.

14 THE COURT: All right.

02:03 15 MR. BROWN: One other point, Your Honor.
16 When we initially deposed Mr. Cherner, there were several
17 questions asked of him concerning Biel's holdings and
18 what percentage or what amount of notes they held. At
19 each instance, those questions were refused to be
02:04 20 answered under some theory of confidentiality, which I
21 didn't understand at the time. We think, again, if the
22 Biel offer is going to be admitted in evidence and
23 considered by the Court, that Biel needs to tell
24 everybody and tell the Court, tell all the parties in

02:04 25 interest, you know, who it is and what its note holdings

AK/RET REPORTING, RECORDS & VIDEO, INC.

181

1 are and it shouldn't be permitted to rely on some
2 confidentiality notions to disable us from ascertaining
3 that information.

4 MR. GERBER: Your Honor, if this is a
02:04 5 motion to compel, I think we at least need to have Biel
6 and Biel's counsel present to respond to it.

7 THE COURT: I won't be available tomorrow
8 morning. I'll be in a conference, I won't be available
9 to rule on specific deposition inquiries. But here we
02:04 10 are at the trial, we've got some issues. This should not
11 be destroying the trial of this matter. Go figure out
12 how to get that worked out. I mean, just as the -- I
13 mean, we had some reluctance from the people at nature
14 conservancy to be deposed and, you know, that certainly
02:05 15 goes to what weight I'm going to their potential offer.
16 I mean, I don't know what Biel is going to do. I don't
17 know what they're going to do, but all that has impact.
18 Now, go out and make it work.

19 MR. GERBER: We will, Your Honor.

02:05 20 THE COURT: All right. Now, who is the
21 next witness?

22 MR. HALE: Your Honor, one final point.
23 We will offer Mr. Dean for deposition tomorrow morning
24 and we suggest some sort of limit on the hours that he's
02:05 25 made available and specifically --

AK/RET REPORTING, RECORDS & VIDEO, INC.

182

1 THE COURT: You-all have got to be here
2 when I'm ready to go to trial, so get it done before I
3 get here. And I suspect it's going to be close to 2
4 o'clock when we start.

02:05 5 MR. KRUMHOLZ: Your Honor, we would
6 request that it begin tonight in light of the
7 circumstances. We need more time than that. We're going
8 to need to be in trial here and I don't know how we're
9 going to get it all done if we don't start tonight.

02:05 10 MR. HALE: We're certainly not going to go
11 real late in the night tonight. Mr. Dean is supposed to
12 testify tomorrow. Your Honor, we will offer him at 9
13 o'clock tomorrow morning, somewhere in the hotel or
14 somewhere around there. I can't imagine they can't get
02:05 15 it done in three hours.

16 MR. KRUMHOLZ: Well, you're wrong. It's
17 going to take a long longer. You know, the disclosure
18 statement, let's just be real clear, you keep on talking
19 about, it's a paragraph, Your Honor, this much. That's
02:06 20 what he's talking about. Not even the business plan,
21 it's a description of the business plan that long. And
22 it has nothing to do --

23 THE COURT: Well, we'll see whether we can
24 start tonight by the time we finish. And all we've
02:06 25 got -- I mean, it's reasonable start at 9 o'clock and I

AK/RET REPORTING, RECORDS & VIDEO, INC.

183

1 suspect it's reasonable to finish by 12:00. But if you
2 need more than that, we'll see about that, whether we
3 have more time than that when we finish tonight.

4 MR. KRUMHOLZ: Thank you, Your Honor.

02:06 5 THE COURT: So let's move on. Now, who
6 are we calling?

7 MR. NEIER: Your Honor, we're calling
8 Mr. Matthew Breckenridge who is a fact witness.

9 THE COURT: Okay. Mr. Breckenridge. This
02:06 10 is proffer number 1 in my book.

11 MR. NEIER: Yes, Your Honor. Do you
12 already have a copy?

13 THE COURT: I do.

14 MATTHEW BRECKENRIDGE,

02:06 15 having been first duly sworn, testified as follows:

16 MR. NEIER: Your Honor, if you'll recall
17 our agreement, our agreement was that we would just rely
18 on the proffers and for expert witness we'll have a
19 little introductory stuff but not for the fact witnesses.

02:07 20 DIRECT EXAMINATION

21 BY MR. NEIER:

22 Q. So I would simply ask Mr. Breckenridge and show
23 him what's been previously marked as MMX 2, ask him to
24 take a look at it and see if he recognizes it.

02:07 25 A. I do.

AK/RET REPORTING, RECORDS & VIDEO, INC.

184

1 Q. And what do you recognize it to be?

2 A. This is my proffer.

3 Q. And is it true and correct?

4 A. It is.

02:07 5 MR. NEIER: Your Honor, I have no further
6 questions.

7 THE COURT: All right.

8 MR. NEIER: And I'd ask that if I need
9 formerly to ask, I ask that the proffer be admitted.

02:07 10 THE COURT: Okay. I guess normally there
11 are a number of exhibits from -- are there objections to
12 those exhibits? Is there anyone here prepared to object
13 to any of the exhibits?

14 MR. HALE: Your Honor, we have a bunch of
02:07 15 objections to the indenture trustee's exhibits. We just
16 got the exhibits list yesterday.

17 THE COURT: They're not here yet. I'm not
18 asking about him. First I'm asking about yours. Do you
19 have any objections to them? Have you decided? You're
02:08 20 not prepared right now?

21 MR. KRUMHOLZ: Well, there haven't been
22 any exhibits admitted as to Mr. Breckenridge, I don't

23 think.

24 THE COURT: Okay. Well, it is admitted.

02:08 25 Go ahead. It's your witness.

AK/RET REPORTING, RECORDS & VIDEO, INC.

185

1 CROSS-EXAMINATION

2 BY MR. KRUMHOLZ:

3 Q. Hello, Mr. Breckenridge, how are you doing
4 today?

02:08 5 A. Very well.

6 Q. You work for Marathon Structured Finance Fund,
7 LP; is that right?

8 A. That's not correct. I work for Marathon Asset
9 Management, the investment manager to the Marathon funds,
02:08 10 of which Marathon Structured Finance is one.

11 Q. And how long have you been employed by that
12 entity?

13 A. Five and a half years.

14 Q. I'm going to refer to the Marathon family's
02:08 15 entities as just Marathon. Will you understand what I
16 mean by that term?

17 A. Yes.

18 Q. I'm also going to be referring to Scopac as
19 Scotia Pacific Company, LLC. Do you understand that?

02:09 20 A. Do you mean the opposite?

21 THE COURT: You're going to say the whole
22 word or are you just going to say Scopac?

23 MR. KRUMHOLZ: I'm going to refer to
24 Scotia Pacific, LLC as Scopac.

02:09 25 THE COURT: Okay.

AK/RET REPORTING, RECORDS & VIDEO, INC.

186

1 A. Okay.

2 Q. So you'll understand what entity I'm talking

3 about in that regard?

4 A. Yes.

02:09 5 Q. And I'm going to refer to the Pacific Lumber
6 Company as Palco. Do you understand that?

7 A. Yes.

8 Q. I'm going to refer to Maxxam, Inc. and all of
9 its related entities that directly or indirectly own
02:09 10 Scopac and Palco as Maxxam. Do you understand that?

11 A. Yes.

12 Q. I'm going to refer to the current holders of
13 the timber notes as the noteholders, okay?

14 A. Okay.

02:09 15 Q. I'm going to refer to the Bank of New York
16 Trust Company as indenture trustee for the timber notes
17 as the indenture trustee, all right?

18 A. Okay.

19 Q. And I'm going to refer to Mendocino Redwood
02:09 20 Company as MRC, okay?

21 A. Okay.

22 Q. Now, Marathon and MRC have proposed a plan.
23 We've been talking about that today, correct?

24 A. Correct.

02:10 25 Q. Were you here for the opening statements?

AK/RET REPORTING, RECORDS & VIDEO, INC.

187

1 A. I was.

2 Q. I hate to -- I don't mean to fuss at you at
3 all, but if you could speak up just a little bit.

4 A. I was.

02:10 5 Q. Thank you. And now, MRC is a competitor of
6 Scopac, right?

7 A. I believe that MRC is a customer of Scopac.

8 Q. And a competitor of Scopac, right?

9 A. I'm not sure if that's entirely correct.

02:10 10 Q. Well, they own some timberlands, right?

11 A. Yes, that's true.

12 Q. Just south of Scopac, correct?
13 A. Yes.
14 Q. And they grow redwood on those timberlands,
02:10 15 right?
16 A. That's correct.
17 Q. And they sell that redwood to third-parties,
18 right?
19 A. Yes.
02:10 20 Q. And so does Scopac?
21 A. No, Scopac sells timber to Palco.
22 Q. Fair enough. Do you not consider them
23 competitive at all?
24 A. Well, considering that Palco, up until
02:10 25 recently, Palco's biggest customer was MRC, I have to

AK/RET REPORTING, RECORDS & VIDEO, INC.

188

1 believe that they are a customer.
2 Q. One thing they're not is a debtor, right?
3 A. That's true.
4 Q. You know they're not a creditor of any of the
02:11 5 debtors; is that right?
6 A. I believe that to be true.
7 Q. And you don't believe that there's some sort of
8 equity holder in any of the debtors, correct?
9 A. I believe that to be true.
02:11 10 Q. Okay. But Marathon is a creditor of one of the
11 debtors, right?
12 A. That's correct.
13 Q. Marathon is a creditor of Palco, right?
14 A. That's correct.
02:11 15 Q. And can you tell the Court what security
16 Marathon has in connection with that debt?
17 A. Palco's -- sorry. Marathon's dip loan to Palco
18 has a first lien on all assets of Palco, which would
19 include a first lien on the town, first lien on the AR
02:11 20 and inventory and a first lien on the mill. And the term

21 loan has a second lien on all of the above.

22 Q. And there's no security interest whatsoever in
23 connection with any of Scopac's assets?

24 A. We have a negative pledge with respect to the
02:12 25 stock of Scopac.

AK/RET REPORTING, RECORDS & VIDEO, INC.

189

1 Q. What did you call it?

2 A. A negative pledge.

3 Q. And you're talking about the stock that Palco
4 owns, that is, Scopac stock?

02:12 5 A. That's correct.

6 Q. Okay. But back to my question. You don't have
7 a lien on any of the assets of Scopac, true?

8 A. I believe that's true.

9 Q. And it's your position in this case that
02:12 10 Marathon is undersecured by the Palco assets, right?

11 A. That's correct.

12 Q. All right. So it would be one of Marathon's
13 motives if they have an incentive, so to speak, to
14 capture value of Scopac given their undersecurity, right?

02:12 15 A. I believe it would be anybody's motive to
16 capture value from any place else, however, I think when
17 you are assuming --

18 Q. I just want you to answer my question.

19 MR. NEIER: Your Honor, I object to the
02:12 20 interruption. The witness was answering the question.

21 MR. KRUMHOLZ: This is cross-examination,
22 Your Honor. He answered the question, he doesn't need to
23 give --

24 THE COURT: The question was asked and let
02:13 25 other counsel redirect if there's some question. So if

AK/RET REPORTING, RECORDS & VIDEO, INC.

190

1 you can answer just the question asked, that would be
2 better.

3 MR. NEIER: Your Honor, the witness should
4 not be interrupted, Your Honor, is my point. He should
02:13 5 be able to finish his question. And if Mr. Krumholz then
6 wants to move to strike as nonresponsive, he can do so.

7 THE COURT: Okay. We don't have a jury
8 and I have found that usually we get through these things
9 a whole lot better if we just ask the questions and the
02:13 10 witness answer them as best they can and we move on.
11 Now, obviously you can object, but do try to answer just
12 the questions you're asked.

13 THE WITNESS: Okay.

14 Q. (By Mr. Krumholz) And so what we were talking
02:13 15 about is the fact that Marathon has an incentive to
16 capture value of the Scopac assets, and I believe your
17 answer was yes before you tried to explain, right?

18 A. What I said was that any investor would have an
19 incentive to capture value.

02:13 20 Q. And that's one of the incentives of Marathon?

21 A. No, that's not correct.

22 Q. Are you saying you haven't talked about that --

23 MR. NEIER: Objection, Your Honor, he's
24 not letting the witness finish his answers.

02:13 25 THE COURT: I'm not --

AK/RET REPORTING, RECORDS & VIDEO, INC.

191

1 MR. KRUMHOLZ: I thought he was finished.

2 THE COURT: I think we're now getting to a
3 question -- if you're asking him in general to -- people
4 who are owed money have an incentive to try to get it
02:14 5 paid, the answer to that, of course, is yes. If you're
6 asking him does he have any specific information whether
7 or not Marathon has some specific interest in this, I
8 think you can tailor that question and ask him
9 specifically. But don't ask rhetorical questions, let's

02:14 10 ask specific questions.

11 Q. (By Mr. Krumholz) The truth is,
12 Mr. Breckenridge, that Marathon does indeed have a
13 specific incentive and motivation to try to capture
14 Scopac -- the value of Scopac's assets in this case,

02:14 15 right?

16 A. Marathon is purchasing through the -- through
17 new cash plus the -- plus bringing the mill into Newco is
18 purchasing the assets of Scopac in our plan of reorg.

19 Q. And when you say you're purchasing it, you're
02:15 20 talking about the \$200 million of cash from Mendocino,
21 that's part of it?

22 A. Yes.

23 Q. And then how much was it from Marathon?

24 A. \$25 million.

02:15 25 Q. \$25 million?

AK/RET REPORTING, RECORDS & VIDEO, INC.

192

1 A. \$25 million.

2 Q. Okay. So \$25 million from Marathon; is that
3 right?

4 A. That's right.

02:15 5 Q. And then you're converting, I guess, some \$135
6 million of debt that was debt of Palco, you're converting
7 it to equity in Newco, right?

8 A. No, that's not correct.

9 Q. You're not?

02:15 10 A. No.

11 Q. What was wrong about that statement?

12 A. What we're doing is we're talking the debt of
13 Palco, we are foreclosing on our assets, we are going to
14 take and create a new company called Townco where
02:15 15 Marathon will own and operate and eventually sell the
16 assets of the town. We will take the mill and the
17 inventory and we will contribute that to Newco where
18 Newco is then purchasing the assets of Scopac.

19 Q. Well, I just want to make sure I understand.
02:15 20 Are you contributing \$135 million worth of debt in order
21 to get this equity or not?
22 A. No.
23 Q. So that's not even part of the consideration,
24 it's just \$225 million?
02:16 25 A. I'm sorry, I don't understand your question.

AK/RET REPORTING, RECORDS & VIDEO, INC.

193

1 Q. The only consideration that Marathon and
2 Mendocino are providing is \$225 million of cash, that's
3 your testimony?
4 A. To what?
02:16 5 Q. To purchase all of the assets of Scopac and
6 Palco?
7 A. Well, let's be clear. Marathon and MRC,
8 Marathon is putting in \$25 million, MRC is putting in
9 \$200 million to Newco. Marathon is additionally putting
02:16 10 in the AR inventory that currently resides at Palco.
11 Marathon is also put in the mill, which we're going to
12 foreclose upon into Newco. Newco is going to purchase
13 the assets of Scopac. And for consideration for the
14 noteholders, we are going to provide them with \$175
02:16 15 million and a new note with a face of 325.
16 Q. Now, I understand what you-all are suggesting
17 that you're giving to the noteholders, but I just want to
18 talk about in terms of actual consideration out of
19 you-all's pocket somehow some way that you are giving up
02:17 20 in order to get this 100 percent interest in this Newco?
21 A. Marathon is only receiving a 15 percent
22 interest.
23 Q. Okay. And when I said 100 percent, I meant
24 Mendocino and Marathon. Is that 100 percent?
02:17 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 Q. The noteholders aren't getting any of that
2 equity, right?

3 A. No.

4 Q. Okay. It's Marathon 15 percent and I guess for
02:17 5 the first time we find out that Mendocino is getting 85
6 percent?

7 A. That's right.

8 Q. All right. But what I'm asking you, what are
9 you giving up --

02:17 10 A. I believe it's in the --

11 MR. NEIER: Excuse me, the witness was
12 giving an answer.

13 A. I believe that's in the disclosure statement.

14 Q. Okay. Now, what is it that you're giving up in
02:17 15 connection with getting that 100 percent total? "You"
16 being Mendocino and Marathon.

17 A. Of the equity?

18 Q. Just period, what are you-all giving up?
19 What's the consideration?

02:17 20 A. Of the equity of Newco? I don't understand
21 your question. What are we giving up in consideration
22 for what?

23 Q. For getting 100 percent of Newco.

24 A. Of the equity of Newco?

02:18 25 Q. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 A. It's \$200 million in cash from MRC, \$25 million
2 in cash from Marathon and the mill from Marathon.

3 Q. And how much is the mill worth, according to
4 you?

02:18 5 A. \$25 million.

6 Q. Okay. So the total consideration that you're
7 providing is \$250 million?

8 A. That's correct.
9 Q. Okay. And --
02:18 10 A. I'm sorry --
11 MR. NEIER: Excuse me, the witness was
12 trying to complete his answer.
13 A. To clarify, to clarify, MRC is also
14 contributing a profits interest in the distribution
02:18 15 business of all lumber that's produced by Palco -- or
16 Newco.
17 Q. Profits interest in all the lumber that's
18 produced by Palco?
19 A. Or Newco. So essentially any lumber that's
02:18 20 created by Newco that is sold to a third-party, any
21 profit on that would -- from the distribution profit
22 would also be contributed by MRC to Newco.
23 Q. That's not dollars they have now, right?
24 A. No, I guess not, because --
02:19 25 Q. That's not new consideration, right?

AK/RET REPORTING, RECORDS & VIDEO, INC.

196

1 A. Well, it would be calculated in the 85/15
2 percentage.
3 Q. I understand you-all might have divvied it up
4 somehow in terms of why -- who -- when you got 15 percent
02:19 5 and they got 85 percent, but the total consideration for
6 the 100 percent interest in Newco is this \$250 million
7 you're talking about?
8 A. No. I will stand by what I said before. The
9 total consideration for equity in Newco is going to be
02:19 10 the \$200 million, the \$25 million, the mill and the
11 profits participation interest in the distribution
12 business.
13 Q. What's the value of the profits participation?
14 A. Initially it's at \$100 million.
02:19 15 Q. So that's you-all's best estimate of the profit
16 participation?

17 A. Excuse me?
18 Q. That's your best estimate of the profits
19 participation?
02:20 20 A. Yes.
21 Q. And so what does that total, \$350 million?
22 A. I believe that's right.
23 Q. And you value Newco -- that is, your expert
24 values Newco to be worth \$540 million?
02:20 25 A. I believe that's right.

AK/RET REPORTING, RECORDS & VIDEO, INC.

197

1 Q. Okay. But you're only paying consideration of
2 \$350 million?
3 A. Well, there's also notes that will be provided.
4 Q. But that's all you're --
02:20 5 A. No, wait.
6 MR. NEIER: Excuse me, he's finishing his
7 answer.
8 A. I believe that you're misunderstanding.
9 MR. KRUMHOLZ: Don't yell.
02:20 10 A. You're saying -- this is probably where we need
11 to clarify. When you say "for consideration," all of my
12 answers have been with respect to equity. A
13 capitalization of a company, the value of a company is
14 the sum of equity plus debt. So when you say, well, the
02:20 15 value of the company is 540, my experts are saying 540,
16 that's true, and the equity participation is 350. The
17 debt on top of that is the notes.
18 Q. Well, just to be clear, though, we can get
19 that -- into that in a few minutes. But you're getting
02:21 20 100 percent, that is, Mendocino, MRC and Marathon are
21 getting 100 percent of the equity in Newco for simply
22 giving up \$250 million in value?
23 MR. NEIER: Objection, mischaracterizes
24 his testimony.
02:21 25 THE COURT: I've got to believe that this

1 witness can handle these questions. These are not that
2 tough and I don't --

3 MR. NEIER: I don't think they're that
4 tough either, Judge, I just don't think that arguing with
02:21 5 the witness over and over again and trying to get some
6 answer is going to work.

7 THE COURT: Go ahead and ask the question
8 again.

9 A. Can you please repeat the question?

02:21 10 Q. Total consideration that Marathon and MRC are
11 providing for this 100 percent equity interest in Scopac
12 is --

13 A. No, that's not correct. In Scopac?

14 Q. Excuse me. In Newco. I appreciate that. In
02:22 15 Newco -- see, he can tell. In Newco is \$350 million
16 according to your evaluation, correct?

17 A. Correct. However, the participation interest,
18 as you pointed out earlier, is not currently there, so
19 it's an additional contribution.

02:22 20 Q. And your valuation expert on an enterprise
21 basis has valued Newco at \$540 million; is that right?

22 A. That's correct.

23 Q. Okay. Now, you indicate in your proffer that
24 through Newco, you're going to integrate the commercial
02:22 25 timberlands with the sawmill operations; is that right?

1 A. Yes.

2 Q. And that means you're going to combine them,
3 right?

4 A. That's right.

02:22 5 Q. And all the assets from Palco and Scopac are

6 transferred to Newco; is that right?

7 A. That's correct.

8 Q. I'm sorry?

9 A. That is correct.

02:22 10 Q. And all debts are either transferred to Newco
11 or converted to equity of Newco?

12 A. That all debts of -- repeat.

13 Q. All debts of the debtors are either transferred
14 to Newco or converted to equity?

02:23 15 A. All the debtors? I believe that the debt of --
16 THE COURT: I think he said all debts.
17 I'm not sure what you mean by that.

18 MR. KRUMHOLZ: What did I say? All
19 amounts owed.

02:23 20 THE COURT: Your debt is not it exactly,
21 is it?

22 Q. (By Mr. Krumholz) Let me ask it a different
23 way. All the assets are pooled to pay all of the
24 creditors, is that right, under that plan?

02:23 25 A. With the addition of the cash that we're

AK/RET REPORTING, RECORDS & VIDEO, INC.

200

1 infusing into Newco.

2 Q. And all the unsecured creditors are paid from
3 the pooled assets plus this cash that you reference; is
4 that right?

02:23 5 A. That's correct.

6 Q. Now, if the timberlands are worth in excess of
7 \$500 million then Newco could actually sell those
8 timberlands for more than MRC says the timberlands are
9 worth, right?

02:23 10 A. I'm sorry, repeat the question.

11 THE COURT: I think that's a rhetorical
12 question. If in fact they're worth more than 540, then
13 they can sell them for more than 540, that's true.

14 Q. (By Mr. Krumholz) The point is, what happens

02:24 15 to the excess cash if they're sold for more than \$500
16 million?

17 A. Sold to whom?

18 Q. Assuming this plan is confirmed and the
19 timberlands are sold for, lets say, \$600 million.

02:24 20 A. Which plan are you talking about?

21 Q. The Marathon/MRC plan, the one you're
22 testifying about.

23 A. And to whom would we sell it?

24 Q. Any third-party.

02:24 25 A. We don't plan to sell it.

AK/RET REPORTING, RECORDS & VIDEO, INC.

201

1 Q. That's not what I asked. Are you finished?

2 A. Yes.

3 Q. All right. If the plan is confirmed and for
4 some reason MRC and Marathon decide they're going to go
02:24 5 ahead and sell the timberlands to a third-party and they
6 sell it for \$600 million or \$700 million, what happens to
7 the excess of that value over the \$500 million that you
8 say that it's worth? Who gets that value?

9 A. I guess it would go to the equity.

02:24 10 Q. It would go to the equity, which is you, right?

11 A. That's correct.

12 Q. Marathon and Mendocino?

13 A. That's correct.

14 Q. And it would get -- it would allow you to
02:25 15 capture value that right now is owned by or is the value
16 that is represented by the security interest that the
17 noteholders have in the timberlands, right?

18 A. Technically that's correct.

19 Q. Now, have you looked at the indenture that was
02:25 20 created and agreed upon and bargained for in connection
21 with the timber notes?

22 A. I have not.

23 Q. You never bothered to look at it?

24 A. No.
02:25 25 Q. You've never looked at it --

AK/RET REPORTING, RECORDS & VIDEO, INC.

202

1 A. I've probably read it, but I don't have it
2 committed to memory.
3 Q. Okay. I'd like to show you a portion of it.
4 MR. KRUMHOLZ: Because of the exhibit
02:25 5 issues, Your Honor, I have prepared nine copies of the
6 exhibits. I'll use them for Mr. Breckenridge.
7 THE COURT: Okay.
8 MR. KRUMHOLZ: Your Honor, may I approach
9 the witness?
02:26 10 THE COURT: You may.
11 MR. KRUMHOLZ: By the way, I'm going to go
12 ahead and offer Indenture Trustee Exhibit 111 and 112
13 into evidence. Do you have an objection to that?
14 MR. NEIER: We have no objection to 111
02:27 15 and 112, Your Honor.
16 THE COURT: All right. 111 and 112 are
17 admitted. Does anybody else have an objection?
18 MR. HALE: No objection, Your Honor.
19 THE COURT: All right.
02:27 20 Q. (By Mr. Krumholz) If you could turn to Exhibit
21 111 for me, Mr. Breckenridge. This is the -- excuse me,
22 112-A. I apologize.
23 MR. KRUMHOLZ: And we actually are
24 offering Exhibit 112-A.
02:27 25 MR. NEIER: No objection, Your Honor.

AK/RET REPORTING, RECORDS & VIDEO, INC.

203

1 THE COURT: All right.
2 MR. KRUMHOLZ: Your Honor, is it admitted?
3 THE COURT: Well, we're going to at some

4 point have all of your exhibits and we will go through
02:27 5 all of them and get those admitted that should be
6 admitted. That's with respect to all of the exhibits.
7 In any event, this one has been admitted, but we'll
8 probably readmit it along with all the rest of it when we
9 have them all.

02:27 10 Q. (By Mr. Krumholz) If you could go to Exhibit
11 112, Mr. Breckenridge, and tell me when you're there.

12 A. What page?

13 Q. 112-A, page 23.

14 A. Okay.

02:28 15 Q. Actually, I have to rephrase that. It's page
16 17. I apologize. Section 4.5. Are you there?

17 A. I am.

18 Q. In the indenture, did you understand that the
19 noteholders actually bargained for the separateness of
02:28 20 Palco and Scopac?

21 A. As I said before, I don't have this committed
22 to memory.

23 Q. I understand that. But did you have an
24 understanding that when the noteholders actually
02:28 25 purchased these notes, they had a concern about the

AK/RET REPORTING, RECORDS & VIDEO, INC.

204

1 separateness of Scopac and Palco going forward?

2 A. I think they have expressed that to me.

3 Q. Okay. So you do have that understanding, at
4 least in a general level?

02:29 5 A. Yes.

6 Q. Okay. And that's not unusual in transactions
7 like this? And I assume you know that simply by the
8 business that you're in?

9 A. Yes.

02:29 10 Q. Is that right?

11 A. That's right.

12 Q. In other words, noteholders often in this

13 circumstance want to make sure that the entity which
14 they're loaning money to is kept separate so that their
02:29 15 assets and collateral are kept separate, right?
16 A. That's right.
17 Q. That's something your company has bargained for
18 from time to time?
19 A. That's right.
02:29 20 Q. And those are important rights?
21 A. That's correct.
22 Q. Why are they so important to creditors?
23 A. Why are -- why are the rights to have a
24 separate asset pool?
02:29 25 Q. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

205

1 A. To keep other creditors from attaching to those
2 assets.
3 Q. Okay. And is it important so that there can't
4 be commingling later on, so to speak, of your asset pool
02:30 5 or collateral with other entities such that it puts it at
6 risk?
7 A. In general, that's correct.
8 Q. Okay. And you understood that when you were
9 proposing this Marathon/MRC plan, right?
02:30 10 A. Yes.
11 Q. Okay. Let's look at some of the provisions
12 that are in this indenture in section 4.5. Do you see
13 where it says "separate existence and formalities"?
14 A. I do.
02:30 15 Q. It says "the issuer hereby covenants and agrees
16 that," and then it gives a laundry list of things, do you
17 see that?
18 A. I do.
19 Q. And these are very typical provisions in these
02:30 20 sorts of agreement, right?
21 A. I don't know. I'm not an indenture specialist.

22 Q. No, you're not, but Marathon often invests as
23 noteholders much like the noteholders in this case,
24 right?
02:30 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

206

1 Q. And these are the kinds of provisions that you
2 would expect to see, true?
3 A. I don't know. I'd have to read them one by
4 one.
02:30 5 Q. Well, you can read through them. Go ahead.
6 You don't need to read them out loud. Read them to
7 yourself and then we'll get back to them.
8 A. Actually, some of these I would not specially
9 request.
02:31 10 Q. Just generally speaking, these are typically
11 the kinds of provisions you expect to see in connection
12 with notes of this nature?
13 A. Notes of what nature?
14 Q. Notes like this where you're lending lots and
02:31 15 lots of money to an entity collateral -- and the
16 collateral will be their assets.
17 A. I've actually never been a party to a
18 transaction where we lend to an SBE, so I'm not trying to
19 avoid your question, but --
02:31 20 Q. I understand. I thought we were on the same
21 page earlier where you said that Marathon invests in
22 these sorts of deals?
23 A. Well, Marathon invested in secured deals, but
24 I've never done an SBE.
02:32 25 Q. Okay. But regardless, you do understand why a

AK/RET REPORTING, RECORDS & VIDEO, INC.

207

1 lender in this context would want to keep Scopac

2 separate?

3 A. To be fair, I think that a lender in this
4 context would like to keep the value of its assets

02:32 5 separate so that it can be monitored rather than have it
6 commingled with other assets.

7 Q. I think that's probably a much better way to
8 put it and I think we're on the same page. Let's get it.
9 It says in No. 1, "the issuer's funds and other assets

02:32 10 will not be commingled with those of Pacific Lumber." Do
11 you see that?

12 A. I do.

13 Q. So you understand that that's something that
14 the noteholders bargained for at the beginning of

02:32 15 executing and negotiating this deal?

16 A. I do.

17 Q. Okay. Do you see No. 2 where it says, "all
18 actions taken by the issuer will be taken pursuant to
19 authority granted by the board of managers of the issuer

02:33 20 to the extent required by law or the issuer's operating
21 agreement." Do you see that?

22 A. I do.

23 Q. In other words, it wasn't going to take
24 direction from the board of managers or board of

02:33 25 directors or some other entity, do you understand that?

AK/RET REPORTING, RECORDS & VIDEO, INC.

208

1 A. I do.

2 Q. No. 3, "the issuer will maintain records and
3 books of accounts separate from those of Pacific Lumber."
4 So it specifically references Palco, right?

02:33 5 A. It does.

6 Q. "In accordance with generally accepted
7 accounting principles." And that's the sort of thing I
8 think you were getting at a moment ago. That's the sort
9 of thing you would expect in an agreement like this?

02:33 10 Keeping --

11 MR. JONES: Your Honor, this is not
12 useful. The witness has testified he isn't an expert on
13 securitization. The documents say what they do. I might
14 as well ask my dog what he thinks of these documents.

02:33 15 THE COURT: I suspect this witness is
16 better than your dog, so I'm not going to go there.

17 THE WITNESS: Thank you, Your Honor.

18 MR. JONES: Your Honor, I apologize. Very
19 bad example. I don't doubt that. The point is this
02:33 20 witness has testified he has no expertise.

21 THE COURT: You're asking a bunch of
22 opinion questions and I thought you-all were objecting to
23 non-expert witnesses. And again, this happens all the
24 time in bankruptcy.

02:34 25 MR. KRUMHOLZ: Your Honor, this is a far

AK/RET REPORTING, RECORDS & VIDEO, INC.

209

1 cry from what we were talking about before. He is an
2 experienced guy in this industry and these are facts that
3 happen all the time.

4 THE COURT: And sometimes securitization
02:34 5 is the big issue in bankruptcy. Sometimes, not very
6 often but sometimes it's redwood forest plans. But you
7 know, how many board feet and things like that, but we do
8 get lots of opinions in bankruptcy court and I can
9 understand how that happens. But there's no question
02:34 10 that these things do say what they say and there's no
11 question that you wanted all of those in there. I mean,
12 I don't think anybody is questioning the fact that all of
13 those things were important to you.

14 MR. KRUMHOLZ: That's fine, I'll move
02:34 15 along, Your Honor. I thought we were here to make sure
16 that the Court understood and what the witness
17 understands under 1129.

18 THE COURT: I appreciate you giving me all
19 of the advice because I can use all that you can give me,

02:35 20 but I think you're asking some obvious questions to this
21 witness and we can probably be better served by going to
22 the important stuff. This is all in evidence and so --
23 and he would agree with you, I suspect, that all of those
24 things were important. And if they were doing the deal
02:35 25 back when they were securizing the loan, they might want

AK/RET REPORTING, RECORDS & VIDEO, INC.

210

1 those things in there also.
2 Q. (By Mr. Krumholz) In other words, to
3 facilitate the noteholders, loaning the amount of monies
4 that they did, you understand that they had these
02:35 5 bargained for rights -- obligations of Scopac as a
6 special purpose entity?

7 A. I believe the indenture trustee did, yes.

8 Q. And did you also -- did you ever look at the
9 LLC incorporation documents along those same lines?

02:35 10 A. Which LLC incorporation documents?

11 Q. For Scopac.

12 A. I did not, no.

13 Q. Okay. Do you agree that the noteholder should
14 have the right to rely upon the separateness of Scopac
02:36 15 for their collateral?

16 A. I'm sorry, can you repeat the question?

17 Q. Yeah. Do you believe -- do you agree that the
18 noteholders should have the right to rely on separate
19 security -- the separate security interest that they
02:36 20 bargained for in these documents?

21 A. I believe that any noteholder has the -- of an
22 operating company should rely upon the value of that
23 operating company for the value of their notes, yes.

24 Q. And they should be able to look to the assets
02:36 25 of Scopac before anybody else can in that regard in light

AK/RET REPORTING, RECORDS & VIDEO, INC.

211

1 of what they bargained for, right?

2 A. I believe they should be able to look to the
3 value of those assets before anybody else, yes.

4 Q. Now, you're proposing a sale of Newco to MRC
02:36 5 and Marathon. We talked about that a few minutes ago,
6 right?

7 MR. NEIER: Objection.

8 A. The creation of Newco.

9 Q. Whereby MRC and Marathon own all the equity?

02:36 10 A. Correct.

11 Q. Okay. And this transaction that you-all are
12 proposing never went through any sort of competitive
13 bidding process to see if any others would be willing to
14 pay more or contribute more than MRC and Marathon, true?

02:37 15 A. That's true since Marathon and MRC are the only
16 two that have ever had discussions about the creation of
17 Newco.

18 Q. You never attempted to solicit any other bids;
19 is that correct?

02:37 20 A. Bids for what, equity of Newco?

21 Q. Bids for the equity of Newco.

22 A. Maybe we're talking past each other, but
23 Marathon and MRC were the only two who ever discussed the
24 creation of Newco.

02:37 25 THE COURT: Then just the answer then

AK/RET REPORTING, RECORDS & VIDEO, INC.

212

1 would be no, you didn't solicit.

2 A. No, we didn't solicit anybody.

3 THE COURT: You're reading more into his
4 question than there are. I think you should just answer
02:37 5 the question.

6 A. Okay. No.

7 Q. You're not proposing some sort of auction
8 process whereby the assets of this Newco would be exposed

9 to the competitive marketplace, right?

02:37 10 A. No.

11 Q. You haven't suggested some sort of go shop
12 provision, right?

13 A. No.

14 Q. Do you know what a go shop provision is?

02:37 15 A. I do.

16 Q. Can you explain that to the Court, please.

17 A. It's similar to a test where we would allow
18 others to come in and bid for the same deal that we have
19 under the same terms just for a higher price.

02:38 20 Q. And just to be clear, there are three
21 mechanisms in your world, so to speak, whereby you can
22 assure that what you're getting is fair market value,
23 right? Mechanisms than that, but --

24 A. Well, I'm sorry, you may have to tell me which
02:38 25 three.

AK/RET REPORTING, RECORDS & VIDEO, INC.

213

1 Q. Well, an auction is one, right, subjecting it
2 to the marketplace through an auction, right?

3 A. Sure.

4 Q. Another one that's routinely done is this go
02:38 5 shop provision, right, a provision like that?

6 A. Okay.

7 Q. Is that right?

8 A. Yes.

9 Q. And a go shop provision can even be done after
02:38 10 you have an agreement with one entity, particular entity
11 for the sale, right?

12 A. Yes, so long as those who have already invested
13 the money would be able to recoup it.

14 Q. Right. So in other words, you can enter into a
02:39 15 contract to purchase the equity of a company with the
16 understanding in those -- in that purchase agreement that
17 there's a go shop period after the purchase before

18 closing that subjects that deal to the marketplace, true?

19 A. True.

02:39 20 Q. And that's a way that we can -- you can

21 actually know whether or not you're getting a good deal

22 in terms of fair market value, right?

23 A. As the buyer or seller?

24 Q. In terms of the -- in terms of the seller of a

02:39 25 company.

AK/RET REPORTING, RECORDS & VIDEO, INC.

214

1 A. Yes.

2 Q. Okay. And actually, that's a way that you're

3 able to assure creditors and equities that you're getting

4 a fair market value, right?

02:39 5 A. Yes.

6 Q. And you understand in your business that's

7 become quite an issue in court cases relating to mergers

8 and acquisitions all over the country, right?

9 A. Well, I know that in mergers and acquisitions

02:39 10 they're usually competitive processes.

11 Q. And to assure that shareholders in those

12 situations are treated appropriately, and creditors in

13 those situations are treated appropriately, many times

14 auctions are required, right?

02:40 15 A. Yes.

16 Q. And many times in addition or alternatively to

17 auctions, go shop provisions or go shop periods are

18 required?

19 A. I'm not aware of go shop provisions in mergers

02:40 20 and acquisitions. Usually it's an auction followed by a

21 shareholder vote.

22 Q. You're not familiar with the private equity

23 industry where the private equity folks enter into an

24 agreement and under applicable regulations or laws

02:40 25 they're required to go shop that deal?

1 A. I wasn't aware of that.

2 Q. Okay. But regardless, you are generally
3 familiar with that concept?

4 A. Yes.

02:40 5 Q. And another way that you can assure fair market
6 value is through a credit bid, right, have more comfort
7 that it's in a fair market value?

8 A. Let me think about that for a minute.

9 Q. Maybe I can get you there through a different
02:41 10 step.

11 A. Okay.

12 MR. NEIER: Your Honor, the witness asked
13 to think about his response before he responds. Let him
14 do that.

02:41 15 MR. KRUMHOLZ: He can answer if he'd like.

16 A. No, actually, I disagree. I don't think credit
17 bids would provide a fair market value unless the --
18 those who are using their credit to bid have paid par for
19 the securities in question that they're credit bidding.

02:41 20 Q. Yeah. And maybe I asked it inappropriately.
21 I'm not necessarily suggesting that it's automatically
22 fair market value if there's a credit bid. What I'm
23 saying is it's a protection against low-ball bids, true?

24 A. Yes.

02:41 25 Q. Okay. And your plan, that is the MRC/Marathon

1 plan, doesn't provide for any sort of credit bid auction
2 or go shop?

3 A. I'm not a bankruptcy attorney, but I thought
4 credit bids were only part of a 363.

02:42 5 Q. Is the answer that's correct?

6 A. Yes.

7 Q. It doesn't?

8 A. It does not.

9 Q. It doesn't do that?

02:42 10 A. It does not.

11 MR. NEIER: Objection, Your Honor, he's

12 got to be able to finish his answers.

13 THE COURT: He tried to answer it again

14 with something about 363. He's not a lawyer, I

02:42 15 understand. I don't even know -- and I know all of you

16 guys know what 363 is, but really all he just needs to do

17 is say yes or no.

18 Q. (By Mr. Krumholz) I want to take a look at --

19 THE COURT: And then we'll get done

02:42 20 quickly. Moving on.

21 Q. (By Mr. Krumholz) At what the noteholders

22 receive in connection with the Marathon/MRC plan, okay?

23 A. Okay.

24 Q. You mentioned \$175 million in cash, right?

02:42 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

217

1 Q. And as I understand it, subject to certain

2 adjustments, \$325 million in new timber notes; is that

3 right?

4 A. Yes.

02:42 5 Q. All right. And you said the face value was

6 \$325 million, correct?

7 A. That's the par value.

8 Q. Okay. And you make a statement in your proffer

9 that the commitment is not subject to financing or due

02:42 10 diligence; is that right?

11 A. That's correct.

12 Q. Can you tell the Court why that's important in

13 your mind?

14 A. Because there's certainty that we can close

02:43 15 tomorrow.

16 Q. And so it was important not to have any
17 conditions that get in the way?

18 A. I believe it's important not only for the town,
19 it's important for the workers, it's important because
02:43 20 the debtors are out of money, and so there is no period
21 between the day -- if our plan is confirmed, there's
22 no -- there's no long delay between that time and when --
23 when we would assume control.

24 Q. And more importantly, there's not any
02:43 25 conditions that pose any significant risks to actually

AK/RET REPORTING, RECORDS & VIDEO, INC.

218

1 getting this deal done, isn't that the point that you
2 were talking about?

3 A. Yes, yes.

4 Q. Okay. So any deal that doesn't condition it on
02:43 5 financing or due diligence, any sale, would be a good
6 thing?

7 A. Yes.

8 Q. Okay. Now, as I understand it, you really
9 don't know what the face amount of the timber notes is
02:44 10 because there's some sort of adjustment that is going to
11 be applied; is that right?

12 A. That's correct.

13 Q. And so as you sit here today, you really don't
14 know what the timber noteholders would receive in
02:44 15 connection with your plan, right?

16 A. I know generally what they'll receive.

17 Q. Well, but you don't know specifically until you
18 go through the new timber note adjustment, as you call it
19 in the plan, right?

02:44 20 A. That's correct.

21 Q. And the new timber note adjustment means a
22 reduction dollar for dollar based upon various equations,
23 right?

24 A. That's right.

02:44 25 Q. For example, "the excess of the amount of the

AK/RET REPORTING, RECORDS & VIDEO, INC.

219

1 allowed Scopac loan claim and post petition financing
2 provided to Scopac and any other secured claim required
3 to be paid by Scopac in excess of the outstanding balance
4 of the effective date in the SAR account," right?

02:44 5 A. Right.

6 Q. That's one of the adjustments that's made. And
7 then it gives a number of other adjustments that are made
8 off of that, true?

9 A. I believe that's right.

02:45 10 Q. All in the dollar for dollar basis?

11 A. That's right.

12 Q. So you can't really tell the Court what the
13 timber notes, the new timber notes will be in terms of
14 par value or face value as you call it?

02:45 15 A. That's true.

16 Q. Now, in connection with those notes, you
17 understand that the indenture trustee's experts have
18 testified that the interest rate is too low?

19 A. I believe -- I believe that they did testify to
02:45 20 that, yes.

21 Q. Okay. And the interest rate on these new notes
22 is just 5 percent; is that right?

23 A. No. It's 5 and a half percent.

24 Q. Excuse me, 5 and a half percent. And have you
02:45 25 done any independent analysis, that is, you, what the

AK/RET REPORTING, RECORDS & VIDEO, INC.

220

1 interest rate should be?

2 A. Yes.

3 Q. Do you disagree with what Houlihan suggests the
4 interest rate should be?

02:45 5 A. I don't know what they suggest the interest
6 rate should be.
7 Q. Okay. So you know it's different, you just
8 don't know to what extent?
9 A. Yeah, I don't remember. I know that everybody
02:46 10 had differing opinions as to the value of the notes. I'm
11 not sure what they said it was worth.
12 Q. What are you saying the value of the notes are?
13 A. I believe they're par.
14 Q. You think that it's \$325 million?
02:46 15 A. Yes.
16 Q. These are negative amortization notes, are they
17 not?
18 A. I believe they're neg am for two years.
19 Q. Well, actually the amount of the principal
02:46 20 keeps on going up each and every year until the middle of
21 the 18th year, right?
22 A. You know, we did so many amortizations, I don't
23 know if that's right. Why would it go up? They're cash
24 pay notes after two years, I thought.
02:46 25 Q. So you don't understand that the new notes are

AK/RET REPORTING, RECORDS & VIDEO, INC.

221

1 negative amortization notes through year 18.5?
2 A. What does negative amortization mean in your
3 mind?
4 Q. It means that the amount that is paid by --
02:46 5 A. Oh, the toggle?
6 Q. -- is less than the interest that is accruing
7 on that debt, each and every period which that -- the
8 note payments are made so that the principal keeps on
9 going up each and every year?
02:47 10 A. I think you're talking about the pick toggle
11 feature where it's a limited period of time.
12 Q. Meaning how long?
13 A. I believe it's five consecutive quarters.

14 Q. So it's not your understanding that it is 18
02:47 15 and a half years?
16 A. No.
17 Q. Whereby the principal keeps on going up?
18 A. Yes.
19 Q. Did you see the last version of it?
02:47 20 A. No, I don't recall. We did so many versions, I
21 actually don't remember what the last version was.
22 Q. So you don't remember what the notes are in
23 that regard, true?
24 A. True.
02:47 25 Q. Would it be unfair and unreasonable to require

AK/RET REPORTING, RECORDS & VIDEO, INC.

222

1 a negative amortization note or a pick toggle feature, as
2 you put it, whereby the principal keeps on increasing for
3 the first 18 and a half years?
4 A. Your question is would it be unreasonable to
02:47 5 have a pick note where you have principal increasing for
6 18 years? No, that's not unreasonable.
7 Q. Would you agree that the credit worthiness of
8 those notes or of Newco -- strike that.
9 Do you agree that that would be a riskier loan
02:48 10 than one which does not -- which is not negatively
11 amortized?
12 A. No. Actually, it's the opposite. A note that
13 has the option to not pay interest in cash and it can
14 instead pick based upon small fluctuations in cash flow
02:48 15 at any given period is less likely to default. And it
16 gives the entity, the lender more flexibility in meeting
17 its debt service.
18 Q. Do you understand that negative amortization
19 loans carry a greater risk of non payment or not?
02:48 20 A. No.
21 Q. So you disagree with that statement?
22 A. I do.

23 Q. Now, do you understand that Scopac has been
24 operated from an operational perspective based on a
02:48 25 positive EBITDA for several years, from the operational

AK/RET REPORTING, RECORDS & VIDEO, INC.

223

1 perspective taking aside the interest on the notes?
2 A. Yes, that's correct.
3 Q. That Palco has not been operating in a positive
4 EBITDA, right?
02:49 5 A. I believe that's correct also.
6 Q. And it hasn't been for a very long time, right?
7 A. I believe that's correct.
8 Q. Okay. And so when you combine Palco and Scopac
9 as you're proposing in Newco, do you agree that the
02:49 10 credit risk of Newco is worse than a stand-alone in
11 Scopac?
12 A. I'm sorry, you're going to have to repeat the
13 question. When you combine the assets -- I want to make
14 sure I --
02:49 15 Q. When you combine Scopac and Palco into Newco --
16 A. Uh-huh.
17 Q. -- do you agree that that's a less credit
18 worthy entity than Scopac alone?
19 A. I do not.
02:49 20 Q. Even though you're -- Scopac alone has a
21 positive EBITDA, a historical positive EBITDA whereas
22 Palco has been losing money for years and years?
23 A. Yes, I think it's a more credit worthy company.
24 Q. Now, have you looked at Mr. Zellen's testimony,
02:50 25 one of the debtors' experts?

AK/RET REPORTING, RECORDS & VIDEO, INC.

224

1 A. No.
2 Q. Okay. Do you have any idea what the range of

3 value of the new notes are according to the debtors?
4 A. Maybe you can tell me.
02:50 5 Q. Have you heard \$160 million to \$230 million
6 range?
7 A. Now I have. That doesn't sound reasonable.
8 Q. Have you heard that IT, the noteholders
9 experts, have suggested that it's \$138.2 million to
02:50 10 \$212.8 million in terms of the value of the new notes?
11 A. Yeah, I had heard that.
12 Q. I'm sorry?
13 A. I had heard that.
14 Q. And the Court was asking, you know, what --
02:51 15 what the range is that would be -- a value would be --
16 the range between -- the difference between what the
17 noteholders would receive if they were getting the value
18 according to Houlihan's or the indenture trustee's expert
19 versus what they would get under your plan. And you
02:51 20 agree that it's somewhere between \$200 and \$300 million
21 less than what they say their collateral is worth?
22 A. I'm sorry, you're going to have to repeat the
23 question.
24 Q. Do you understand that according to Houlihan's
02:51 25 models, valuation models if your plan is confirmed, then

AK/RET REPORTING, RECORDS & VIDEO, INC.

225

1 the lost value of collateral of the noteholders is
2 somewhere in the range of \$2- to \$300 million?
3 A. And so can I do the math out loud and you just
4 agree? So they believe that the trees are worth \$600
02:52 5 million and our plan provides them with \$500 million, a
6 combination of cash and bonds. And so that's \$100
7 million. And then where does your other number come
8 from?
9 Q. No. I'm saying if the value of the new notes
02:52 10 are actually not as you suggest, \$325 million, they're
11 actually what Houlihan or Mr. Zellen, the debtors' expert

12 suggests.

13 A. So if Houlihan or the debtors' valuation were
14 correct, then mathematically I believe you're right.

02:52 15 Q. And as we indicated earlier, the equity of
16 Newco would get the benefit of that value, true?

17 A. Benefit of what value, sir?

18 Q. The difference. If your plan is confirmed.

19 A. Well, then no, because if I -- if I think that
02:53 20 their valuation of the first lien notes is correct, then
21 the discount rate -- well, first of all, it means that
22 Newco is a much less credit worthy entity and so most
23 likely my equity is out of the money, and so I'm probably
24 going to be losing money in my equity investment.

02:53 25 Q. But Newco gets the value of that difference in

AK/RET REPORTING, RECORDS & VIDEO, INC.

226

1 value, not the noteholders, right?

2 A. I still -- I still don't understand your
3 question.

4 Q. Have you-all looked into the question of
02:53 5 whether the acquisition by MRC of the 85 percent of Newco
6 violates any antitrust rules?

7 A. I do not.

8 Q. Do you know of anyone who has?

9 A. I do not.

02:54 10 MR. KRUMHOLZ: I pass the witness, Your
11 Honor.

12 THE COURT: All right. Anyone else have
13 any questions? Does the debtor have any questions?

14 MR. LAMB: Yes, Your Honor.

02:54 15 THE COURT: All right.

16 CROSS-EXAMINATION

17 BY MR. LAMB:

18 Q. Good afternoon. My name is George Lamb. I
19 don't think we've met before.

02:54 20 A. No, we haven't. Hi, George.

21 Q. I represent Pacific Lumber Company. I wanted
22 to ask you a couple of questions about a couple of things
23 in your proffer. Could we put up page 3. Blow up
24 paragraph 6. You say that "there is an excess of \$160
02:55 25 million of senior secured prepetition and post petition

AK/RET REPORTING, RECORDS & VIDEO, INC.

227

1 debt owed to Marathon. Marathon believes that the value
2 of Palco's assets is clearly less than the amount of the
3 senior secured obligations owed to Marathon." How does
4 the \$160 million senior secured debt break down?

02:55 5 A. There's \$75 million post petition dip loan and
6 then \$85 million dollars of the prepetition term loan,
7 and then there's accrued interest on both.

8 Q. Do you know what that is?

9 A. I don't know off the top of my head, probably
02:55 10 several million dollars. I know that we're owed at least
11 three on April 18th.

12 Q. Then you say "Marathon believes that the value
13 of Palco's assets is clearly less than the amount of the
14 senior secured obligations." Have you done any valuation
02:56 15 of all of Palco's assets?

16 A. Personally or --

17 Q. Marathon.

18 A. Yes.

19 Q. Who did that?

02:56 20 A. Mainly me.

21 Q. And how have you valued the assets?

22 A. Well, it's three-fold. It would be what is the
23 value of the AR and inventory, since that's the most
24 liquid, the long-term value of the town and all the
02:56 25 ancillary real estate assets of the town, which we call

AK/RET REPORTING, RECORDS & VIDEO, INC.

228

1 Townco. And then the value of the mill.

2 Q. Have you added in values for other mills,
3 Fortuna mill?

4 A. That's what I say by ancillary and real estate.

02:56 5 Q. Have any of these items been independently
6 valuated, valued besides the town assets?

7 A. We hired a real estate firm to take a look at
8 it.

9 Q. So is there a valuation report on the Scotia
02:57 10 mill?

11 A. No.

12 Q. Is there a valuation report on the Fortuna
13 mill?

14 A. No. I relied on Mr. Clark's affirmation that
02:57 15 there's an LOI for that mill.

16 Q. I'm sorry, would you say that again?

17 A. Mr. Gary Clark, the CFO of the company, I
18 called him and asked him directly, do you have an LOI out
19 on the Fortuna mill, and I believe his other one was the
02:57 20 Carlotta mill, and he said yes and then he told me the
21 amounts.

22 Q. The numbers. And the Scotia mill valuation you
23 did yourself?

24 A. Not more as what is this in combination with,
02:57 25 discussing with our experts what is this potentially

AK/RET REPORTING, RECORDS & VIDEO, INC.

229

1 worth if it's operating. And then we, believe if not,
2 it's just scrap value.

3 Q. And is it -- is there some appraisal or report
4 that reflects the number you came up with?

02:58 5 A. I'm sorry, which number?

6 Q. The value for the Scotia mill.

7 A. Yeah, I know, but under what circumstance?
8 Under --

9 Q. A going concern value?

02:58 10 A. No, there's no report.
11 Q. And when you add up all your numbers, what do
12 you come to?
13 A. It's about \$110 million.
14 Q. So under your valuation that you've done, the
02:58 15 value of the Palco assets is greater than your term loan,
16 correct?
17 A. Yes.
18 Q. Have you ascribed any value to Palco's interest
19 in the Headwaters litigation?
02:59 20 A. No.
21 Q. Have you had anybody else study that?
22 A. Other than a cursory review by our lawyers, no.
23 Well, I should apologize. Our lawyers told me to ascribe
24 a zero value to it.
02:59 25 Q. And you did that? You ascribed a zero value to

AK/RET REPORTING, RECORDS & VIDEO, INC.

230

1 that?
2 A. That's correct.
3 Q. One quick question about page 5 of your
4 proffer, paragraph 12. You say there that the Marathon
02:59 5 plan is feasible inasmuch as the debtors will have
6 sufficient funds from cash on hand to operate or, if
7 necessary, there will be a short-term bridge financing.
8 As you sit here today, is that bridge financing going to
9 be necessary, do you think?
03:00 10 A. Yes.
11 Q. And what would be the amount and terms of that
12 bridge financing?
13 A. We really haven't discussed what the amount or
14 terms would be, but presumably it would be what is the
03:00 15 cash hold to get us between confirmation and the day upon
16 which we can take control.
17 Q. And you simply don't know what that number is
18 right now?

19 A. No. I would assume it's more than \$10 million.
03:00 20 Q. I'd like to talk more about the Headwaters
21 litigation. You're aware of the lawsuit that the debtors
22 have pending against the State of California?
23 A. I am.
24 Q. And have you reviewed the debtor's damage
03:00 25 expert calculations of the damages that the debtors will

AK/RET REPORTING, RECORDS & VIDEO, INC.

231

1 be seeking?
2 A. I have not.
3 Q. Do you have an understanding that Palco is
4 seeking or calculates its damages somewhere between \$227
03:00 5 and \$251 million?
6 A. I'll take your word for it.
7 Q. Scopac \$388 to \$399 million?
8 A. Once again.
9 Q. For a total of \$626 to \$639 million?
03:01 10 A. Okay.
11 Q. Does that sound right?
12 A. That sounds right.
13 Q. Under the Marathon/MRC plan, what happens to
14 those damage claims if your plan is confirmed?
03:01 15 A. We would be purchasing them.
16 Q. And where would they go?
17 A. Into Newco.
18 Q. And what is your plan for them once they're in
19 Newco?
03:01 20 A. Well, Marathon won't be the managing partner.
21 I believe it would be up to MRC.
22 Q. Have you talked with or do you have an
23 understanding of what MRC's contentions are regarding the
24 Headwater litigation?
03:01 25 A. I believe they will resolve them quickly.

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 Q. Have you discussed an amount at which they
2 would be resolved?
3 A. No.
4 Q. Have you discussed whether any amount --
03:01 5 A. No.
6 Q. -- would be realized in a resolution?
7 A. No, no.
8 Q. Do you have any understanding about what they
9 mean when they're going to resolve it quickly?
03:02 10 A. No.
11 Q. Have they told you they are just going to quit?
12 A. No.
13 Q. You have established a litigation trust under
14 your plan, correct?
03:02 15 A. Yes.
16 Q. But this litigation is not in that trust, is
17 it?
18 A. That's correct.
19 Q. Why not?
03:02 20 A. I believe MRC specifically requested that we
21 not include it.
22 Q. So MRC made the call to exclude the Headwaters
23 litigation from the litigation trust?
24 A. Yes.
03:02 25 Q. And I take it you would defer to MRC as to

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 whether you're willing to take the Headwaters litigation
2 and put it in a trust where it could be pursued for the
3 benefit of creditors and other stakeholders?
4 A. Yes.
03:02 5 Q. That's MRC's decision?
6 A. Well, considering that MRC is the managing
7 partners of the trust -- of Newco.

8 Q. I just want to be sure that's their call, not
9 yours?
03:03 10 A. That's right.
11 Q. In developing your plan, did Marathon retain
12 any experts to do a highest and best use study of the
13 timberlands or any portion of the timberlands?
14 A. You mean an alternative use?
03:03 15 Q. Yes.
16 A. No.
17 Q. Did Marathon make any effort to find ways to
18 enhance the value of the timberlands over and above their
19 value as timberlands?
03:03 20 A. No.
21 Q. The last subject I would like to talk to you
22 about are the MMCAs. Do you have an understanding of
23 what the MMCAs are?
24 A. I do.
03:04 25 Q. About 6,640 acres, correct?

AK/RET REPORTING, RECORDS & VIDEO, INC.

234

1 A. Sounds right.
2 Q. Where do they go under your plan?
3 A. We would be purchasing them.
4 Q. And do they end up in Newco?
03:04 5 A. Yes.
6 Q. And what is Newco planning to do with them?
7 A. I believe maintain them based upon the HCP and
8 the Headwaters agreement.
9 Q. Does your plan ascribe any value to the MMCAs?
03:04 10 A. No, not -- no cash value.
11 Q. Since you're ascribing no value to them, is
12 Marathon willing to carve the MMCAs out and put them in a
13 trust or some other vehicle where their value might be
14 pursued?
03:05 15 A. Well, firstly we'd have to -- well, MRC would
16 make that call initially, but if you're asking would

17 Marathon consider it, I believe it would be a mistake
18 because these are timberlands that are in the -- well,
19 the Newco lands would be surrounding the MMCAs. The
03:05 20 Newco lands, you would have people crossing across our
21 property. You would have the potential of other
22 regulatory issues where if somebody else tried to do
23 something else with the MMCAs, it could affect our
24 ability to harvest. So probably not.
03:05 25 Q. That's going to be MRC's call?

AK/RET REPORTING, RECORDS & VIDEO, INC.

235

1 A. Well, it would be the board of directors call,
2 but MRC would control the board.
3 Q. Is there any reason that would not to attempt
4 to sell them to a conservation group or to a government
03:06 5 group?
6 A. It would depend upon restrictions.
7 Q. Suppose that they can be sold to the government
8 or these environmental groups with their existing
9 restrictions in place?
03:06 10 A. We would have to see it, but I would consider
11 anything.
12 Q. Do you know if there is any plan to market or
13 pursue a --
14 A. I know there is not.
03:06 15 Q. There is not?
16 A. No.
17 Q. One last question. I'm sorry. Among the
18 assets you listed for Palco, you didn't talk about the
19 power plant. Was that in your --
03:07 20 A. That was part of the town.
21 Q. Okay. And what is your understanding of the
22 value of the town and the power plant?
23 A. I believe it's \$70 million.
24 Q. Okay. And what's the value of --
03:07 25 A. And that would not include the ancillary real

1 estate. The majority --
2 Q. What's the value of the mill?
3 A. \$25 million.
4 Q. What's the value of Fortuna, Carlotta and Brett
03:07 5 mills?
6 A. \$21 million.
7 Q. And what's value of the industrial properties
8 that are not part of the town?
9 A. That's included in the \$70 million for the
03:07 10 town.
11 Q. All of it?
12 A. Yeah.
13 Q. Okay. What does all of that add up to?
14 A. I don't know if I have my math correct, but I
03:07 15 did the math as \$110 million.
16 Q. Thank you, sir.
17 THE COURT: Anybody else over here at this
18 table? The other debtor?
19 MR. DOREN: No, Your Honor.
03:08 20 THE COURT: All right. Redirect?
21 MR. NEIER: Yes, Your Honor.
22 RE-EXAMINATION
23 BY MR. NEIER:
24 Q. Mr. Breckenridge, are you familiar with a
03:08 25 marketing process that took place by UBS in 2004 or 2005

1 time frame, 2006 as well?
2 A. I am aware, yes.
3 Q. And how would you describe that process? Was
4 it a small process involving very few people or was it an
03:08 5 extensive and broad marketing process?

6 A. From what I understand, books went out to
7 several hundred people and tens of groups were invited to
8 come in to do due diligence, or did come in and do due
9 diligence and no sale was consummated.

03:08 10 MR. DOREN: Your Honor, I'm just -- I
11 object for lack of foundation. This gentleman is
12 testifying as a fact witness. The opening question was
13 are you aware of. If we can just get a little more
14 foundation about whether he has personal knowledge of
03:08 15 those efforts or whether he --

16 MR. NEIER: Well, he answered yes.

17 THE COURT: Lay a foundation.

18 MR. NEIER: I said, are you aware and he
19 answered yes. I think that is a foundation.

03:09 20 MR. DOREN: Aware is not having any
21 personal at all.

22 MR. NEIER: You can redirect on it,
23 Mr. Doren.

24 THE COURT: Go ahead and ask him some more
03:09 25 questions.

AK/RET REPORTING, RECORDS & VIDEO, INC.

238

1 Q. (By Mr. Neier) Are you aware of the marketing
2 process that UBS --

3 A. I'm aware that one took place.

4 Q. And are you aware of the breadth of that
03:09 5 marketing process?

6 A. I believe I read that hundreds of people were
7 sent books, and that if my memory serves, 30 or so were
8 invited in to do due diligence.

9 Q. And was any sale transaction consummated for
03:09 10 the assets of what are now the debtors?

11 A. No.

12 Q. In this case, are you aware of what exclusivity
13 means?

14 A. Yes.

03:09 15 Q. And the termination of that exclusivity?
16 A. Yes.
17 Q. And has there been a termination of exclusivity
18 in this case?
19 A. There has been.
03:09 20 Q. And there are competing plans for the
21 reorganization and the sale of the debtors, correct?
22 A. Yes.
23 Q. And are you aware that as part of terminating
24 exclusivity, that the Houlihan Lokey, the noteholders
03:09 25 financial advisor solicited offers of expression?

AK/RET REPORTING, RECORDS & VIDEO, INC.

239

1 A. I am aware.
2 Q. And that they received three nonbinding subject
3 to due diligence expressions of interest?
4 A. I am aware.
03:10 5 SPEAKER: Your Honor, if Mr. Neier is
6 going to lead him so much, perhaps we could stick to the
7 cross rather than leading him all over the field beyond
8 the cross on redirect.
9 MR. NEIER: This is directly responsive,
03:10 10 Your Honor. The witness was asked --
11 THE COURT: I think he is still your
12 witness, though, so I think he is correct, you should ask
13 him questions without leading.
14 MR. NEIER: Okay.
03:10 15 Q. (By Mr. Neier) Do you know if there were any
16 expressions of interest received by Houlihan?
17 A. I was told that there were three.
18 Q. Were they binding or non-binding?
19 MR. KRUMHOLZ: Your Honor, this is just
03:10 20 objection, hearsay. I mean, he clearly doesn't have
21 personal knowledge of this. He was told it. He's not an
22 expert.
23 MR. NEIER: I mean, Mr. Krumholz showed

24 him the indenture. He doesn't have any personal
03:10 25 knowledge of the indenture either, for crying out loud.

AK/RET REPORTING, RECORDS & VIDEO, INC.

240

1 THE COURT: Right. But I think I'll allow
2 you to -- I mean, I agree that it is all hearsay, it's
3 stuff that I can -- I'm not sure that this is stuff
4 that's really in question. Is there any question about
03:11 5 what happened during that process? I mean, everything
6 he's saying is correct, isn't it? I mean, it is true
7 that it's hearsay, all he knows is what he was told. I
8 agree with you on that. But on the other hand, is it
9 something that we need -- I mean, is this something -- I
03:11 10 mean, are we going to -- are we required to have him call
11 some other witness?

12 MR. KRUMHOLZ: He's going to call some
13 other witness.

14 MR. NEIER: I'm glad Mr. Krumholz is
03:11 15 trying my case now.

16 THE COURT: Well, I don't know. Are you
17 going to call somebody? If this issue is important
18 enough to you, are you going to call one of the parties
19 that participated in that and ask them about it?

03:11 20 MR. NEIER: I believe a lot of evidence
21 will be introduced about the three nonbinding expressions
22 of interest, but I think I am entitled --

23 THE COURT: Go ahead and ask a few
24 questions here. Is there any more? Let's move on.

03:12 25 Q. (By Mr. Neier) With respect to the

AK/RET REPORTING, RECORDS & VIDEO, INC.

241

1 Marathon/MRC plan -- and you were involved in discussions
2 in crafting that plan, correct?

3 A. Yes.

4 Q. And with respect to that plan, are you familiar
03:12 5 with an 1111(B) election?
6 A. Yes.
7 Q. And was an 1111(B) election made by MRC and
8 Marathon in their plan?
9 A. One was offered.
03:12 10 Q. One was offered. Was it accepted?
11 A. No.
12 Q. There was no election?
13 A. Correct.
14 Q. You might want to step away from the microphone
03:12 15 a little bit because it's rubbing against it.
16 In your experience, can a company reorganize
17 without having a 363 liquidation sale?
18 A. It happens all the time.
19 Q. You spoke about the new timber adjustment. Do
03:12 20 you recall that testimony?
21 A. Yes.
22 Q. Now, are you familiar with what's known as the
23 SAR account?
24 A. Yes.
03:12 25 Q. And what is the SAR account, to your general

AK/RET REPORTING, RECORDS & VIDEO, INC.

242

1 understanding?
2 A. It was a separate account set up for the
3 benefit of the creditors of Scopac to which Bank of New
4 York -- sorry, Bank of America has a priority lien on
03:13 5 that SAR account. That SAR account was there to make
6 that service payments if cash at Palco -- sorry, if
7 Scopac was insufficient to make the payment.
8 Q. Okay. And so you understand that Bank of
9 America has a lien on the SAR account. Do the
03:13 10 noteholders also have a lien on the SAR account?
11 A. I believe they have a second lien on the SAR
12 account.

13 Q. And what is happening to this SAR account, to
14 your knowledge?

03:13 15 A. It's diminishing.

16 THE COURT: It's what?

17 A. It's diminishing.

18 Q. So the collateral of Bank of America and the
19 noteholders is diminishing. Why is it diminishing? This
03:13 20 is a cash account, the SAR account?

21 A. I believe it's the cost of the trial and the
22 case.

23 Q. And I believe you were asked is a reduction in
24 the SAR account part of the new timber note adjustment?

03:14 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

243

1 Q. And why is that?

2 A. Because reduction in the amount of cash
3 available to pay Bank of America doesn't increase the
4 amount that I want to pay for an asset. The asset is
03:14 5 worth the same amount today as it would be -- essentially
6 we came up with a value for the asset, and the assets of
7 the SAR account are there to pay Bank of New York --
8 sorry, Bank of America. If those monies diminish,
9 then --

03:14 10 THE COURT: Can you back up a little?

11 Right there. That's better. Don't change that, just
12 stay right there.

13 A. If those monies diminish, it's --

14 THE COURT: Back up a little more. There
03:14 15 you go.

16 MR. NEIER: Don't move.

17 A. If those monies diminish, it does not mean that
18 we want to pay more. It does not make the asset worth
19 any more. It is less cash available to pay the
03:15 20 liabilities -- the position liability of the company.

21 Q. Okay. So there were a couple of interruptions

22 there because of the microphone. So as the collateral
23 declines, the offer declines?

24 A. That's correct.

03:15 25 Q. Are you familiar with what a balloon payment

AK/RET REPORTING, RECORDS & VIDEO, INC.

244

1 is?

2 A. A balloon payment?

3 Q. A balloon payment.

4 A. Are you talking about in a bond context?

03:15 5 Q. In a bond context.

6 A. Yes, it is.

7 Q. And what is a balloon payment?

8 A. A balloon payment is a final payment at

9 maturity for 100 percent of a bond.

03:15 10 Q. So in other words, is it the principal of the
11 note?

12 A. Yes.

13 Q. So if you service the interest and then you pay
14 the principal at the end, that is a balloon payment?

03:15 15 A. That's right.

16 Q. And is a balloon payment negative amortization
17 in your view?

18 A. No.

19 Q. Okay. So if you service the debt, you pay the
03:15 20 interest and then you have a balloon payment at the end,
21 that's not negative amortization, is it?

22 A. No.

23 Q. And are you familiar with the pick feature in
24 the notes?

03:16 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

245

1 Q. And the pick feature is for how long?

2 A. I believe it's for five consecutive quarters.
3 Q. So two years?
4 A. Yeah.
03:16 5 Q. Or two years and one quarter?
6 A. Right.
7 Q. And --
8 A. No, I think it's like a year and a quarter.
9 Q. Year and a quarter. Sorry. Year and a
03:16 10 quarter. And is the pick feature for 100 percent of the
11 interest payment or is it for less than 100 percent of
12 the interest?
13 A. Less than 100 percent of the interest.
14 Q. How much?
03:16 15 A. 50 percent.
16 Q. So 50 percent of the interest gets paid for the
17 first five quarters and 50 percent is picked, if you
18 will?
19 A. Yes.
03:16 20 Q. Is that negative amortization, the five
21 quarters?
22 A. Yes.
23 Q. Okay. Now, if Marathon and MRC chose to, they
24 could simply reduce the \$175 million in initial payment
03:16 25 and make a full interest payment in the first five

AK/RET REPORTING, RECORDS & VIDEO, INC.

246

1 quarters, correct?
2 A. Yes.
3 Q. It's just delaying payment?
4 A. Yes.
03:16 5 Q. Okay. Instead of paying the money up front?
6 A. Yes.
7 Q. Now, you were asked a lot of questions about
8 the value of the new timber notes. Let me ask you a
9 question. How much do you believe the noteholders are
03:17 10 owed, the existing timber notes, how much are they owed

11 right now approximately?

12 A. Maybe 800 plus million dollars, including past
13 due interest.

14 Q. And the new timber notes will be 325 less the
03:17 15 adjustment, correct?

16 A. Yes.

17 Q. Would you rather be a holder of the new timber
18 notes or the existing timber notes?

19 A. If I bought them at par, I would prefer to own
03:17 20 the new timber notes.

21 Q. Why is that?

22 A. Because the company is significant delevered.
23 There is additional profit coming in from the
24 distribution business, which will be available to service
03:17 25 the debt. And they have less likelihood of defaulting

AK/RET REPORTING, RECORDS & VIDEO, INC.

247

1 because if you have a low cash quarter, you have the
2 ability to pick for a quarter, so you'll be more likely
3 to remain current.

4 Q. And what about in your --

03:18 5 A. And to add to it, you're secured by the same
6 collateral you were before, so it's the same collateral
7 with a lower face. I should say your LTV is
8 significantly lower.

9 Q. And what does LTV stand for?

03:18 10 A. Loan to value.

11 Q. And you mentioned bridge financing when you
12 were testifying earlier. What bridge financing is going
13 to be required or may be required?

14 A. Well, if we're successful and our plan is
03:18 15 confirmed, we don't want the mill to close in the
16 meantime, we don't want operations of the company to
17 close. The company is out of money, so Marathon and MRC
18 would discuss and provide a loan to the debtors between
19 confirmation and closing.

03:19 20 Q. And who would provide that financing?
21 A. An affiliate of Marathon, asset management and
22 Mendocino Redwood Company.
23 Q. But you're not going to have to go out and seek
24 financing from some third-party and there's some
03:19 25 contingency or something like that, correct?

AK/RET REPORTING, RECORDS & VIDEO, INC.

248

1 A. No.
2 Q. So the financing is going to be provided by you
3 and MRC?
4 A. That's right.
03:19 5 Q. I believe Mr. Lamb asked you some questions
6 about exploring an alternative use on the debtor's
7 property, correct?
8 A. Yes.
9 Q. And you mentioned that Marathon has not hired
03:19 10 an expert in this field, correct?
11 A. That's correct.
12 Q. Have you talked to any other experts in this
13 field from any of the other constituencies?
14 A. We had a conference call with Dr. Mundy maybe
03:19 15 six months ago or so.
16 Q. So you talked to Dr. Mundy about his plan?
17 A. Yes.
18 Q. What did you think of it?
19 A. I thought it was completely infeasible. We
03:19 20 discussed it with our own internal real estate group.
21 When we were discussing the plan, there was no
22 feasibility study done, there were no long-term
23 projections. There have not been any discussion about
24 who would be able to afford these demographics and any
03:20 25 indication of interest from anybody.

AK/RET REPORTING, RECORDS & VIDEO, INC.

249

1 MR. NEIER: I have no further questions,
2 Your Honor.

3 THE COURT: All right. What are we doing
4 now? We had direct of the proffer, we had cross which
03:20 5 was in between and then we had redirect, so what else do
6 we have?

7 MR. KRUMHOLZ: A small recross.

8 MR. NEIER: Your Honor, I'm going to
9 object to that.

03:20 10 THE COURT: So why would we be doing that?
11 I mean, that --

12 MR. KRUMHOLZ: I think I'm allowed to have
13 a recross on topics he brought up that's new.

14 THE COURT: You're supposed to object to
03:20 15 those topics if they exceed the scope of your
16 cross-examination, okay?

17 MR. KRUMHOLZ: There was an objection.

18 THE COURT: I will give you a brief cross.
19 And perhaps there are other judges that don't follow
03:20 20 those rules, but those are the rules we're following from
21 now on.

22 MR. KRUMHOLZ: Okay.

23 THE COURT: Now, you didn't want to ask
24 questions, you now want to ask him a question?

03:21 25 MR. JONES: Yes, Your Honor, precisely

AK/RET REPORTING, RECORDS & VIDEO, INC.

250

1 because over my objection he was permitted to ask
2 questions beyond the cross and beyond --

3 THE COURT: And what area was that?

4 MR. JONES: The potential bridge loan. I
03:21 5 think I only have two or three questions, but --

6 THE COURT: All right. Go ahead.

7 MR. KRUMHOLZ: Do you want to go first?

8 MR. JONES: I'm happy to go first, Your

9 Honor.

03:21 10 THE COURT: Okay. Now, don't go too far.

11 CROSS-EXAMINATION

12 BY MR. JONES:

13 Q. Good afternoon, sir, Evan Jones representing

14 Bank of America. I would like to start by apologizing

03:21 15 for the dog comment. That was a very poor word choice.

16 You mentioned if your plan is confirmed that MRC/Marathon

17 would consider a bridge loan to get the debtor to an

18 effective date. Do you recall that?

19 A. Yes.

03:21 20 Q. What collateral would you anticipate asking for

21 in connection with that?

22 A. I hadn't really thought about it, but I

23 would -- I would guess it would be part of an equity

24 investment or unsecured investment.

03:21 25 MR. JONES: That's all, Your Honor, thank

AK/RET REPORTING, RECORDS & VIDEO, INC.

251

1 you.

2 THE COURT: All right.

3 MR. KRUMHOLZ: I think I just have one

4 question.

03:22 5 CROSS-EXAMINATION

6 BY MR. KRUMHOLZ:

7 Q. Mr. Neier asked if you would rather have the

8 timber notes as they exist today or the old timber

9 notes -- excuse me, the new timber notes or the existing

03:22 10 timber notes. Do you recall that?

11 A. Yes.

12 Q. And if you knew you could sell the current

13 timber notes for \$600 million in the next three to seven

14 months, would you rather have them?

03:22 15 A. Of course.

16 MR. KRUMHOLZ: Pass the witness.

17 THE COURT: All right. Now you can step

18 down. Okay. The next witness.
19 MR. SCHWARTZ: Your Honor, we call Richard
03:22 20 Lamont.
21 THE COURT: All right.
22 MR. CLEMENT: Your Honor, might this be a
23 time to take a five-minute break?
24 THE COURT: Sure.
03:22 25 (A recess was taken.)

AK/RET REPORTING, RECORDS & VIDEO, INC.

252

1 THE COURT: Be seated. We're ready for
2 our next witness. Who is the next witness?
3 MR. SCHWARTZ: Richard Lamont, Your Honor.
4 RICHARD LAMONT,
03:39 5 having been first duly sworn, testified as follows:
6 MR. SCHWARTZ: Good afternoon, Your Honor.
7 Steven Schwartz from Winston Strawn on behalf of
8 Marathon. Since this is the first expert witness, I just
9 wanted to remind the Court of the arrangement that we
03:39 10 agreed, that we would do 15 minutes.
11 THE COURT: Right.
12 MR. SCHWARTZ: Thank you, Your Honor.
13 DIRECT EXAMINATION
14 BY MR. SCHWARTZ:
03:39 15 Q. I would like to show the witness what has been
16 previously marked as MMX Exhibit 4.
17 THE COURT: All right.
18 Q. (By Mr. Schwartz) Mr. Lamont, do you recognize
19 what's been marked as MMX 4?
03:40 20 A. Yes. This is my proffer and attached report.
21 Q. And is your proffer true and correct?
22 A. Yes, it is.
23 Q. And does the report and your proffer contain
24 all your opinions in this case?
03:40 25 A. Yes, it does.

1 MR. SCHWARTZ: Your Honor, I move the
2 admission of Exhibit 4.
3 THE COURT: Any objection?
4 SPEAKER: No objection, Your Honor.
03:40 5 THE COURT: They will be admitted.
6 Q. (By Mr. Schwartz) Can you briefly describe
7 your educational background?
8 A. I have a bachelor's in forestry from Oregon
9 State University.
03:40 10 Q. And in what year did you receive that degree?
11 A. In 1981.
12 Q. What is your current occupation?
13 A. I am a timberland appraiser and forestry
14 consultant.
03:40 15 Q. And for how long have you been in that
16 occupation?
17 A. I have been that since '82, so 25 plus years.
18 Q. As part of your occupation, do you conduct
19 appraisals of timberlands?
03:41 20 A. Yes, I do.
21 Q. In the last 15 years roughly, how many
22 timberlands have you conducted an appraisal for?
23 A. Probably over 200 properties.
24 Q. In what states were those timberlands located?
03:41 25 A. Oregon, Washington, Idaho and California.

1 Q. Can you generally give me a range of the size
2 of the acreage of those timberlands that you've
3 appraised?
4 A. Typically I do properties that are 30 to
03:41 5 150,000 acres, typical commercial timberlands. Some even
6 larger, up to 6 or 100,00, a million acres.

7 Q. What does it mean to be a certified general
8 appraiser?

9 A. That's a state licensing that you go through,
03:41 10 educational requirements and experience that you --
11 licensed with the state.

12 Q. Are you a certified general appraiser in any
13 states?

14 A. Yes, I'm a certified general appraiser in
03:42 15 Oregon, Washington and California.

16 MR. SCHWARTZ: Your Honor, at this time
17 based on Mr. Lamont's proffer, his report and the direct
18 testimony today in court, I would ask the Court to
19 qualify him as an expert in timberland appraisals.

03:42 20 THE COURT: Any objection?

21 SPEAKER: No objection.

22 SPEAKER: No objection, Your Honor.

23 THE COURT: All right.

24 Q. (By Mr. Schwartz) Mr. Lamont, what were you
03:42 25 retained to do in this case?

AK/RET REPORTING, RECORDS & VIDEO, INC.

255

1 A. I was retained to prepare an appraisal of the
2 property of Scopac.

3 Q. And did you perform such appraisal?

4 A. Yes, I did.

03:42 5 Q. Did you reach a conclusion as to the value of
6 the Scopac timberlands?

7 A. Yes, I did.

8 Q. What was your conclusion?

9 A. The fair market value, in my opinion, was \$430
03:42 10 million.

11 Q. Did you also reach a value based on a
12 liquidation value?

13 A. Yes. The liquidation value was \$260 million.

14 Q. In doing your appraisal, is part of the
03:42 15 requirement to determine what's the highest and best use

16 of the property is?

17 A. Yes.

18 Q. Did you make a determination of what, in your
19 opinion, the highest and best use of the Scopac

03:43 20 timberlands is?

21 A. Yes. I reviewed the timberlands, and my
22 conclusion was its highest and best use was timber and
23 timberland.

24 Q. Why did you reach that conclusion?

03:43 25 A. There's a series of tests that you go through,

AK/RET REPORTING, RECORDS & VIDEO, INC.

256

1 legally permissible, physically possible. And given the
2 zoning, the current use and the physical nature of the
3 property, the property as a whole is timber property.

4 It's remote, it's rugged and it's around trees, it's not
03:43 5 suitable for farming or industrial uses. And recreation
6 is very limited. Access is an issue for the property.
7 So it was generally reviewed as a timber and timberland
8 property.

9 Q. In considering what the highest and best use of
03:43 10 the property was, did you take into account the proposals
11 offered by the debtor for are the reserve project?

12 A. Yes, I was aware of the different proposals
13 from the debtor on the ranch and reserves, and I did not
14 find them feasible or plausible given the current
03:44 15 conditions and market.

16 Q. Can you briefly for the Court explain how you
17 arrived at your valuation for the timberlands of \$430
18 million?

19 A. Yes. I started with the forest inventory data
03:44 20 provided by the company that was the most recent
21 available data that they were able to provide, and I put
22 that into a computer model that then grew every
23 individual stand in the forest, and then calculated when
24 it would be available for harvest and then calculated a

03:44 25 harvest schedule or harvest volume from that mathematical

AK/RET REPORTING, RECORDS & VIDEO, INC.

257

1 computer program.

2 Q. Why did you use a computer model?

3 A. It's important when you're modeling large
4 properties that are sophisticated in the sense of

03:44 5 different species, different ages to use a computer

6 program to simulate the growth and the progression

7 through time of the ages of trees and stands which are

8 available and where they're located across this property

9 so you can model the different constraints that are, you

03:45 10 know, imposed on the property.

11 Q. What type of constraints are you referring to?

12 A. Particularly in the Scopac property they have

13 watershed restrictions, harvest volume that limits that

14 can come from different properties. And they also have a

03:45 15 dynamic species mixed of the property, Douglas Fir and

16 redwood, so it's important to model those.

17 Q. Did you program those constraints into your

18 computer model?

19 A. Yes. I set different levels of harvest flow

03:45 20 from different constraints like freshwater. And it also

21 has a very limited harvest right now because of the water

22 board issues. And so those were built into my analysis.

23 Q. And those are regulatory constraints, right?

24 A. Those are regulatory constraints.

03:45 25 Q. Now, in determining what prices to use for the

AK/RET REPORTING, RECORDS & VIDEO, INC.

258

1 logs in doing your valuation, what -- how did you decide

2 what price?

3 A. I reviewed the different sources of redwood and

4 Douglas Fir pricing. The state board of equalization

03:45 5 provides a report of stumpage, and I reviewed that. I
6 looked at Pacific Rim Wood Market report that also
7 collects data from log sellers and buyers, and that has
8 historical data. I reviewed that and determined the
9 historical averages for pricing. And then I had to look
03:46 10 at a forward looking forecast to anticipate what would
11 happen in the future. And based on current conditions, I
12 set the price using that -- those methods.

13 Q. In doing your appraisal, did you study what the
14 trend in price for logs has been over the past six
03:46 15 months?

16 A. I studied the price previously and the current
17 six months, yes.

18 Q. And what did you conclude with respect to the
19 last six months?

03:46 20 A. Prices have fallen from the '07 period now to
21 '08 by as much as 10 to 15 percent, \$50 to \$100 per
22 thousand, particularly in young growth redwood.

23 Q. Do you have an opinion on what the general
24 cause of that reduction in price over the last six months
03:46 25 is?

AK/RET REPORTING, RECORDS & VIDEO, INC.

259

1 A. Yes. I mean, we've had a general economic
2 slow-down, but it has been particularly critical in the
3 housing market, and that has depressed prices uniformly
4 across all forest products. It has hit especially
03:47 5 projects like redwood and specifically Douglas Fir.

6 Q. Now, we talked about two elements of your
7 analysis, the harvest forecast and the pricing. What
8 other factors went into your obtaining the value of the
9 property?

03:47 10 A. The available acres that you can harvest on,
11 what's available through regulatory and operational
12 constraints and also the costs. I went through and did a
13 detailed analysis of the operating statements that were

14 provided by the company and my own personal experience on
03:47 15 operating statements and developed a cost basis for the
16 revenues.

17 Q. And you programmed those into your model as
18 well?

19 A. Correct.

03:47 20 Q. Now, did you perform -- after you concluded the
21 harvest forecast price and cost, did you do a discount
22 and cash flow model?

23 A. Yes. I did two methods of valuation. I did
24 the discount and cash flow model and a sales comparison
03:48 25 approach.

AK/RET REPORTING, RECORDS & VIDEO, INC.

260

1 Q. Well, let's start with the discount and cash
2 flow model. For how long did you -- for what period of
3 time was your model?

4 A. I modeled -- my discount and cash flow models
03:48 5 were 50 years.

6 Q. Why did you choose 50 years?

7 A. It's important in commercial property to
8 simulate the harvest and growth of the forest over at
9 least one rotation of a tree. So trees that you harvest
03:48 10 today, you plant back and then you'll eventually harvest
11 them out about 45, 50 years. And so you get to see the
12 effect of species dynamics of the property, which is
13 particularly important in this property.

14 Q. Just as an example, a redwood tree that's
03:48 15 harvested today, how long would it take before you could
16 harvest that tree again?

17 A. Typically this is very productive land, but
18 it's about 45 years for a second growth redwood.

19 Q. Now, once you've got your harvest forecast
03:49 20 pricing and costs, how do you account for the fact that
21 you're modelling out 50 years and you're trying to come
22 up with the present value of the property?

23 A. You have to determine an appropriate real
24 discount rate. And so what I did was I looked at where I
03:49 25 had available data, which was an extensive list of sales

AK/RET REPORTING, RECORDS & VIDEO, INC.

261

1 in Oregon and Washington where I could calculate what the
2 actual discount rates were from actual sales. And I
3 developed an average of those recent sales for a base
4 price for a base discount rate.

03:49 5 And then I looked at the market and I did
6 interviews with local appraisals and determined what
7 additional risks would be appropriate for the northern
8 California market because of the regulatory environment
9 that northern California is compared to my other
03:49 10 comparables.

11 Q. Let's start with the other comparables. You
12 said they were in Oregon and Washington. What was the
13 reason you used sales and other transactions in Oregon
14 and Washington rather than California?

03:50 15 A. There has actually been quite a few sales,
16 recent sales, in Oregon and Washington, so it's a very
17 good market to look at for nearby by sales. And there's
18 been probably seven or eight high quality sales that I
19 had detailed information for.

03:50 20 Q. And then you considered whether to change the
21 discount rate to account for California; is that correct?

22 A. Correct. Based on the -- California has a
23 unique regulatory environment that we've been discussing
24 today, and that creates additional risk. Like there's a
03:50 25 current House bill that wants to limit the amount of

AK/RET REPORTING, RECORDS & VIDEO, INC.

262

1 clearcutting, and those are additional risks to future
2 harvests, so you have to increase your harvest rate to

3 account for those additional risks over your planning
4 horizon.

03:50 5 Q. Let me show you what has previously been marked
6 as MMX Exhibit 58.

7 MR. SCHWARTZ: Excuse me, Your Honor, I
8 have to get one more copy. I apologize, Your Honor.

9 Q. (By Mr. Schwartz) Mr. Lamont, can you identify
03:51 10 what's been marked as Exhibit 58?

11 A. This is an Assembly Bill 2926. It was
12 introduced February 22nd.

13 Q. And what does the bill provide for?

14 A. This bill would require the board to develop
03:52 15 statewide rules that would prohibit certain clearcutting
16 timber operations in adjacent timberlands. And it goes
17 through other restrictions of limiting clearcutting to
18 less than ten acres and so on.

19 Q. Just a general matter, if this bill were
03:52 20 adopted in California, what impact would it have on the
21 harvest ability and value of the property?

22 A. It would be a negative impact because it would
23 increase the cost of harvesting and also limit the volume
24 harvestable, particularly on the Scopac property, because
03:52 25 of the adjacency issues that it would create.

AK/RET REPORTING, RECORDS & VIDEO, INC.

263

1 Q. Now, we talk about discount rate. What
2 discount rate did you use?

3 A. I used the 7 percent real discount rate.

4 Q. And what was the discount rate for the Oregon
03:52 5 and Washington properties?

6 A. The recent Oregon and Washington sale was at 6
7 percent.

8 Q. So you added one percent to account for the
9 regulatory risk in California; is that correct?

03:53 10 A. Correct.

11 Q. Now, in addition to performing your own

12 appraisal, did you also review the appraisal report
13 prepared by Mr. Fleming, the noteholders' experts?

14 A. Yes, I did.

03:53 15 Q. Did you reach any conclusions regarding
16 Mr. Fleming's analysis and appraisal?

17 A. Yes, I did.

18 Q. What was your conclusion?

19 A. Mr. Flemings's appraisal overstates the value
03:53 20 of the property and is flawed in several areas.

21 Q. Can you give us an example as what you viewed
22 as the biggest flaw in Mr. Fleming's analysis?

23 A. Mr. Fleming chose a September valuation date
24 and then -- actually, October 1st, and surveyed prices
03:53 25 happened in September. And the prices are significantly

AK/RET REPORTING, RECORDS & VIDEO, INC.

264

1 different today than they were back in September. I just
2 recently interviewed log buyers and found that prices
3 were around 800 to 850 for younger redwood, where
4 Mr. Fleming uses 975, which is a relatively high price
03:54 5 for younger redwood.

6 Q. Now, did you do any analysis with respect to
7 what you viewed as the appropriate price to use as
8 compared to Mr. Fleming?

9 A. Yes. I reproduced Mr. Fleming's spreadsheet
03:54 10 and then plugged in 850, 800, 850 into his pricing, and
11 it lowered his valuation by 100 to 150 million dollars.

12 Q. And what -- do you recall what his original
13 valuation was?

14 A. 605 for the total property.

03:54 15 Q. So just making -- if I understand you
16 correctly, just making the one change from \$975 per
17 thousand board feet to 800 or 850 reduced Mr. Fleming's
18 appraisal by approximately \$150 million; is that right?

19 A. Correct.

03:54 20 Q. Did anything in Mr. Fleming's appraisal change

21 your view on your conclusion regarding the value of the
22 property?

23 A. No.

24 Q. Did you read Mr. Fleming's deposition?

03:54 25 A. Yes, I did.

AK/RET REPORTING, RECORDS & VIDEO, INC.

265

1 Q. Did you attend his deposition?

2 A. I also did, yes.

3 Q. Did anything at his deposition change your view
4 as the value of this property?

03:55 5 A. No.

6 MR. SCHWARTZ: Your Honor, I think my 15
7 minutes is up, so I will pass the witness. Oh, yes, Your
8 Honor, I would like to move Exhibit 58 into evidence.

9 THE COURT: What's 58?

03:55 10 MR. SCHWARTZ: That was the bill.

11 THE COURT: Any objection?

12 MR. DOREN: It's not authenticated, Your
13 Honor. It's certainly material the expert reviewed and
14 relied upon, but I'm not sure that makes it evidence.

03:55 15 THE COURT: It hasn't passed yet, has it?

16 MR. SCHWARTZ: It hasn't passed.

17 THE COURT: Was that an objection?

18 MR. DOREN: That was an objection.

19 THE COURT: What about over here?

03:55 20 SPEAKER: Same objection.

21 THE COURT: Okay. I think -- I think he's
22 testified about these potential bills. I think probably
23 we won't add it to the record. That would be one more
24 thing that's a potential thing in the record that I think
03:55 25 probably we don't need, so I won't admit that. Go ahead.

AK/RET REPORTING, RECORDS & VIDEO, INC.

266

1 MR. SCHWARTZ: Thank you, Your Honor.

2 MR. DOREN: Thank you, Your Honor.

3 CROSS-EXAMINATION

4 BY MR. DOREN:

03:56 5 Q. Good afternoon, Mr. Lamont. I just wanted to
6 actually ask you one more question about that assembly
7 bill. It speaks in terms of prohibiting clearcutting on
8 adjacent tracks of land until there's 50 percent ground
9 cover, so that's not an absolute prohibition on
03:56 10 clearcutting, correct?

11 A. No. It's just another limitation.

12 Q. And this bill does not expressly address
13 variable retention harvesting, does it?

14 A. No. I mean, variable retention is a type of
03:56 15 shelter or deflection harvest and no, it doesn't.

16 Q. And variable retention harvesting can result in
17 the harvesting of 70, 80 or even 90 percent of the trees
18 in a particular harvest area, correct?

19 A. Again, that's very specific to a particular
03:56 20 unit, so I can't address that specific percentage, but
21 you can harvest 50 percent or whatever, but you have to
22 maintain proper crown closure.

23 Q. Or substantially more, depending on the
24 property, right?

03:57 25 A. Yeah, depending on the type of stand.

AK/RET REPORTING, RECORDS & VIDEO, INC.

267

1 Q. Now, you were originally retained in this
2 matter by Marathon, correct?

3 A. Correct.

4 Q. And you were hired originally as a consultant?

03:57 5 A. Yes.

6 Q. And when did that occur?

7 A. I believe it was probably August, late summer.

8 Q. August 2007?

9 A. Of '07, yeah.

03:57 10 Q. And from August 2007 until January or so 2008,
11 you were advising Marathon on how the debtors' property
12 should be operated if they were able to inquire them?

13 A. I think our initial project was just to assess
14 the current state of what was going on and create some

03:57 15 review.

16 Q. And you were not acting as an appraiser at that
17 time, correct?

18 A. No.

19 Q. And your assignment changed at the end of 2007,
03:57 20 didn't it?

21 A. Correct.

22 Q. And it was at that time that you were asked to
23 do an appraisal report on the debtor's property?

24 A. Yeah. I think it was late December.

03:58 25 Q. And was that also the time when Mendocino

AK/RET REPORTING, RECORDS & VIDEO, INC.

268

1 Redwoods joined the team with Marathon?

2 A. I'm not exactly sure of the exact timing. I
3 know in January we were talking to Mendocino, but I don't
4 know exact time.

03:58 5 Q. You don't recall attending meetings with
6 Marathon and Mendocino in December 2007?

7 A. I believe I attended them in January, but
8 that's my recollection.

9 Q. And at that time, you stopped giving advice to
03:58 10 Marathon as a consultant and became its independent
11 third-party appraiser, correct?

12 A. Yes, that was our assignment.

13 Q. And at that time, you quit offering consulting
14 services to Marathon and became an independent

03:58 15 third-party expert for purposes of this litigation; is
16 that right?

17 A. True.

18 Q. Now, in performing your appraisal work, you

19 were provided MRC's models, weren't you?

03:59 20 A. Yes. At some point, yes, I did look at those.

21 Q. And that was at some point before you concluded
22 your appraisal process, correct?

23 A. Yes.

24 Q. And that included -- that model included
03:59 25 information that compared MRC's operations with those of

AK/RET REPORTING, RECORDS & VIDEO, INC.

269

1 Scopac, correct?

2 A. Correct.

3 Q. And it also included the document prepared by
4 MRC that showed their assumptions about Scopac's
03:59 5 operations going forward, didn't it?

6 A. Yes.

7 Q. And it showed scenarios that MRC would intend
8 to implement in the event they took control or ownership
9 of the property, correct?

03:59 10 A. Yeah, it was part of their plan.

11 Q. And that was, again, a 50-year plan?

12 A. They did two models, one was a short-term look
13 and the other one was like a 50 year look.

14 Q. And both included timber harvest levels?

03:59 15 A. Yes.

16 Q. And those were in the range of 55 million board
17 feet per year?

18 A. That was a starting point. They held that
19 harvest down and it increased over time up to 9500

04:00 20 million feet.

21 Q. But the models that you saw from MRC before you
22 completed your appraisal process began with harvest of
23 about 55 million board feet, and then over the long-term,
24 those harvests increased to something close to 100

04:00 25 million board feet; is that right?

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 A. Yes.

2 Q. And that was -- and I'm sorry, I just want to
3 make sure. That was the Marathon model that reflected
4 what we just discussed?

04:00 5 A. No.

6 Q. The Marathon model showed an initial harvest of
7 55 million board feet, correct?

8 A. No; the MRC model.

9 Q. Thank you very much. I appreciate that. It's
04:00 10 late in the day. The MRC model. I appreciate your
11 clarification. Now, prior to your engagement for
12 Marathon, had you ever testified as an appraiser in
13 litigation before?

14 A. No.

04:00 15 Q. Have you ever served as an expert witness?

16 A. No.

17 Q. So you've only done it here where you're
18 consulting client asked you to act as their testifying
19 expert; is that correct?

04:01 20 A. I was asked to prepare an appraisal report as a
21 part of this litigation, in which I assumed would become
22 part of an expert report, so I assumed I was going to
23 court.

24 Q. Now, you've already described that you used a
04:01 25 50-year projection in doing your discount of cash flow

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 analysis, correct?

2 A. Yes.

3 Q. And you consider that to be an appropriate
4 projection period?

04:01 5 A. Yes.

6 Q. And, in fact, the necessary projection period
7 in a timber harvest -- or a timber valuation?

8 A. Yeah, it's typical, yes.

9 Q. And given the complexities of a 50-year
04:01 10 calculation on timberland, do you consider it also to be
11 industry standard to use computer modeling to project
12 harvests, especially with larger properties?

13 A. Yes.

14 Q. And the computer model that you used is called
04:01 15 Woodstock; is that correct?

16 A. Correct.

17 Q. And Woodstock is a linear program; is that
18 right?

19 A. Yes.

04:02 20 Q. And it's a mathematical model solution?

21 A. Correct.

22 Q. And you've heard of Options and Dr. Reimer's
23 model?

24 A. Yes.

04:02 25 Q. And Options is a simulations model, correct?

AK/RET REPORTING, RECORDS & VIDEO, INC.

272

1 A. Correct.

2 Q. It's not a linear program?

3 A. No.

4 Q. And that means that Dr. Reimer's simulation
04:02 5 model iterates and solves for solutions based on
6 criteria, correct?

7 A. Yes. They're both optimization models. They
8 solve to an optimal solution.

9 Q. Do you consider Mr. Reimer's model to be an
04:02 10 optimizer?

11 A. Yes.

12 Q. Now, you don't have an opinion personally as to
13 whether Woodstock, the linear program, or Dr. Reimer's
14 model, Options, is better, do you?

04:02 15 A. No, I do not.

16 Q. Let's turn to log pricing. I believe you said

17 broadly, but you used two sets of data, SBE pricing and
18 Pacific Rim Wood Market pricing; is that correct?

19 A. Right.

04:03 20 Q. Let's talk first about SBE. Now, SBE pricing
21 is a rolling two-year average for prices that's released
22 by the state of California about every six months; is
23 that correct?

24 A. Correct.

04:03 25 Q. And that is weighted in favor of more recent

AK/RET REPORTING, RECORDS & VIDEO, INC.

273

1 months? In other words, it's a weighted average?

2 A. It's a backwards-looking average of the sales.

3 So yes, it's weighted average.

4 Q. And it reflects data from every redwood sale in
04:03 5 a particular geographic area, correct?

6 A. I don't know if it includes every redwood sale
7 because I think there are some limitations on the size
8 and volume sold, so very minor sales are not included in
9 that, but it does include a significant amount of volume.

04:03 10 Q. And the reason that you can be sure of that is
11 because it reflects the volumes on which timber yield
12 taxes are charged, correct?

13 A. Yes, the state requires that for tax purposes.

14 Q. And so if a seller who fit the parameters for
04:04 15 SBE pricing doesn't report that to the Board of
16 Equalization, they would be in violation of state law,
17 correct?

18 A. Yes.

19 Q. If I can just show you what is Defendant's
04:04 20 Exhibit 83. And you actually -- if you want it, you have
21 it in a binder there.

22 A. I can see it on the screen.

23 Q. That's right, you have a monitor there. And is
24 this an example of SBE -- of an SBE pricing sheet?

04:04 25 A. Yes, it is.

1 Q. And specifically could I direct you to the
2 entry for redwood, the second line up from the bottom.
3 And is this the standard information that is provided on
4 redwood pricing every six months?

04:04 5 A. Yes, it is.

6 Q. And can you please describe what the different
7 categories are here?

8 A. What particular? For redwood?

9 Q. Yes. Yes, exactly.

04:04 10 A. Well, they list three sizes of logs that they
11 charged for, so there's over 300 board foot logs, 150 to
12 300 board foot logs and under 150 board foot logs. So
13 different sizes, which goes back to quality and so on.

14 Q. Thank you. So it breaks the pricing out by
04:05 15 each of those categories?

16 A. Correct.

17 Q. And then if we can look a little bit further
18 over, I notice there are different timber value areas.
19 What does that reflect?

04:05 20 A. There are different geographic areas where they
21 collect the prices, so those refer to different zones or
22 timber areas, as it's labeled.

23 Q. Now, redwood only grows in a portion of the
24 state, correct?

04:05 25 A. Correct.

1 Q. So where we see the N/A's in the table, would
2 that reflect those are timber value areas, if you will,
3 where redwood would not have been sold?

4 A. Correct.

04:05 5 Q. And then if I can show you the map that is also

6 a part of Exhibit 83. And, again, if you've got it there
7 on the monitor. Is this the division of the state, if
8 you will, into the different timber value areas?

9 A. Correct.

04:06 10 Q. And we see in the upper left that Humboldt
11 County, Del Norte County and is zone 1; is that right?

12 A. Yes.

13 Q. And zone 2N is Mendocino?

14 A. Yes.

04:06 15 Q. Now, the second source of pricing information
16 that you used was the Pacific Rim Wood Market, right?

17 A. Correct.

18 Q. And the way you use that -- let me back up.

19 You used SBE pricing and you looked at a ten year average
04:06 20 for SBE pricing to determine what pricing trends were.

21 Do I have that right?

22 A. That was one of the elements of the appraisal,
23 was to look at pricing trends, yes.

24 Q. Sure. And you did that in part by looking at
04:06 25 SBE pricing for the last ten years?

AK/RET REPORTING, RECORDS & VIDEO, INC.

276

1 A. Yes.

2 Q. And then another part of your discounted cash
3 flow analysis was to identify the baseline price for
4 logs, if you will, that you would assume is a starting
04:07 5 point as you moved out over the next 50 years, correct?

6 A. Correct.

7 Q. And that's where the Pacific Rim Wood Market
8 came in? Do I have that right?

9 A. That was the major basis for the pricing, yes.

04:07 10 Q. Okay. And if I can show you Exhibit 62. And
11 is this an example of a Pacific Rim Wood Market report?

12 A. Yes.

13 Q. And is this a newsletter?

14 A. Yeah, that's what it is.

04:07 15 Q. And is it based on voluntary surveys of buyers
16 and sellers in terms of the pricing information contained
17 here?

18 A. Correct.

19 Q. And so it's not a state agency where sellers
04:07 20 are obligated to submit information?

21 A. No.

22 Q. And there's no penalty for inaccurate or
23 incomplete information that may be submitted to a Pacific
24 Rim Wood Market report?

04:08 25 A. No.

AK/RET REPORTING, RECORDS & VIDEO, INC.

277

1 Q. And you don't have any direct knowledge as to
2 how this information is solicited from people, do you?

3 A. My general understanding of how the data is
4 collected, it's a survey of typically log buyers, or in
04:08 5 some cases, sellers.

6 Q. And do you know how that process is undertaken?

7 A. Typically it's a monthly survey where people
8 actually call and talk to the different operators in the
9 area and collect pricing.

04:08 10 Q. Do you know who at the Pacific Rim Wood Market
11 are making those calls?

12 A. No.

13 Q. Do you know what their methodology is for
14 making those calls?

04:08 15 A. No, I do not.

16 Q. And I believe you testified in your deposition
17 that the Pacific Rim Wood Market report prices tend to be
18 10 to 15 percent lower than SBE prices?

19 A. The tend to be -- well, you have to look at SBE
04:08 20 prices are actual stumpage, so you have to make some
21 assumption for log and haul to get them on a comparable
22 basis. But generally, yes, you find that the Pacific Rim
23 Wood Market prices are somewhat less.

24 Q. And that's after you make the adjustment,
04:09 25 correct?

AK/RET REPORTING, RECORDS & VIDEO, INC.

278

1 A. Yes.

2 Q. That's after you adjust the price to apples and
3 apples so they both include logging and hauling. You
4 find, from your experience, that the Pacific Rim Wood
04:09 5 prices are lower than the SBE prices?

6 A. Slightly, yes.

7 Q. Now, one of the factors in the cost of a log is
8 how far it has to be hauled; is that correct?

9 A. Absolutely.

04:09 10 Q. And, in fact, one of the advantages that
11 Marathon says its plan offers is that it keeps the mill
12 nearby in operation so the hauls don't need to be -- the
13 logs don't need to be hauled further away, correct?

14 A. Correct.

04:09 15 Q. And, in fact, you heard counsel for the
16 indenture trustee today during opening saying that it's
17 only logical that someone would step up and keep the mill
18 operating because you always want to have the mill close
19 to the forest. You were here this morning and heard
04:09 20 that, right?

21 A. Yes.

22 Q. So the timber industry in that regard is
23 something of a local market, correct?

24 A. Yeah, it's very much so.

04:10 25 Q. Now, is it your understanding that the Pacific

AK/RET REPORTING, RECORDS & VIDEO, INC.

279

1 Rim Wood Market reports redwood prices for Mendocino
2 County as well as Del Norte and Humboldt counties?

3 A. They're collected across the region. They

4 probably include Mendocino, yes.

04:10 5 Q. First of all, do you know how far it is from
6 Scotia to, say, Ukiah in Mendocino County?

7 A. Not in exact miles. It's probably another \$50
8 or \$75 haul.

9 Q. 130 miles, how much does that cost.

04:10 10 A. Again, it's a haul. It's probably \$50.

11 Q. So the Pacific Rim Wood Market prices reflect a
12 broader area than those collected within SBE pricing?

13 A. Yes.

14 Q. Now, let me show you the pricing page in this
04:10 15 report, if I can. And specifically, again, let's focus
16 on the redwood line. And, again, is this the specific
17 pricing data that you were pulling each month from the
18 Pacific Rim Wood report?

19 A. Yes.

04:11 20 Q. And so this does not break it out by size or
21 quality, correct?

22 A. No. They have a high and low -- I mean,
23 they're camp run type pricing.

24 Q. So each month we see there is nothing else in
04:11 25 that row, it's just a single box with SG camp run 900 to

AK/RET REPORTING, RECORDS & VIDEO, INC.

280

1 950, correct?

2 A. Right. So it would be a 900 low and high 950.

3 Q. Now, do you know how many transactions are
4 included in that number?

04:11 5 A. No, I do not.

6 Q. Do you know what the mix of log was in terms of
7 size?

8 A. No. Again, it says camp run, which generally
9 means it's just every size class.

04:11 10 Q. Do you know what the volume is that was
11 included in that number for that month?

12 A. There's very little volume traded outside of

13 company transfers in the redwood market, so it's not a
14 high percentage of volume in either SBE or in this. This
04:12 15 probably includes more, but --
16 Q. Do you know how much volume is included in that
17 number?
18 A. No.
19 Q. Do you know from what areas of the redwood
04:12 20 producing region that number came from?
21 A. Again, it's a survey of the log buyers, which
22 there's only like about five or six, so it's a small
23 market.
24 Q. Throughout the redwood producing region,
04:12 25 correct?

AK/RET REPORTING, RECORDS & VIDEO, INC.

281

1 A. Correct.
2 Q. Now, do you believe that is limited to
3 Humboldt, Mendocino and Del Norte Counties?
4 A. Generally.
04:12 5 Q. Well, let me show you a map of the SBE pricing
6 for redwood throughout the county or throughout
7 California, rather. And I will represent to you that we
8 colored in the zones for which SBE pricing is reflected
9 for redwood. And again, you see zone 1 is Humboldt, zone
04:12 10 2N is Mendocino, and then you have counties stretching
11 all the way down to Monterrey up the coast and inland as
12 well. How many of these zones are used in the Pacific
13 Rim Wood Market reports?
14 A. Again, primarily because a Pacific Rim Wood
04:13 15 Market report is a survey of log buyers, most of the
16 mills that they are interviewing are going to be in
17 Humboldt, Del Norte and Mendocino.
18 Q. So in other words, if someone in Monterrey
19 needs to take their logs to a mill, they're going to have
04:13 20 to call them up the coast, correct?
21 A. Yes.

22 Q. And so do you know what the volume is from the
23 different regions that goes into the Pacific Rim Wood
24 Market pricing?

04:13 25 A. I'm answering the question again, no.

AK/RET REPORTING, RECORDS & VIDEO, INC.

282

1 Q. And isn't it the case that redwood prices in
2 Santa Cruz County or in Monterrey County are pretty
3 irrelevant to the pricing in Humboldt County?

4 A. Yes.

04:13 5 MR. SCHWARTZ: Excuse me for interrupting.
6 He sounded like he needed a drink of water.

7 MR. DOREN: Absolutely.

8 Q. (By Mr. Doren) You've already mentioned that
9 SBE pricing and Pacific Rim Wood Market pricing is
04:14 10 different in another way, and that is that SBE pricing is
11 stumpage pricing, correct?

12 A. Correct.

13 Q. And can you describe again for the Court the
14 difference two the two?

04:14 15 A. Stumpage is the return to the log grower, the
16 value, and doesn't include the log and haul to get it to
17 the mill. So hauling price or delivered price includes
18 the cost to get to the mill. And so it's usually about
19 \$200 for logging and hauling, \$220.

04:14 20 Q. And so what you did to adjust is you added into
21 the SBE price an amount you estimated that it would cost
22 to cut and haul logs, correct?

23 A. Typical log and haul, yes.

24 Q. You didn't use actual pricing, you used, as you
04:14 25 described, typical pricing?

AK/RET REPORTING, RECORDS & VIDEO, INC.

283

1 A. Of log and haul, yes.

2 Q. Do you know how far, on average, the Pacific
3 Rim Wood Market logs have to be hauled?

4 A. I do not know specifically. Again, most of the
04:15 5 production comes out of those three counties.

6 Q. And so it would be the data from those three
7 counties. And, in fact, the data involving the
8 relationship between the specific logs and the specific
9 mill to which they go would be most relevant?

04:15 10 A. Can you restate that again?

11 Q. Sure. So it would be the data from zone 1 that
12 would be the most relevant to what the hauling costs
13 would be in zone 1?

14 A. Not necessarily for the purposes of appraisal
04:15 15 because I'm not looking at just all logs flowing to the
16 Palco mill. It could go to other mills north or even
17 down to mills in Mendocino County. So I am looking at a
18 broader area.

19 Q. And what you did, after looking at the Pacific
04:15 20 Rim Wood Market pricing, is you took a three-year average
21 at the Pacific Rim Wood Market and you used that as your
22 baseline for future pricing; is that correct?

23 A. That was the starting point to look at what the
24 historical pricing had been to this point.

04:16 25 Q. For three years?

AK/RET REPORTING, RECORDS & VIDEO, INC.

284

1 A. For three years.

2 Q. But to determine what the trend in pricing was,
3 you looked at SBE pricing for ten years, correct?

4 A. That was just one source of my comparison for
04:16 5 looking at price increases.

6 Q. It was one of the primary sources, correct?

7 A. Yeah.

8 Q. And Pacific Rim -- the Pacific Rim Wood Market
9 three-year price average wasn't part of your overall
04:16 10 trend calculation, was it?

11 A. My trend calculation was based on future
12 anticipation and log -- and market movement. And so --

13 Q. I apologize. I'm talking about the past -- for
14 example, your establishment of the ten-year trend in
04:16 15 pricing over the last ten years, that was based on SBE
16 pricing?

17 A. Yes.

18 Q. After you established the three-year average
19 for the Pacific Rim Wood Market, you cut that price
04:17 20 lower, correct?

21 A. Correct.

22 Q. By how much?

23 A. Approximately \$50 to \$100, depending which log
24 size. About 10 to 14 percent, somewhere around there.

04:17 25 Q. So you took the Pacific Rim Wood Market prices,

AK/RET REPORTING, RECORDS & VIDEO, INC.

285

1 which you believe to be about 10 to 15 percent below SBE
2 prices, and then you cut that three-year average 10
3 percent, correct?

4 A. Because it didn't reflect current pricing.

04:17 5 Q. And you did that to take the current down
6 market into account; is that right?

7 A. Correct.

8 Q. And by the way, your three-year average ran
9 from when?

04:17 10 A. It would have started -- I was looking at data
11 as of the end of the year, so it would have gone back for
12 '07, '06 and '05.

13 Q. So your three-year average brought you all the
14 way up through '07; is that right?

04:17 15 A. Yeah, through '07.

16 Q. And from that Pacific Rim price, you then
17 dropped 10 percent, correct?

18 A. Correct.

19 Q. And then going forward, did you allow for price

04:17 20 recovery for redwood?

21 A. Right. Based on the current economic cycle,
22 prices are going to recover most likely in the next year
23 to two years. So by 2010, prices return back to what I
24 would describe as typical average pricing.

04:18 25 Q. And again, the price that you have it returning

AK/RET REPORTING, RECORDS & VIDEO, INC.

286

1 to by 2010 is a three-year average of the Pacific Rim
2 Wood Market, correct?

3 A. Correct.

4 Q. And then from 2010 forward, for the balance of
04:18 5 your 50-year model, you have no real growth in redwood
6 prices, correct?

7 A. Correct.

8 Q. Taking inflation out of the equation, redwood
9 prices remain flat in perpetuity?

04:18 10 A. In real terms because that's part of the
11 analysis in my model.

12 Q. In perpetuity?

13 A. For the 50 years, yeah.

14 Q. And you don't include anything for price
04:18 15 increases after 50 years, do you?

16 A. Or decreases either.

17 Q. In calculating costs for the next 50 years, you
18 included the costs for complying with the Habitat
19 Conservation Plan, correct?

04:19 20 A. Yes, as the part of the overall operating
21 statement and costs, yes.

22 Q. And all other environmental regulations?

23 A. As completely as I understood them, yes.

24 Q. And you tried to model all the prescriptions
04:19 25 related to the Habitat Conservation Plan as well?

AK/RET REPORTING, RECORDS & VIDEO, INC.

287

1 A. Not specifically, but in aggregate.

2 Q. Can you explain that?

3 A. Well, there are all sorts of individual

4 treatments that are required by the Habitat Conservation;

04:19 5 storm proofing, road and, you know, different types of

6 costs. So by looking at the operating statements from

7 the historical and also from the Sequoia proposed model,

8 I developed an operating statement that looked at the

9 broad categories between staffing and road improvements,

04:19 10 capital expenditures for storm proofing elements

11 categories.

12 Q. And when you were doing your harvest forecasts

13 in terms of how you allocated prescriptions to a

14 particular polygon, if you will, a particular area in the

04:20 15 woods, would you do that on the basis of either a cut, no

16 cut or partial cut classification?

17 A. Correct.

18 Q. Would you take it to anymore granular level

19 than that?

04:20 20 A. It was -- depending on the method of harvest.

21 If it was selected, it had one harvest on board truck or

22 harvest logging costs. Or if it was a clearcut, it had

23 another logging cost.

24 Q. Sure. But I'm speaking now in terms of the

04:20 25 projection of harvestable timber. You did that based on

AK/RET REPORTING, RECORDS & VIDEO, INC.

288

1 whether the plot was no cut, partial cut or no

2 restriction, correct?

3 A. Correct.

4 Q. And did you make anymore refined delineations

04:20 5 than that?

6 A. Well, you're describing the forest by age, each

7 individual stand, so each individual stand by species,

8 age, site and location.

9 Q. I'm now speaking specifically about
04:20 10 prescription. You've identified the three bands.
11 A. Yes, the three major prescriptions were no cut,
12 cut, or selection.
13 Q. And that's the three categories you used?
14 A. Correct.
04:21 15 Q. And you didn't use any subcategories, correct?
16 A. No.
17 Q. Let's look now at your harvest projections.
18 And you ran four projections, correct?
19 A. Yes.
04:21 20 Q. And three of those assumed an ongoing
21 enterprise, if you will, and the fourth was the
22 liquidation scenario?
23 A. Correct.
24 Q. And what you did is you entered inventory
04:21 25 information into your system, correct?

AK/RET REPORTING, RECORDS & VIDEO, INC.

289

1 A. Yes.
2 Q. And that was from Scopac?
3 A. Yes.
4 Q. And that was based on Scopac's January 1, 2007
04:21 5 inventory?
6 A. Correct.
7 Q. And that included species and age classes for
8 each bands as you've described, correct?
9 A. And their area, yes.
04:21 10 Q. And then you selected harvest levels and ran
11 the three different scenarios; is that right?
12 A. No.
13 Q. Excuse me?
14 A. I did input some of the harvest constraints,
04:22 15 but the model then determined what the harvest levels
16 would be. Some I didn't put some model. It was selected
17 based on optimization.

18 Q. Now, all were run, though, on a non-declining
19 even flow basis, correct?

04:22 20 A. Right.

21 Q. Can you describe for the Court what that means?

22 A. Which means that the harvest this year will
23 never go down, so you have to determine the harvest level
24 today that can go up into the future. It never will go
04:22 25 down. So it's typically harvesting what you're growing

AK/RET REPORTING, RECORDS & VIDEO, INC.

290

1 on a long-term basis. But the harvest does not decline
2 over time.

3 Q. So from year one, you need to assure that you
4 pick a harvest level that, according to your model, with
04:22 5 all the factors you've identified, would never go down in
6 any year over the 50-year projection period?

7 A. Correct.

8 Q. By as much as a board foot, correct?

9 A. Actually, I put ten year steps in there, so
04:22 10 there was some tolerance for the model to go up and down.
11 And it could have -- it wouldn't go down, no. It would
12 not go down by a board foot, but there was some ability
13 for the model to move around.

14 Q. It could move around, but it could never go
04:23 15 down?

16 A. It could go up, but it couldn't go down.

17 Q. So over a ten-year period, the only thing the
18 model could do is ratchet up, but you set it in a way
19 where from year to year it could never go down?

04:23 20 A. Correct.

21 Q. There's always a floor after the harvest?

22 A. Yes.

23 Q. And that led to the need to take certain
24 conservative assumptions to assure that never happened,
04:23 25 correct?

1 A. No. The non-declining flow algorithm
2 calculates that.

3 Q. So your computer calculated that so it never
4 went down?

04:23 5 A. Yeah. I didn't.

6 Q. Now, on average, redwood grows between 4 and 6
7 percent a year; is that right?

8 A. Depending on the stand and the age, it can grow
9 more than that. It just depends on what tree stand
04:23 10 you're looking at.

11 Q. So 4 to 6 percent, though, is a pretty safe
12 estimate in terms of redwood growth?

13 A. No.

14 Q. That's what you --

04:23 15 A. You asked about a stand, and that is typical of
16 stand growth.

17 Q. I appreciate that. It's your business, not
18 mine. So the typical redwood stand grows 4 to 6 percent
19 a year, and it could be more?

04:24 20 A. Or less, yes.

21 Q. In your experience, you find that the -- that a
22 reasonable estimate is 4 to 6 percent, correct?

23 A. No. You have to look at individual stands,
24 like particularly on this property, they have old growth,
04:24 25 which those individual trees may not be growing very much

1 and they may be growing zero with mortality. Where you
2 look at young growth stands, they could grow from
3 anywhere 10 to 12 percent depending on what age you look
4 at.

04:24 5 Q. Do you recall testifying in your deposition
6 that redwood stands are probably growing on average 4 to

7 6 percent, depending on their age and time?
8 A. That's exactly what I said.
9 Q. And do you still agree with that statement?
04:24 10 A. Yes.
11 Q. And do you consider Humboldt County to be
12 particularly good redwood growing country, don't you?
13 A. It's more productive than other areas, yes.
14 Q. For example, Mendocino you would identify
04:25 15 as --
16 A. Less productive in general.
17 Q. And in fact, for your purposes, there are
18 things called site indexes, aren't there?
19 A. Site classes, site indexes, yes.
04:25 20 Q. And a site index of 1 is cream of the crop and
21 5 would be the lower end of the spectrum?
22 A. Yes. It's like classes, 1 is the best and 5 is
23 the lowest.
24 Q. And you generally categorize Humboldt County as
04:25 25 a class 2 site?

AK/RET REPORTING, RECORDS & VIDEO, INC.

293

1 A. Yes.
2 Q. And Mendocino County as a class 3?
3 A. Correct.
4 Q. Let's look at your first run, if we may.
04:25 5 A. Sure.
6 Q. And this is from your report. I'm actually
7 looking for table 13 on page 49. And this run assumes 60
8 million board feet for the first five years; is that
9 right?
04:26 10 A. I can't see what you're looking at, so --
11 Q. Okay. Why don't we --
12 A. What page are you on?
13 Q. Page 49.
14 A. 49. Okay.
04:26 15 Q. And what is your assumption for harvest for the

16 first five years?

17 A. In this particular model I'm inputting the 60
18 million feet for the first five years.

19 Q. And for the next five years?

04:26 20 A. Then it goes up and calculates in steps, but
21 it's basically 66 million feet. And then it goes up to
22 80 and higher.

23 Q. So on run one, it's not until year 11 that a
24 harvest level is reached that is equal to or greater than
04:26 25 what Scopac cut in 2007, correct?

AK/RET REPORTING, RECORDS & VIDEO, INC.

294

1 A. Correct.

2 Q. And the harvest level in your first run are
3 levels that you selected in terms of the starting point?

4 A. Correct.

04:26 5 Q. In other words, your model did not say to you
6 that you should start at 6; that's a number you selected?

7 A. Not in run 1. In run 3, the model selected the
8 starting point.

9 Q. I'm talking about run 1.

04:27 10 A. Correct.

11 Q. In run 3 where you let the model pick it, it
12 went to 73, correct?

13 A. Correct.

14 Q. And you chose 60 million board feet in part to
04:27 15 allow for the new owner that might have a different
16 philosophy for how to harvest, correct?

17 A. Correct.

18 Q. A new owner like Mendocino Redwood?

19 A. Any new owner. Obviously the system here with
04:27 20 Scopac has been contentious, to say the least, and so any
21 different owners can probably take a different approach
22 than the current one.

23 Q. But Mendocino Redwood was the only potential
24 new owner that you were aware of, correct? The only one

04:27 25 that had shown --

AK/RET REPORTING, RECORDS & VIDEO, INC.

295

1 A. It was immaterial who was the new owner,
2 possible new owner. I'm looking at a likely buyer in
3 these analysis.

4 Q. But when you ran run 1, you had seen
04:27 5 Mendocino's model, correct?

6 A. Yes.

7 Q. And then if you can turn to page 53. And
8 again, your second run begins at 60 million board feet;
9 is that correct?

04:28 10 A. Yes.

11 Q. And then it increases to 75 million board feet
12 in year six?

13 A. Yes.

14 Q. And under this run, you assume that 60 percent
04:28 15 of the harvest will be selective harvesting?

16 A. Correct.

17 Q. And how do you define selective harvesting?

18 A. I was looking at some sort of basiliary
19 retention. Typically you had to keep 175 basiliary on the
04:28 20 stand and you could remove the additional excess
21 basiliary.

22 Q. And do you know what the average of that would
23 be over a 20 acre area, for example?

24 A. I'm not clear what your question is.

04:28 25 Q. Selective harvesting, how much can you take out

AK/RET REPORTING, RECORDS & VIDEO, INC.

296

1 of an average 20 acre harvest unit, for example?

2 A. When you say how much, in board feet?

3 Q. Yes, in board feet.

4 A. In a per acre basis?

04:28 5 Q. Yes.

6 A. So it's going to be highly variable. You've
7 got a lot of stands out there that are mediumly stocked.
8 They've already had some treatments. But typical mature
9 40 to 50-year-old stand on the Scopac property runs about
04:29 10 35- to 40,000 board feet per acre.

11 Q. And what was --

12 A. So you're going to take out -- may I finish?
13 So you're going to take out anywhere from 10 to as much
14 as 20,000 board feet depending on the condition of the
04:29 15 stand.

16 Q. And that was my next question. So up to about
17 50 percent; is that right?

18 A. It depends, again, on how much is already
19 there. A lot of these stands already have 300 basal area
04:29 20 or 350. So you can take down -- 50 is probably the most
21 you can get out of the stand.

22 Q. Thank you. In run 3, you allowed the model, if
23 you will, to select a starting point; is that right?

24 A. Correct.

04:29 25 Q. And again, that was based on the non-declining

AK/RET REPORTING, RECORDS & VIDEO, INC.

297

1 even flow restraint?

2 A. Correct.

3 Q. And in run 3, the harvest slowly increases to
4 92 million board feet, correct, at about year 40?

04:30 5 A. Yeah. Or year 30 or so, actually.

6 Q. Thank you. And are we talking now about soft
7 wood specifically, correct?

8 A. Correct.

9 Q. Which includes redwood?

04:30 10 A. Yeah.

11 Q. And that 92.3, it's a 50-year projection. Your
12 table only goes up to 40. But that 92.3 actually runs
13 out to year 50, doesn't it?

14 A. Correct.

04:30 15 Q. So there's no increase in the harvest on the
16 property based on your model after year 31, correct?

17 A. No. Correct.

18 Q. But your model projects 92.3 million board feet
19 of soft wood from year 30 to year 50, correct?

04:30 20 A. Yes.

21 Q. Now, you use a discount rate of 7 percent; is
22 that right?

23 A. Correct.

24 Q. And again, that was based on a 6 percent
04:30 25 discount rate from other transactions in Oregon and

AK/RET REPORTING, RECORDS & VIDEO, INC.

298

1 Washington, and then you added a one percent California
2 premium, if you will; is that right?

3 A. For the additional risk of operating in
4 California, yes.

04:31 5 Q. Now, the discount rate is applied to your
6 projected cash flow, of course?

7 A. Yes.

8 Q. And your cash flow assumptions include all
9 prescriptions on harvest that you believe are caused by
04:31 10 the HCP, correct?

11 A. Yeah, the manager of the property, yes.

12 Q. And in fact, the HCP should actually create
13 some level of stability on the property from a regulatory
14 perspective, correct?

04:31 15 A. Yes, that's the intent of it.

16 Q. And did you reduce harvest levels at all based
17 on increases in future regulatory issues?

18 A. That was anticipated through the discount rate
19 adjustment. That was the additional risk to future
04:31 20 regulations, so the harvest was not affected. The
21 assumption was being calculated through that additional
22 one percent of discount rate.

23 Q. In fact, one of your extraordinary assumptions
24 in your appraisal was that no further environmental
04:31 25 restrictions would be imposed on the timberland after the

AK/RET REPORTING, RECORDS & VIDEO, INC.

299

1 date of the appraisal, correct?

2 A. Correct.

3 Q. Let's take a moment to talk about your
4 comparable sales analysis. And specifically, you based
04:32 5 your comparable sales transactions on log values; is that
6 right?

7 A. Yes, the units of comparison are four foot per
8 unit, four foot.

9 Q. So you took no highest and best use factors
04:32 10 into account or other variables?

11 A. Well, they all -- all the properties have
12 similar. They're all being operated as commercial
13 timberlands, so they all have same highest and best use.
14 I'm not mixing.

04:32 15 Q. The assumption is the highest and best use is
16 timber. And now you go on to what the log values are for
17 each property?

18 A. Yes, in general.

19 Q. And is this table 17 from your report?

04:32 20 A. Yes.

21 Q. And it shows the comparable sales summary from
22 your analysis?

23 A. Yes.

24 Q. And the first comparable, number 1 there, would
04:33 25 that be the Mendocino redwood property?

AK/RET REPORTING, RECORDS & VIDEO, INC.

300

1 A. Yes.

2 Q. With a total of 224,000 acres?

3 A. Yes.

4 Q. With the total inventory of about 2.3 million
04:33 5 board feet, if you will, 2.3 billion board feet?

6 A. Yes.

7 Q. About 10 -- about 10,400 board feet per acre;
8 is that right?

9 A. Right, 10.4 MBF per acre, yes.

04:33 10 Q. Now, in calculating that data, did you take any
11 restrictions or prescriptions from a regulatory
12 perspective into account?

13 A. No, because at the time of the sale, that was
14 what the property stated it was on. That was almost ten
04:33 15 years ago.

16 Q. Now, directing your attention to the subject
17 property line, here you note that it's 209,000 acres and
18 it has a volume of about 229 billion; is that correct?

19 A. Right, with a note underneath the table.

04:34 20 Q. Which is "the subject volume on available acres
21 is 2.9 billion compared to 4.45 billion for the entire
22 property"?

23 A. Correct.

24 Q. So in making that calculation for Scopac's
04:34 25 properties, here you did basically carve out all of the

AK/RET REPORTING, RECORDS & VIDEO, INC.

301

1 acreage that you found to be subject to prescriptions,
2 correct?

3 A. It was unavailable for harvest.

4 Q. And is unavailable no cut?

04:34 5 A. No cut.

6 Q. Where do partial cuts come in?

7 A. Partial cuts are in there.

8 Q. Are in the 2.9 billion?

9 A. It should be in the 2 point.

04:34 10 Q. And it was after you removed no cut that you
11 calculated the board feet per acre as about 13,800,

12 correct?

13 A. Correct.

14 Q. For any of your other comparables 1 through 8,
04:35 15 do you make a similar adjustment for screen buffers or
16 any other sort of prescription?

17 A. No, I did not.

18 Q. Now, you know Phillip Tedder, correct?

19 A. Correct.

04:35 20 Q. Was he your partner at Resource Economics?

21 A. Absolutely.

22 Q. And he was also or is also an advisor to
23 Marathon?

24 A. Yes.

04:35 25 Q. And he, too, is providing an expert opinion in

AK/RET REPORTING, RECORDS & VIDEO, INC.

302

1 this case?

2 A. Yes.

3 Q. And that's regarding Mr. Yerges's appraisal, I
4 believe, correct?

04:35 5 A. Yes, I believe.

6 Q. Now, the two of you talked as you each prepared
7 your reports?

8 A. We discussed different components, and that's
9 referenced in my report.

04:35 10 Q. And you read his report after you finished
11 yours?

12 A. Basically, yes.

13 Q. And he reviewed yours?

14 A. Yes, we both looked at each others' reports.

04:35 15 Q. Now, you used Pacific Rim Wood Market pricing,
16 correct?

17 A. Correct.

18 Q. And he used SBE pricing?

19 A. Right. Under the premises of his analysis,

04:35 20 yes.

21 Q. And you used a 50-year projection period,
22 correct?
23 A. Yes.
24 Q. And he cut his off at 38?
04:36 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

303

1 Q. And you both used a 7 percent discount rate,
2 correct?
3 A. I believe so, yes.
4 Q. And that was based on a 6 percent base plus a 1
04:36 5 percent regulatory premium, if you will?
6 A. In my analysis, yes.
7 Q. And by the way, when you said that you had
8 interviewed appraisers to help determine that, you're
9 talking specifically about Mr. Forsberg, correct?
04:36 10 A. Yes.
11 Q. You and Mr. Tedder went out to lunch with him,
12 you called him and had some further discussions. And on
13 the basis of that discussion, both you and Mr. Tedder
14 went to a 7 percent discount rate, correct?
04:36 15 A. That was not my only source of information, but
16 that was a very important source of information.
17 Q. That was the primary source of information?
18 A. Absolutely.
19 Q. Now, your opinion is a value of \$430 million
04:36 20 without cell towers and gravel contracts, correct?
21 A. I think it has cell -- it has a secondary
22 income, so I think cell towers are in there, but not
23 gravel and rock.
24 Q. Do you know what value Mr. Tedder arrived at in
04:37 25 his his calculation about cell tower and gravel

AK/RET REPORTING, RECORDS & VIDEO, INC.

304

1 contracts?

2 A. Not in front of me, no, I do not know.

3 Q. Are you aware that it was \$436?

4 A. I think that's generally what I remember it

04:37 5 being, but I don't remember specifically.

6 MR. DOREN: Thank you. I pass the

7 witness.

8 THE COURT: Anyone over here? All right.

9 What about over here?

04:37 10 MR. CLEMENT: Your Honor, the deal with

11 the exhibits issue that was mentioned earlier, we've got

12 a folder here of anyone's I might use in this

13 examination, which I will tender to Your Honor.

14 THE COURT: Thank you.

04:37 15 MR. CLEMENT: And also the witness, if I

16 might approach.

17 THE COURT: And we're going to have all of

18 them by tomorrow afternoon?

19 MR. CLEMENT: That's correct, Your Honor.

04:39 20 MR. SCHWARTZ: Your Honor, we don't have a

21 set of what Mr. Clement handed to you.

22 MR. CLEMENT: Your Honor, what's in the

23 folder I handed up to Your Honor and the witness contains

24 only exhibits that are either in the debtors books or in

04:39 25 Marathon's books and they've got numbers on them, so

AK/RET REPORTING, RECORDS & VIDEO, INC.

305

1 we'll call them out.

2 THE COURT: So as he mentions one, you'll

3 get the number. There's nothing mysterious about them.

4 There's the Fleming tables, there's a comparison chart

04:39 5 that's Exhibit No. 7, then there's the Fleming proffer,

6 the Daniel proffer, the Johnson proffer, Lamont proffer

7 and the Yerges proffer.

8 MR. CLEMENT: Thank you, Your Honor.

9 SPEAKER: Your Honor, Exhibit 7 to what,

04:39 10 if I may ask?

11 THE COURT: The comparison is -- it's IT
12 Exhibit 7. What does that mean? Indenture trustee 7,
13 which is Exhibit A. I don't know what it is, but it's a
14 little chart.

04:40 15 MR. CLEMENT: Which we will have up on the
16 screen. May I begin, Your Honor?

17 THE COURT: Yes.

18 CROSS-EXAMINATION

19 BY MR. CLEMENT:

04:40 20 Q. Mr. Lamont, where did you get your beginning
21 tree inventory?

22 A. It was provided from the interlink site. It
23 was a Scopac data.

24 Q. Isn't it a fact that you took exactly what the
04:40 25 debtors had estimated for tree inventory as of January 1,

AK/RET REPORTING, RECORDS & VIDEO, INC.

306

1 2007?

2 A. Correct.

3 Q. And isn't it a fact that the debtors used that
4 same data?

04:40 5 A. Yes, I believe so.

6 Q. And isn't it a fact that Mr. Fleming used
7 essentially that same data?

8 A. I believe so.

9 Q. So everybody started with the same tree
04:40 10 inventory. Now, but the debtors cut trees during the
11 year 2007, didn't they?

12 A. Absolutely.

13 Q. And the trees grew during 2007?

14 A. Yes.

04:41 15 Q. Did they cut more or grow more?

16 A. They cut approximately what they grew in 2007
17 and their harvest level was about 74 million feet. And I
18 estimated the growth of that particular year in 2007 to

19 be about 74 million feet.

04:41 20 Q. But you never made that adjustment in your
21 report, did you?

22 A. I addressed the issue in my report. I
23 described the methodology that I used and the assumptions
24 imbedded in that.

04:41 25 Q. Isn't it a fact that you took January 1, 2007

AK/RET REPORTING, RECORDS & VIDEO, INC.

307

1 numbers and you used them to do a prospective evaluation
2 as of April 30, 2008?

3 A. Yes.

4 Q. And you made no adjustments to those numbers
04:41 5 for growth versus cutting, did you?

6 A. I'm modeling the forest as of that condition,
7 so I made the assumptions I needed to model it. But no,
8 I did not make any additional adjustments beyond the
9 analysis that I performed.

04:42 10 Q. Now, sir, I'm going to ask that they put up on
11 the screen the thing that I call the big chart.

12 MR. SCHWARTZ: Can you tell us what the
13 exhibit number is, please?

14 SPEAKER: Exhibit A.

04:42 15 Q. (By Mr. Clement) This big chart is Exhibit A
16 to Mr. Daniel's proffer. Now, sir, do you see the big
17 chart there that says Exhibit A in the top right corner?

18 A. Yes.

19 Q. Now, isn't it a fact that for the first ten
04:42 20 years your harvest rate is below that assumed by Fleming
21 and Yerges?

22 A. Can you point me in the direction?

23 Q. Well, let's talk about annual harvest years 1
24 through 10. This is an average. Yerges is about 85
04:42 25 million, Fleming is about 85 million, Daniel is about 83

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 million, and you're in at 65; is that correct?

2 A. That must be referring to my run 1. I'm
3 unclear. I did three harvest schedules. One was at 73
4 million, 74 million feet for the first ten years, so I'm
04:43 5 assuming that you must be using my run 1 or 2. I'm not
6 sure.

7 Q. This is an average of what you were using in
8 the first ten years?

9 A. Okay. I'm looking at your footnote --

04:43 10 MR. SCHWARTZ: Your Honor, I object to the
11 use of this document. The witness has never seen this
12 document before. He has no idea what its contents are.

13 THE COURT: All this does is summarize
14 what he said the various different experts have said
04:43 15 about the harvest in the first ten years. Now, if he
16 doesn't think it's that, he can say whatever it is. He's
17 got his stuff there and probably got his materials, but
18 he probably ought to know what his average runs are. I
19 don't know if he knows specifically.

04:44 20 A. Looking at that, the 65 was from run 1. I had
21 like 74 million feet or more from run 3. So just to
22 characterize, that 65 is not the only number that I was
23 using in my analysis.

24 THE COURT: Well, so do you believe -- I
04:44 25 mean, I think the question is do you believe that your

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 average harvest in the years 1 through 10 is 63 or
2 whatever that is, 65?

3 A. For only one of my runs. I guess it doesn't
4 represent the three runs I made. It's not an average of
04:44 5 the three; it's the average of run 1.

6 Q. Isn't it a fact, sir, that you have run 1 in
7 which you started at 60 and run 2 which you start at 60

8 and run 3 in which you start at 73?

9 A. Yes.

04:44 10 Q. Now, sir, isn't it a fact that back in
11 December, before Mendocino came along, you projected that
12 the harvest could be -- that the forest could be
13 harvested at a rate of 78?

14 A. Yes, we did prepare some analysis back in the
04:44 15 fall, yes.

16 Q. But now you're down instead of at 78, at
17 65-ish?

18 A. There's different assumptions for each of those
19 scenarios. They really are apples and oranges there at
04:45 20 that comparison. It would really be the 78 to 74 number
21 for about four million per production, which was based on
22 conversations we had late in the year with Dr. Barrett
23 and his staff.

24 Q. Now, sir, isn't it a fact that in one of your
04:45 25 three runs, run 3, you use 73 million board feet a year?

AK/RET REPORTING, RECORDS & VIDEO, INC.

310

1 A. The model calculated that, yes.

2 Q. In the first ten years; is that correct?

3 A. Yes. I'd have to double-check it, but yes.

4 Q. Well, let's double-check. It's page --

04:45 5 A. 55.

6 Q. -- 55 of your report?

7 A. In the first ten years, I think it would
8 probably be close to 74 million feet, yes.

9 Q. Well, actually, let's turn back to page 47
04:46 10 where there is a nice summary there. And this is --

11 MR. CLEMENT: Your Honor, this is
12 Mr. Lamont's bound report, page 47.

13 THE WITNESS: Yes.

14 Q. (By Mr. Clement) Sir, down here in run 3
04:46 15 you're talking about 73 million board feet for the first
16 how many years?

17 A. It says it's the initial harvest level. And
18 then I was looking at page 53 to see what the first ten
19 years were. And when I look at -- actually, on page 55,
04:46 20 excuse me. And when I look at page 73 for the first five
21 years and then it goes up to 74.8 for the next five
22 years. So if you looked at an average for the ten years,
23 which is what you're trying to do in your example here,
24 I'd say it's close to 74 million feet for the first ten
04:46 25 years.

AK/RET REPORTING, RECORDS & VIDEO, INC.

311

1 Q. Now, sir, if we use run 3, is that 74 million
2 annual board feet harvest rate sustainable?
3 A. Absolutely.
4 Q. Indeed over time, you work your way back up to
04:47 5 about 100 million board feet, am I not correct?
6 A. No. I think it's about 95, but it does go up.
7 Q. It goes up to 95, is that it?
8 A. Yeah, depending on what run you look at.
9 Q. And so how long does it take you in your
04:47 10 approach to get back up to about 100 -- 95, as you say?
11 A. It takes about 30 years to get there.
12 Q. Isn't it a fact that by year 20 you're pretty
13 close?
14 A. I wouldn't say so. I'm just looking at the
04:47 15 three runs. And run 1 at 20 years I'm at 80 million feet
16 soft wood. Run 2, I'm at like 85 million, 86 million
17 feet. In run 3 I'm at 75 million feet in 20 years. So I
18 think it would take closer to 30.
19 Q. Over 30 years you're getting up close to 100;
04:48 20 is that correct?
21 A. 95.
22 Q. Now, isn't it a fact that the Marathon business
23 plan, which has been used by other experts in this case,
24 starts cutting at 55?
04:48 25 A. I believe that's correct, yes.

1 Q. You were once at 78, now your highest is at 74,
2 and Marathon is down to 55; is that a fair summary?

3 A. Yes.

4 Q. Sir, let's look at the top of page 46. And
04:48 5 there's some language there.

6 A. Okay.

7 Q. "As part of the DCF analysis, several harvest
8 scenarios were developed. The purpose of the harvest
9 scenarios is to determine what the harvest volume
04:48 10 potential is of the property." Is that correct?

11 A. Yes.

12 Q. Harvest volume potential. Now, let's turn over
13 to page 47 and talk about the run 1. There you say
14 "based upon current management with some near term
04:49 15 reduction to avoid higher cost harvesting, political
16 pressure and a complete comprehensive plan."

17 Now, here's my question: What does avoiding
18 higher cost harvesting -- I assume you mean avoiding
19 political pressure, and completing comprehensive planning
04:49 20 have to do with determining the harvest volume potential
21 of the land?

22 A. Different owners are going to have different
23 objectives, and so the purpose of developing a range of
24 harvest schedules in runs 1 through 3 was to test the
04:49 25 sensitivity of different management regimes on the

1 harvest level and to look at what the impact on value
2 would be. So the potential -- again, run 3 runs an even
3 flow straight across, which would be probably the biggest
4 capability or capacity run. Runs 1 and 2 examines
04:50 5 sensitivity of different regimes around that.

6 Q. Isn't it a fact, sir, that in run 1 and in run
7 2, in both cases you say that harvesting will be limited
8 quote "to avoid higher cost harvesting, political
9 pressure and complete comprehensive planning."

04:50 10 A. I don't think I used the word limited, but yes,
11 I do use the word to reduce -- to avoid higher cost
12 harvesting, political pressure, yes.

13 Q. And is it a fact that that one limitation in
14 those two runs have nothing to do with determining the
04:50 15 harvest volume potential of the land?

16 A. I disagree. I think that the runs are trying
17 to model what likely buyers would do under different
18 alternative runs. And so it's the potential from one
19 owner to the other under different prescriptive ideas.

04:51 20 Q. Sir, as you testified in your deposition, how
21 many potential buyers concerning the Scopac property have
22 you had any conversation with?

23 A. The only one I had a conversation with is
24 Mendocino. But I know that, as you can certainly see,
04:51 25 other ones have expressed interest.

AK/RET REPORTING, RECORDS & VIDEO, INC.

314

1 Q. Sir, the only conversation you've had with any
2 potential buyer is with Mendocino, who thinks it's a good
3 idea to start off cutting at 55 and ratchet it on up from
4 there; is that correct? That's the only one?

04:51 5 A. Correct.

6 Q. Now, sir, let's move to table 1, which we will
7 put up on the screen.

8 A. Is that my report?

9 Q. It's some's tabs. This is table 1 of 7
04:52 10 attached to the Fleming proffer. So you've had it since
11 Friday night.

12 A. Okay. I see it.

13 Q. Now, my question, sir, is: How is it that
14 you're proposing to cut less during the early years than

04:52 15 Yerges, for the debtor, and Fleming for the indenture
16 trustee? What is it you're doing different during those
17 first ten years?

18 A. Is that a statement or a question?

19 Q. What is it you're doing different so that you
04:52 20 cut less during those first ten years?

21 A. In runs 2 and 2 I specify a lower harvest level
22 for the first five or ten years until the planning can be
23 completed and a new owner would understand the nature of
24 the property and the inventory.

04:53 25 Q. Sir, if we look here at table 1 for redwood,

AK/RET REPORTING, RECORDS & VIDEO, INC.

315

1 Fleming is cutting 58 million board feet a year, yours is
2 59. Lamont run 1, 49; Lamont run 2, 56; Lamont run 3,
3 61. You're not so far off on the redwood cut, are you?

4 A. No.

04:53 5 Q. However, you're just proposing not to cut much
6 Douglas Fir for that early period; isn't that correct?

7 A. Absolutely.

8 Q. Why?

9 A. It's uneconomic in the current market and it's
04:53 10 going to be uneconomic to harvest Douglas Fir,
11 specifically Douglas Fir stands for the new future. So
12 in the model, I'm trying to avoid below cost harvesting,
13 uneconomic loss.

14 Q. Now, would it surprise you if there was a
04:54 15 different view hold by other experts that say you do not
16 need to go entirely away from Douglas Fir harvesting?

17 A. I would find it illogical, but yes, I would
18 believe it.

19 Q. Now, sir, if what you do over time is to
04:54 20 selectively not cut Doug Fir, what happens to the forest?

21 A. You cut it another day.

22 Q. Isn't it a fact that over time that tends to
23 move the forest to a higher percentage of Doug Fir?

24 A. No, not at all.
04:54 25 Q. Does that not explain why over time you move

AK/RET REPORTING, RECORDS & VIDEO, INC.

316

1 the forest to a higher percentage of Doug Fir?
2 A. I moved to a higher percentage of Doug Fir in
3 the outer years because that's the available acres to
4 harvest on.
04:54 5 Q. Now, sir, am I correct that your projection
6 goes out 50 years?
7 A. Correct.
8 Q. Am I correct that Mr. Yerges' projection goes
9 out 50 years?
04:55 10 A. Correct.
11 Q. Am I correct that Mr. Fleming, who represents
12 the indenture trustee, has a projection that only goes
13 out to ten years?
14 A. Yes.
04:55 15 Q. Nine years of DCF and then he has a terminal
16 value in year ten?
17 A. Yes.
18 Q. Now, isn't it a fact that it is inherently
19 risky to project anything out over 50 years?
04:55 20 A. I don't -- I'm not sure what you're saying.
21 Over 50 years is inherently riskier?
22 Q. Isn't a 50-year projection inherently risky?
23 A. No.
24 Q. Isn't it much more reasonable to project out
04:55 25 ten years with the terminal value than to project out 50

AK/RET REPORTING, RECORDS & VIDEO, INC.

317

1 years in the future?
2 A. Absolutely not.
3 Q. Do you expect to be alive in 50 years?

4 A. No. Hopefully I make it 30 at least.

04:56 5 Q. If you project out 50 years, is there a higher
6 risk to the projection?

7 A. Well, you've got to remember we're growing
8 trees here, so the trees that we're planting in the
9 ground today are going to be the ones we're getting in 50
04:56 10 years and vice versa. The trees that we're cutting in
11 the next 20 years are already plant, we know where they
12 are, we can measure them. So this is not something like
13 your stock market. These are trees that grow over time.
14 They don't go anywhere.

04:56 15 Q. Isn't it a fact that when you project out 50
16 years, you need to project out price for the trees?

17 A. Yes.

18 Q. Isn't it a fact when you project out 50 years,
19 you have to project out costs of operating the tree
04:56 20 operation?

21 A. Yes, you have to account for all those factors.

22 Q. And isn't it a fact when you go out 50 years,
23 you have to adjust your discount rate to take into
24 account the length that you've gone into the future?

04:56 25 A. Yes, that's one of the components. It's

AK/RET REPORTING, RECORDS & VIDEO, INC.

318

1 typical of what buyers do to calculate the values of
2 timberlands, though. That's why I'm doing 50 years.

3 Q. Now, sir, let's go to table 2. Lastly, when
4 you project out to 50 years, aren't you having
04:57 5 necessarily to guess which way the forest is going to go
6 in growing trees?

7 A. No.

8 Q. Well, let's look at the fact that with Fleming
9 we have an 83 million dollar -- 83 million board foot
04:57 10 harvest in years 1 through 10, 69 or almost 70 percent
11 growth. Now, Mr. Fleming keeps that standard or set when
12 his terminal value is done in year ten; is that not

13 correct?

14 A. Well, Mr. Fleming uses a giant pool of volume.

04:57 15 He has no clue what it does over time, so he just takes a
16 dip out of the bucket, an average scoop, and that's what
17 he harvests.

18 Q. Sir, isn't it a fact that what we see with

19 Mr. Yerges is that his forest goes from about 66 percent
04:58 20 redwood to in years 39 to 50 98 percent rate?

21 A. Right, but Mr. Yerges assumes that he's
22 replanting almost every acre in redwood, which isn't
23 feasible.

24 Q. You disagree with that, don't you?

04:58 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

319

1 Q. How long is it going to take to find out

2 whether you're right or he's right about how the trees
3 will grow after they replant them?

4 A. About two years because they die off in two to

04:58 5 five years. If you plant redwood on Douglas Fir stands,
6 they aren't sustainable.

7 Q. So when we go out 50 years, Mr. Yerges has an
8 assumption about change in the midst of the forest, and
9 you fundamentally disagree with him?

04:58 10 A. Yes.

11 Q. Let's look at what happens when you go out 50
12 years.

13 A. Yeah.

14 Q. Look over when you say run 1, percentage

04:58 15 redwood. It moves all over the place, doesn't it?

16 A. Because it changes as the dynamics of the
17 stands that you harvest over time change, so you run in
18 different kinds of stands to harvest.

19 Q. Look at run 2. In run 2 you end up with a

04:59 20 forest that's only 49 percent redwoods and 49 percent
21 Doug Fir; is that correct?

22 A. Yeah. That's going to change the year after
23 that, yeah.

24 Q. And in run 3 you end up with a forest that's 55
04:59 25 percent redwood and 45 percent Doug Fir?

AK/RET REPORTING, RECORDS & VIDEO, INC.

320

1 A. Can I clarify something?

2 Q. Am I correct that that's what you end up with
3 run 3?

4 A. Yes.

04:59 5 Q. Let me move on.

6 MR. SCHWARTZ: Your Honor, the witness
7 asked to clarify an answer. I think he should be allowed
8 to.

9 THE COURT: Well, that's why we have
04:59 10 redirect. So write on it down, if it's important.

11 MR. SCHWARTZ: I got it.

12 THE COURT: He doesn't get to make that
13 decision, you do. So go ahead.

14 Q. (By Mr. Clement) Now, sir, you talked in your
04:59 15 direct testimony about how you put material into your
16 model on a stand-by-stand basis; is that correct?

17 A. True.

18 Q. Now, isn't it a fact that the data that you got
19 from the debtors was not developed on a stand-by-stand
05:00 20 basis?

21 A. My understanding of the data provided by Scopac
22 was that they took your GIS data and developed area
23 assumptions for every individual stand. And back in
24 2001, they extrapolated that strata inventory, which was
05:00 25 for broad areas, into each of those data and then grew

AK/RET REPORTING, RECORDS & VIDEO, INC.

321

1 and updated each individual stand. So I believe I am

2 dealing with stand level data provided by Scopac.

3 Q. Isn't it a fact, sir, that what you have just
4 described is that Scopac doesn't have the data on a
05:00 5 stand-by-stand basis, they have it on a strata basis.

6 And they use extrapolations of various sorts to say what
7 the average stand will look like in that strata?

8 A. That's not what's been represented to me; by
9 stand.

05:00 10 Q. Isn't it a fact, sir, that I could show you two
11 pictures up on that screen of timberland that supposedly
12 has the same composition and you look at it and you say
13 this is obviously different?

14 A. There is always minor adjustments and changes
05:01 15 in inventory stands. I'm sure that you could find those
16 and make examples of them.

17 Q. And isn't it a fact that because the data that
18 you've got which have been extrapolated out to be on a
19 stand-by-stand basis, when you put it in and pretend that
05:01 20 it's actual stand-by-stand data gives you a nonsense
21 output from your computer?

22 A. Absolutely not.

23 Q. Would it surprise you that there's a different
24 view of that?

05:01 25 A. I'm not surprised.

AK/RET REPORTING, RECORDS & VIDEO, INC.

322

1 Q. Now, we talked about how Mr. Fleming built his
2 model. Do you know how he built his model?

3 A. I have a fairly good understanding of how
4 Mr. Fleming built his model, yes.

05:01 5 Q. Isn't it a fact that Mr. Fleming has evaluated
6 more redwood sales in Humboldt County than anybody on
7 Shula?

8 A. I do not know that.

9 Q. And do you know that Mr. Fleming built his
05:02 10 projection essentially bit by bit, piece by piece from

11 the ground up?

12 A. He used Excel to do this, so I don't believe
13 that.

14 Q. So your point is since he didn't put his data
05:02 15 into a computer that has a whole bunch of preconceived
16 assumptions, that his is not as reliable as yours; is
17 that it?

18 A. Absolutely.

19 Q. Now, sir, let's go on to table 2. We've
05:02 20 already done table 2. Let's move on to table 3, please.
21 Now, do you recall, Mr. Doren asking you and actually
22 using your deposition to refresh your recollection, and
23 that is, what you testified about concerning the growth
24 rate of redwood trees?

05:03 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

323

1 Q. What is it?

2 A. And, again, Mr. Doren had a question related
3 back to my deposition when we were talking about stand
4 level growth rate. And again, on stand level growth
05:03 5 rate, I said they were like 4 to 6 percent for redwood,
6 but that is not a forest wide growth rate, and so I'm not
7 sure what your reference is.

8 Q. Well, let's take the 4 to 6 percent. We can
9 come back later and argue what stand level means. But
05:04 10 take 4 to 6 percent. Look at table 3.

11 A. Correct.

12 Q. Harvest rate?

13 A. Yeah.

14 Q. Summary of harvest and growth estimates by
05:04 15 Lamont. About the fourth column over, it says percent?

16 A. Yes.

17 Q. You start out cutting at 2.3 percent. The next
18 five years it's 2.2?

19 A. That's the harvest percent.

05:04 20 Q. Right. Harvest percent.
21 A. Yeah, not the growth percent.
22 Q. Now, here's the question: Show me where in
23 your report you express the value of the tree growth
24 you're not cutting.
05:04 25 A. Easy. Let's look at the next graph of that.

AK/RET REPORTING, RECORDS & VIDEO, INC.

324

1 In a second here. Okay. Page 50, figure 26. This issue
2 came up in the Fleming proffer and in this table, as the
3 people who prepared this don't understand the difference
4 between growth on a forest and harvest on a forest. And
05:05 5 figure 26 on page 50 illustrates the point, which is I'm
6 only cutting under your scenario of 2.3 percent, which is
7 the red line. While the growth of the forest, it looks
8 to me, 70 to 75 million feet of growth in that first four
9 or five years.

05:05 10 Q. Thank you, sir. Because let's take page 50.

11 A. Sure.

12 Q. All of those red lines up there on the top of
13 that figure 27, I assume that's what you're talking
14 about?

05:06 15 A. No. I'm talking about in figure 26 because
16 those red lines in figure 27 are total forest inventory
17 where the green bars are available soft wood forest
18 inventory, which is the more critical measure when doing
19 an appraisal.

05:06 20 Q. Well, here's my question, sir: Are you showing
21 that you're going to cut the -- in figure 26 that you're
22 going to cut the forest faster than the growth rate
23 beginning, for example, in the year 2017?

24 A. Yes, I am actually harvesting above the growth
05:06 25 on average for that time period. That's the beauty of a

AK/RET REPORTING, RECORDS & VIDEO, INC.

325

1 harvest scheduling model, which is that the forest is
2 dynamic. And that's why up there at 2038 when those
3 young acres that have been harvested in the last 20 years
4 finally come on-line, the growth actually surges. But
05:06 5 the harvest schedule, based on the non-declining even
6 flow, allows you to harvest on average that growth rate
7 as it increases over time. And so that's why the green
8 bar buries around here, but the area of the two or the
9 average of the two is going to be the same. You're
05:07 10 harvesting what you're growing on a 50-year basis.

11 Q. So here's the question, sir: In the early
12 years when you're harvesting less than growth --

13 A. Correct.

14 Q. -- how much more does that add to your \$430
05:07 15 million number?

16 A. I think when we looked at the comparison -- I
17 have one of those. Hang on a minute. On page 59, you
18 can look at the differences, figure 38. Run 1 I have
19 \$430 million; run 2 is \$407 million; and run 3 is \$446
05:07 20 million. So I would say that \$16 million is the foregone
21 value of not harvesting that in the first ten years or
22 so.

23 Q. Now, sir, let's move on. So let's look at
24 years 1 through 10. If you just harvested at the rate of
05:08 25 three percent of growth instead of what you are proposing

AK/RET REPORTING, RECORDS & VIDEO, INC.

326

1 to harvest at in year one, what would your harvest rate
2 go up to?

3 A. Okay. Help me out here. Where are you on this
4 table?

05:08 5 Q. I'm on table --

6 A. I'm on table 3, I understand that, but where
7 are you on the table?

8 Q. I'm going down to about a third of the way down

9 on the page where it talks about three percent growth and
05:08 10 it shows that in year one you would be at 79, is that
11 correct, if you were harvesting three percent of the
12 growth rate?

13 A. Yeah. I mean, this is your analysis, not mine.

14 Q. And in year five you would be harvesting at the
05:09 15 rate of 80 million board feet a year?

16 A. Yeah. Those are your numbers. I don't agree
17 with them.

18 Q. And in year 10 you would be harvesting at 80.
19 Now if you go down to the next one, which is using an
05:09 20 annual growth of 3.5, you would be harvesting at 92, 93,
21 94 where you end up ultimately; isn't that right?

22 A. Yeah, but it's totally illogical because it
23 misses the fact that there's regulations on this forest
24 and other constraints that don't allow you to cut 92
05:09 25 million feet of redwood. If they would, they would have

AK/RET REPORTING, RECORDS & VIDEO, INC.

327

1 been cutting it today.

2 Q. Isn't it a fact that the debtors' projection
3 contemplates starting in the first year cutting at 84
4 million?

05:09 5 A. My latest view of the Reimer report shows that
6 if they put 74 in and then they get up to like 80
7 something in year two, which again doesn't make sense.
8 But I think that's what the debtors are doing.

9 Q. So there's a learned professional in this trial
05:10 10 who says you can be cutting at 80 right now; isn't that
11 right?

12 A. Well, again, if they could, they would. I
13 mean, this is the problem in this whole case, is they
14 overstate the harvest, overstate the cash flow, and then
05:10 15 they have indebted it too high to pay the bills. And the
16 likely buyer is not going to want to pay that in an
17 appraisal, and that's why I'm looking at a more realistic

18 approach on what you can harvest and then how you can get
19 there, which is what another buyer would do.
05:10 20 Q. Now, sir, let's go on to table 5. Am I correct
21 that the three variables in pricing this property are
22 harvest rate, cost of operations, and price of logs?
23 Those are the three major variables, aren't they?
24 A. Okay. I was focusing on a sentence. Could you
05:11 25 just repeat that question? Sorry.

AK/RET REPORTING, RECORDS & VIDEO, INC.

328

1 Q. Isn't it a fact that the three major variables
2 in evaluating this property are harvest rate, price of
3 the logs, and cost of harvesting the logs?
4 A. I'd say discount rate is a close third in
05:11 5 there, to be honest.
6 Q. We'll come to that one.
7 A. Okay.
8 Q. Because frankly, there's not that much
9 difference between the various experts on discount rate,
05:11 10 is there?
11 A. We can get there in a minute if you want to get
12 there.
13 Q. Isn't it a fact that there isn't that much
14 difference between the experts on discount rate?
05:11 15 A. One percent discount rate is like 50 million
16 dollars of value, so I would disagree with your
17 statement.
18 Q. Well, then we'll get to that.
19 A. Sure.
05:11 20 Q. Now, on cost, am I correct that you are at \$496
21 per million board feet?
22 A. Are you on table 4 or 5?
23 Q. I'm on table 5.
24 A. Okay. Yes. Okay, I see it there, too.
05:12 25 Q. You're at \$496 per million board feet, and

1 that's \$64 above Fleming and \$138 higher than Yerges?
2 A. Yeah. This is a real cool little trick here
3 because you're looking at fixed cost verse a harvest
4 level, but you can't change most of the fixed costs of
05:12 5 the operation. You have to have so many people there
6 every day. So if you look at the average of my --
7 MR. CLEMENT: Objection, move to strike.
8 All of this is just voluntarily speech. I simply
9 asked --
05:12 10 THE COURT: He hasn't asked a question
11 yet, so wait until he asks a question.
12 A. Keep going.
13 Q. So I will reask the original question, which
14 is: Isn't it a fact that your number is 496 and that you
05:12 15 are \$64 higher than Fleming and \$138 higher than Yerges?
16 A. That would be true in year one, yes.
17 Q. Correct?
18 A. Correct, in year one.
19 Q. Costs lower than Fleming tend to increase
05:13 20 value, don't they?
21 A. Well, if you look at the total cost in mine,
22 I'm at 31 million versus his 35 million, so he's actually
23 higher than I am, so I'm confused.
24 MR. CLEMENT: Your Honor, can we have some
05:13 25 sort of direction? The witness has apparently decided to

1 quit answering questions.
2 MR. SCHWARTZ: He is answering questions.
3 THE COURT: Let's be sure that we ask
4 specific questions. And you answer his questions. And
05:13 5 you have very capable counsel who will ask you the right
6 ones on redirect, will allow you to further explain what

7 you want. But he gets to ask the questions in the most
8 favorable light to him. So if he only wants to ask you
9 what the bottom price per foot is, he gets to ask you
05:14 10 that, and then you can point out later, if they think
11 it's important, that that's because you have fewer board
12 feet and more fixed costs. But go ahead.

13 Q. (By Mr. Clement) Now, sir, isn't it a fact
14 that as represented on this chart, your cost number is
05:14 15 496 per million board feet and \$64 higher per million
16 board feet than Fleming and \$138 feet higher per million
17 board feet than Yerges?

18 A. It's per thousand board feet, but your numbers
19 are correct, sir.

05:14 20 Q. Thank you. Now, isn't it a fact that when you
21 have a lower cost, it tends to increase the value?

22 A. Yes.

23 Q. Isn't it a fact that when you have a higher
24 cost, it tends to decrease value?

05:14 25 A. Yes.

AK/RET REPORTING, RECORDS & VIDEO, INC.

331

1 Q. Now, look down here at road maintenance.

2 THE COURT: Road maintenance?

3 MR. CLEMENT: Yes, sir.

4 Q. (By Mr. Clement) Road construction.

05:15 5 A. Okay. Yes, road maintenance, road
6 construction, yes.

7 Q. You have really large numbers in there for road
8 maintenance and road construction, don't you?

9 A. Yeah. In the first five years I state in my
05:15 10 report, yes, I have higher costs because of the THP
11 issues on the property.

12 Q. Now, are the costs of those roads just dealt
13 with in the first five years? Or do you project them out
14 over 50 years?

05:15 15 A. They're dealt with in the first five years.

16 Q. You don't project them out over 50 years?
17 A. The level goes down. There's an extra 7
18 million in the first five years and then it goes back
19 down to more of a maintenance level. For right now they
05:15 20 have a backlog. So is that --
21 Q. Isn't it a fact, sir, that you take those road
22 maintenance costs and act as if they are there forever?
23 A. Can I look at my report?
24 Q. Go ahead.
05:16 25 A. Yes, my road maintenance cost does stay the

AK/RET REPORTING, RECORDS & VIDEO, INC.

332

1 same. My cap-x, which is an additional cost, does
2 decline. So you're correct in your statement of road
3 expenses, road maintenance, yes.
4 Q. And isn't it a fact that what you're dealing
05:16 5 with right now is a backlog, one might call it deferred
6 maintenance here, that has occurred with respect to road
7 maintenance?
8 A. And that -- yes. And that value is in the
9 cap-x, if you look at the detail BCF sheets.
05:17 10 Q. And that once caught up, it ought not to be
11 counted again that way in the future?
12 A. To a certain level it goes down. Yes, there's
13 a backlog. But part of the problem was they weren't
14 paying their bills. There's a higher cost on average
05:17 15 than they were accounting for. They didn't spend all the
16 money in the last few years, so that's why they have this
17 backlog. But they should be spending a little bit more
18 every year to keep up. So that's accounted for in my
19 cap-x roads out into the future after year five.
05:17 20 Q. And isn't it a fact, sir, that what you've done
21 is built into your costs over the years a much higher
22 cost relating to roads and road maintenance, which is
23 premised on a continuation of this catch-up activity?
24 A. No.

05:17 25 Q. Now, isn't there a similar phenomenon going on

AK/RET REPORTING, RECORDS & VIDEO, INC.

333

1 here with storm proofing?

2 A. That's all rolled into two categories on my
3 analysis, road expenses and that cap-x roads. So the
4 storm proofing and everything, you've got to have the
05:18 5 right description. The storm proofing, as it was related
6 to the HCPs, is included in that additional money.
7 Typical storm proofing for operating a farm is most
8 likely in my road expense, so I'm not sure what you're
9 asking about.

05:18 10 Q. Yes or no? Have you done a similar thing
11 concerning perpetuating out into the future storm
12 proofing activity, which is actually limited in time
13 duration?

14 A. No.

05:18 15 Q. Now, sir, let's go back to the issue of log
16 price. Isn't it a fact that log prices right now today
17 are in a trough?

18 A. Yes.

19 Q. And isn't it a fact that if you looked at SBE
05:19 20 prices, which have a look back period, that they tend to
21 give you a price that is a more long-term price
22 unaffected by today's trough in pricing?

23 A. No.

24 Q. The SBE price doesn't give you a resistance to
05:19 25 the trough because it involves prices a couple of years

AK/RET REPORTING, RECORDS & VIDEO, INC.

334

1 back?

2 A. No. If you look on my page 34, there's a
3 historical picture of SBE prices. And if you'll look at
4 the 2001 recession that we went through after 9/11,

05:20 5 there's a huge drop-off in SBE prices. There was a big
6 run-up and then drop-off, so they don't even out the
7 trough.

8 Q. Now, sir, did you take us to page 34?

9 A. Page 34 of my report? Figure 13?

05:20 10 Q. Sir, do you have a ruler or a pencil or
11 anything of that sort up there?

12 A. No, but I've got a sheet of paper.

13 Q. You've got a sheet of paper. Am I correct that
14 the BOE price, or that is, the SBE price from the Board

05:20 15 of Equalization?

16 A. Right. SBE/BOE, they're the same thing, it's
17 synonymous.

18 Q. It starts in the bottom left corner and goes up
19 to the top right. If you piece that piece of paper on

05:20 20 there, it angles up, doesn't it?

21 A. Yes, from 1981 to January, yes.

22 Q. Isn't it a fact that there is a long-term trend
23 shown on the very exhibit you just took us to of increase
24 in the price of redwood?

05:21 25 A. On a nominal basis there is a significant

AK/RET REPORTING, RECORDS & VIDEO, INC.

335

1 increase. On a real basis, it's much smaller. And if
2 you use a significant time period of like the '90s, it's
3 like less than a quarter of a percent.

4 Q. You're suggesting if we took a different time

05:21 5 period than the one shown on your exhibit, it would be
6 closer to your point of view of that long-term rate of
7 growth for prices?

8 A. Correct.

9 Q. This is the chart you chose to put on page 34

05:21 10 of your exhibit, isn't it?

11 A. Right. And then if you go to the next page,
12 which shows the same thing on figure 14 and figure 15,
13 which is the relevant time period, '99 to 2000, if I put

14 a map -- a piece of paper on those, my paper goes down or
05:21 15 stays flat.

16 Q. So your testimony is, sir, that what you put in
17 figure 13 is irrelevant but what you put on the next page
18 in figures 14 and 15 is relevant?

19 A. I'm trying to create a basis for your
05:22 20 understanding what the price movements have been, so
21 first I try to show you the largest picture and then I
22 try to show you on page 35 what's been going on in the
23 market in the last ten years, which is the more relevant
24 time period. So I'm kind of building blocking you up
05:22 25 because if you didn't see that big spike there, you'd

AK/RET REPORTING, RECORDS & VIDEO, INC.

336

1 wonder what was going on on a longer term basis.

2 Q. Now, sir, let's move on finally to discount
3 rate that we talked about earlier.

4 A. Okay.

05:22 5 Q. Actually, before we move away from price, is it
6 your testimony that the trend shown on figure 13 that
7 goes from July of 1981 through January of what year?

8 A. That's going to be as of this year. It's like
9 January '08.

05:23 10 Q. Does not represent appropriately the long-term
11 trend of SBE -- or excuse me, of log price increase?

12 A. That's what the long-term would be, but it's
13 not appropriate for appraisals purposes.

14 Q. Let me move on then, sir, to discount rate,
05:23 15 which is table 6.

16 A. Okay.

17 Q. It's actually easier to understand the discount
18 rates if we go back to the big chart, so I'll just ask
19 that that be put back up on the board.

05:24 20 Now, sir, before we get tied up in the
21 language, describe the difference between a nominal
22 discount rate and a real discount rate.

23 A. Okay. It's probably easier to start with
24 nominal. A nominal rate is a rate you observe today
05:24 25 which includes inflation. If you back out inflation,

AK/RET REPORTING, RECORDS & VIDEO, INC.

337

1 then you get to a real rate or the real risk of cost of
2 capital. So it has -- real rates do not include
3 inflation.

4 Q. Now, if we go to the big chart here where it
05:25 5 says nominal discount rate, that's the one that has in it
6 the rate of inflation, correct?

7 A. Correct.

8 Q. Now, what do you think the long-term rate of
9 inflation is?

05:25 10 A. In my analysis, I looked at two industrial wood
11 product indexes and it ranged from about 2.9 to 3.4, and
12 I selected a 3 percent rate for industrial properties.

13 Q. So in your view, you would take three off of
14 each of these numbers, but they're all expressed in the
05:25 15 same nominal number, so let's go across. Yerges is 9
16 percent, correct?

17 A. Right.

18 Q. Fleming is 9 percent, correct?

19 A. Yes.

05:25 20 Q. Daniel, 10.5 percent?

21 A. Okay. I didn't look at his report
22 specifically, so --

23 Q. If you have a higher discount rate, what does
24 it do to value?

05:25 25 A. The more risk the analysis, the higher rate, it

AK/RET REPORTING, RECORDS & VIDEO, INC.

338

1 lowers the value.

2 Q. So do you think that Mr. Daniel's number is too

3 high or too low?

4 A. Again, I don't know. I don't have an opinion

05:26 5 of Mr. Daniel's rate because I have not reviewed all of

6 his analysis.

7 Q. Am I correct that your discount rate is 10?

8 A. Yes. It's appropriate for my analysis.

9 Q. So if Mr. Daniel moved his number from 10.5

05:26 10 down to your 10, the value would go up, correct?

11 A. Yeah. Mathematically, yes.

12 Q. Now, sir, let's go to your comparable sales

13 analysis. And if we could, please, turn to page 64 of

14 your report.

05:26 15 A. Okay.

16 Q. What does the note say there?

17 A. "Subject volume on available acres is 2.8

18 billion feet compared to 4.4 total volume."

19 Q. Now, when you say the subject volume, you think

05:27 20 that's available to be cut; is that correct?

21 A. Yes.

22 Q. And the 4.4 is much larger, of course. And you

23 think that involves areas available to be cut plus areas

24 not available to be cut?

05:27 25 A. Correct.

AK/RET REPORTING, RECORDS & VIDEO, INC.

339

1 Q. Is the reason that areas are not available to

2 be cut essentially regulation? For example, the MMCAs

3 can't be cut?

4 A. Yes.

05:28 5 THE WITNESS: I'm just going to stretch

6 for a second.

7 MR. CLEMENT: Your Honor, we're getting

8 close to the end.

9 Q. (By Mr. Clement) So, sir, keep your thumb

05:28 10 there on page 64.

11 A. Okay.

12 Q. Where we just talked about the areas that had
13 to be excluded from your analysis because regulation
14 keeps you from cutting them. And flip over to page 71.

05:29 15 A. Yeah.

16 Q. "Industrial timberlands are purchased on an
17 income basis. The harvest level and the available acres
18 volumes are direct multipliers to the overall value.

19 It's the appraiser's opinion that a conservative estimate
05:29 20 of 25 percent reduction for the impact of the ACP lowers
21 the value for the best four comparables down to 400 to
22 425 million." So you took off another 25 percent for
23 regulatory limitations here, didn't you?

24 A. I'm not double counting, if that's what you're
05:29 25 saying. I did take off 25 percent based on what you just

AK/RET REPORTING, RECORDS & VIDEO, INC.

340

1 read from the previous comparable value.

2 Q. And isn't it a fact that if you didn't do that
3 double counting and take off that additional 25 percent,
4 that your comps are about the same as Mr. Fleming's
05:30 5 analysis?

6 A. Yes.

7 Q. Now, sir, what's your definition of fair market
8 value?

9 A. I have one. Give me a minute and I can find
05:31 10 it. Okay. No, that's the -- okay, here we go on page 8.

11 Do you want me to --

12 Q. Go ahead.

13 A. Okay. On page 8 I define market value as the
14 "most probable price as of a specific date in terms of
05:31 15 cash or in terms equivalent to cash in order to -- or in
16 other precisely revealed terms for which the specified
17 property rights should sell for after exposure,
18 reasonable exposure in a competitive market under all
19 conditions requisite for fair sale with a buyer and
05:31 20 seller each acting prudently, knowledgeably and for self

21 interest, and assuming that neither is under due duress."

22 That's from the appraisal dictionary for real estate

23 appraisal.

24 Q. Isn't it a fact that near the end of your

05:32 25 deposition your counsel took you through so that you

AK/RET REPORTING, RECORDS & VIDEO, INC.

341

1 could restate your definition of fair market value and

2 that, in essence, you said, I'm looking for a probable --

3 a probable buyer at a likely price?

4 A. I think I said likely buyer and probable price.

05:32 5 Q. And isn't it a fact, sir, that if we have a

6 rock solid offer of \$603 million, that that meets your

7 definition of fair market value when someone is a likely

8 buyer at a probable price?

9 A. No.

05:32 10 Q. Isn't it a fact that at your deposition you

11 testified to the contrary?

12 A. Do you want to bring that out?

13 Q. Is that or not a fact?

14 A. No, that's not what I said.

05:33 15 Q. Move to page 171. Move back to page 170.

16 "Could you restate the standard you're applying

17 concerning likely buyers?"

18 "While trying to look at property at a harvest

19 level, you have to look at what a realistic capability of

05:33 20 the property, and then you have to look at the

21 marketplace and incorporate your knowledge and

22 experience."

23 "Sir, if someone with adequate financing comes

24 in and offers 600, is that \$600 million price a probable

05:34 25 price offered by a likely buyer?"

AK/RET REPORTING, RECORDS & VIDEO, INC.

342

1 A lot of objections.

2 "Again, is that a yes or no answer? Is it

3 probable and likely -- is that a likely buyer?"

4 "If they could offer and consummate that sale,

05:34 5 yes, they would be a likely buyer."

6 So suppose we have an offer from someone who

7 will not back down for \$603 million, is that a likely

8 buyer?

9 A. Yes, it's a likely buyer.

05:34 10 Q. Move on to the next page. Well, even on that

11 page: "And would the \$600 million offer from an

12 adequately financed buyer be a probable price?"

13 Witness: "It could be a probable price if it

14 was a sincere, direct offer, if it could be consummated

05:34 15 and then its value."

16 So if we have an offer from someone who has a

17 lot of money and financing and isn't going to back down

18 and it's for \$603 million, is that a probable price?

19 A. Yes, but it's not a market value.

05:35 20 Q. Is it a likely buyer if it's someone who's

21 adequately financed and won't back down, yes or no?

22 A. Restate it again.

23 Q. If it's someone who is adequately financed and

24 offers and will not back down \$603 million, is that a

05:35 25 likely buyer?

AK/RET REPORTING, RECORDS & VIDEO, INC.

343

1 A. Yes.

2 Q. And if the offer is for \$603 million, is that a

3 probable price?

4 A. Yes.

05:35 5 MR. CLEMENT: Pass the witness, Your

6 Honor.

7 THE COURT: All right. That was this side

8 over here. So now we've all finished. We're back to

9 redirect. Or does Bank of America have anything?

05:35 10 MR. JONES: No, Your Honor. Thank you.
11 THE COURT: Okay. You're back.
12 MR. CLEMENT: Your Honor, as I understood
13 your instruction earlier, it is that if questioning goes
14 beyond the scope of my cross, I should object rather than
05:36 15 assuming I have a redirect?
16 THE COURT: Right.
17 REDIRECT EXAMINATION
18 BY MR. SCHWARTZ:
19 Q. Mr. Lamont, in choosing the progress rates in
05:36 20 your models, your three runs, did you adopt the harvest
21 rates being used by MRC in the proposed plan of
22 reorganization?
23 A. No, I did not.
24 Q. How did your models compare in terms of the run
05:36 25 rate -- the harvest rate?

AK/RET REPORTING, RECORDS & VIDEO, INC.

344

1 A. All my runs are higher than the MRC.
2 Q. And that would, all things being equal,
3 increase and provide a higher value, correct?
4 A. Correct.
05:36 5 Q. If you were doing this appraisal of this
6 property and MRC was not in the picture, would you have
7 used the same runs?
8 A. Absolutely.
9 Q. Can you explain why?
05:37 10 A. Again, I'm looking at likely buyers in the
11 marketplace, and so I'm looking at -- trying to develop
12 scenarios that would mimic what they would do and
13 specifically about harvest. So you have other buyers
14 like the Nature Conservancy or other foundations and
05:37 15 potentially other industrial owners that would buy the
16 property. So, again, that's why I developed the three
17 scenarios to look at different alternatives of management
18 and harvest levels.

19 Q. In determining the harvest levels, you were
05:37 20 asked whether you spoke to any other buyers. Is that --
21 is there any requirement or guidelines in the appraisal
22 standards for doing that one when conducting appraisals?
23 A. No, because you don't know who all they are, so
24 you look at the marketplace to see what's out there, but
05:37 25 that's not a requirement.

AK/RET REPORTING, RECORDS & VIDEO, INC.

345

1 Q. So what do you base your decision on what the
2 harvest level should be in your models?
3 A. Again, you look at the biological capabilities
4 and then look at the regulations and other issues that
05:38 5 are in place on the property to develop what is an
6 operational level harvest. And then from there, you can
7 develop cash flow.
8 Q. Now, in determining what harvest levels to use,
9 did you look at the debtors' historical harvest levels?
05:38 10 A. Yes. I have a graph of that.
11 Q. And can you tell me where in your report that
12 is?
13 A. Yes. It's page 70, figure 39.
14 Q. And can you explain what this graph shows?
05:38 15 A. The blue line is the historic Scopac harvest
16 level since '97 to 2007. And you can see the harvest
17 level sort of pre-HCP and then what the harvest has done
18 in the last ten years, and specifically in the last two
19 or three years how it's dove off compared to where it was
05:39 20 even four or five years ago.
21 Q. Did you reach any conclusions as to why the
22 harvest rate has dropped off for Scopac as shown in your
23 report here on figure 39?
24 A. Yes. I mean, review of their data, discussions
05:39 25 with their staff, it's been obvious that they have

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 regulatory restraints that have limited their amount of
2 volume harvest. And they also have operability issues
3 that limit the economic acres that they can harvest on,
4 which is what's been lowering their harvest level
05:39 5 recently.

6 Q. There was some discussion about you estimating
7 a 78 million dollar -- million board feet earlier in
8 December and now your runs are different than that. Can
9 you explain why you made the change?

05:40 10 A. Yes. We prepared those initial analyses in
11 like November.

12 Q. Of 2007?

13 A. Of 2007. And we subsequently in just early to
14 mid December we had conversations with Scopac. We had a
05:40 15 discussion for a whole day over costs of managing the HCP
16 and the different issues that they were facing. And
17 also, specifically the constraints they were having in
18 the freshwater and Elk or Humboldt watershed where the
19 water boards have limited the amount of volume they can
05:40 20 cut. And I think currently Dr. Barry indicated like 14
21 or 17 million feet was all they could harvest out of
22 there, even though they had a right to go in and get like
23 25 or 30, they were only able to get 17 this year. And
24 they felt like they were going to have difficulties there
05:40 25 for a few years. So that's what reduced my harvest

AK/RET REPORTING, RECORDS & VIDEO, INC.

1 schedule from November to my appraisal schedules.

2 Q. Did the change in your harvest levels have
3 anything to do with you being retained to do an appraisal
4 on this property for the for the schedule?

05:41 5 A. None whatsoever.

6 Q. And there was a lot of talk about prices during
7 your examination. I just want to go back to that a

8 little bit. If you could put up Defendant's Exhibit 83,
9 which as you will recall was the chart of the SBE prices.
05:41 10 And while we're getting the chart up, can you just
11 explain how SBE prices are determined?
12 A. SBE prices are used or developed for the
13 purpose of paying taxes. And so they want to develop
14 what is the stumpage value, so they estimate what -- they
05:41 15 get the reported values and the reported volume cost and
16 they back out the collected data to what the value of
17 return to the owner is going to be, the revenue back to
18 the owner.
19 And then those are the prices reported,
05:42 20 basically lagged back for the previous six months. And
21 so it's rolling sort of backward looking at a six month
22 average that they calculate for the SBE, but they've
23 already taken out the logging and hauling costs.
24 Q. And I'm looking at this chart. This date says
05:42 25 January 1st, 2008 through June 30th, 2008?

AK/RET REPORTING, RECORDS & VIDEO, INC.

348

1 A. Right.
2 Q. Do you know, based on your work in the
3 industry, what information the State the Board of
4 Equalization had when they developed this chart for SBE
05:42 5 prices for that time period?
6 A. So these are the numbers that are going to be
7 used to derive your taxes on for the first half of 2008,
8 but they're actually the backward looking prices that
9 were reported in 2007, and it's a rolling average.
05:42 10 Q. Okay. So if I understood you correctly, just
11 taking a look at the redwood column --
12 A. Yes.
13 Q. -- the prices shown there would not reflect the
14 current market prices; is that correct?
05:43 15 A. No.
16 Q. They would reflect the market prices in the

17 second half of 2007?

18 A. Primarily, yes.

19 Q. And just to make it clear, I think you

05:43 20 testified before. What has been the change in prices

21 since late 2007 until now?

22 A. Prices are off probably \$100 per thousand for

23 today based on today prices looking back to the fall of

24 '07.

05:43 25 Q. And so just as an example, again looking at the

AK/RET REPORTING, RECORDS & VIDEO, INC.

349

1 chart, for the redwood 150 to 300 volume per log, do you

2 see the price in area one is 820?

3 A. Correct.

4 Q. Based on your experience, what would roughly

05:43 5 the current market price be for that category?

6 A. It would be probably 720.

7 Q. Now, why did you use the Pacific Rim prices in

8 doing your analysis?

9 A. Well, I felt that they were reliable because

05:44 10 that's what log buyers are paying for logs. And so other

11 owners -- I mean, other owners are selling their logs in

12 the marketplace and these mills are buying them. And so

13 it's the most reflective transaction price and it's a

14 good source of monthly data, so you can get a little

05:44 15 broader spectrum. This SBE only comes out twice a year,

16 so it's rather choppy, where the Pacific Rim Wood Market

17 comes out on a monthly basis.

18 Q. And what was the difference between the SBE

19 prices and the Pacific Rim prices?

05:44 20 A. You have to adjust the SBE prices up for costs,

21 but there's about five or ten percent difference. The

22 SBE tends to be higher.

23 Q. Now, in terms, again, of the harvesting, there

24 was some questions about your decision or your modelling

05:45 25 that indicated that in the near term you weren't cutting

1 Douglas Fir. Do you recall that?

2 A. Correct.

3 Q. Can you explain to the Court why it is that
4 your models do not propose cutting a significant amount
05:45 5 of Douglas Fir in the first few years?

6 A. Currently Douglas Fir prices are \$375. They're
7 probably under \$400 per thousand. And as was pointed
8 out, the cost basis for the harvesting is in excess of
9 \$400 a thousand board foot. So the harvest of Doug Fir
05:45 10 is a negative cash flow.

11 And on the property when you cut one acre of
12 redwood, you're going to get a certain percentage,
13 depending on where you are of these other species. But
14 you want to minimize stands that have Douglas Fir in them
05:45 15 and have stands that are higher redwood concentration
16 now. Later when prices recover, you go back and cut the
17 Douglas Fir stand.

18 Q. How do the current Douglas Fir prices compare
19 to the historical prices of Douglas Fir?

05:46 20 A. They're at historic all-time lows.

21 Q. Do you know if the Scotia mill is currently
22 milling Douglas fir?

23 A. No. It's only cutting redwood, and they're
24 selling on the open market their Douglas Fir and redwood.

05:46 25 Q. So to the extent Scopac or any new owner of the

1 property would harvest Douglas Fir now, they would not
2 mill it now, but try to sell it in the open market; is
3 that what you're saying?

4 A. Right. And they would be losing money.

05:46 5 Q. And they would be losing money. Now, there was

6 some discussion about inventory, and I just want -- what
7 I want to do is clarify something. You took -- if I
8 understood you correctly, you took the inventory that
9 Scopac provided to you as of January 1st, 2007; is that
05:47 10 correct?

11 A. Correct.

12 Q. Did you make any adjustments to that inventory
13 for your valuation date of April 2008?

14 A. I made a review of the harvest that occurred
05:47 15 over 2007 and the model growth rates that I was getting
16 out of that and calculated that they were approximately
17 the same. And so I did not make a material adjustment to
18 the inventory, but I have to also say that I requested
19 data from the company, was never received any 1108 type
05:47 20 data.

21 Q. Did you -- so did you reach a conclusion that
22 no adjustment was necessary in the inventory because the
23 growth approximated the harvest?

24 A. Yes. And for a long-term modeling project,
05:47 25 that wasn't a material difference. It would be less than

AK/RET REPORTING, RECORDS & VIDEO, INC.

352

1 the -- just points of percent difference in the overall
2 inventory.

3 Q. If, for example, the information you received
4 from the company had shown that the growth rate in the
05:47 5 last year was significantly higher than the harvest,
6 would you have made an adjustment to the inventory for
7 that?

8 A. I may have made some adjustment if it was
9 significantly higher, but again, if you're only looking
05:48 10 at five or ten million feet difference comparing that to
11 3 billion, it's such a small percentage that it's really
12 a trivial issue to the overall valuation.

13 Q. Now, you used a 50-year model. Can you explain
14 why it is that you feel that that's more appropriate than

05:48 15 a ten-year model?

16 A. Trees grow on anywhere from 45, 55 years on a
17 rotation basis. So by forecasting over a full rotation,
18 you can see what the property can do biologically. And
19 we also find out whether there are age class gaps or

05:48 20 significant problems with availability. This property
21 has a large component of young acres, which kind of push
22 through the system in about 30 years. And so by modeling
23 over a long period of time, you get to see this dynamic.
24 And the value or the harvest levels change over time and
05:49 25 you can reflect that. And that's why it's important to

AK/RET REPORTING, RECORDS & VIDEO, INC.

353

1 model over a long period of time for tree growth.

2 Q. Is there an industry standard in terms of
3 modeling for timber harvest and timber growth?

4 A. There's not a single standard, but my industry
05:49 5 perspective has been that all the owners that I work for
6 do 50-year forecasts, so I do that also.

7 Q. Do you know what Scopac has done in the past?

8 A. For their modeling?

9 Q. Yes.

05:49 10 A. Yes, they're doing like 50-year forecasts also.

11 Q. Why did you determine in run 1 to use 60
12 million board feet as the initial harvest level?

13 A. Again, looking at new owners coming in, they're
14 going to have to go through a lot of planning and also
05:50 15 get to work with the regulatory agencies and create their
16 own sort of environment for working. And so run 1 and 2
17 were to look at the sensitivity of starting -- a company
18 coming in and starting a harvest level and not being --
19 cutting just the maximum biological potential, but

05:50 20 allowing them to get their feet on the ground, understand
21 the forest better, and also reduce them out of
22 contentious sort of harvest that Scopac has experienced.

23 Q. Now, your run 3 calculated the maximum harvest

24 possibility, right?

05:50 25 A. Correct.

AK/RET REPORTING, RECORDS & VIDEO, INC.

354

1 Q. Okay. And that was 73 million board feet?

2 A. Yes. Yeah.

3 Q. And what factors contributed to the

4 determination, I guess, by the model that 73 million

05:50 5 board feet was the maximum sustainable harvest under run

6 3 in the first few years?

7 A. Again, it's a non-declining harvest level, and

8 so it had to calculate a level that it could cut over

9 time that would not decline. And also a key ingredient

05:51 10 for sustained yield planning, which the state regulates

11 all these forests for, is that you don't have declining

12 soft wood inventory. So one of the big constraints in

13 the model was to maintain the current level of soft wood

14 inventory over time.

05:51 15 And so it knows how much volume. And every

16 year, over the 50 years that's available. And so you can

17 have a harvest rate higher with non-declining, but your

18 soft wood inventory might dump off in year 40 or 50. And

19 again, it wouldn't be sustainable with soft wood

05:51 20 inventory, which is a requirement of the sustained yield

21 planning in the state of California.

22 Q. So if you didn't follow that same yield plan,

23 you would be violating the governmental regulations?

24 A. It wouldn't be a feasible plan if you didn't

05:51 25 follow the regulations versus a new plan.

AK/RET REPORTING, RECORDS & VIDEO, INC.

355

1 Q. And your model complies with the environmental
2 regulations?

3 A. Yes. That's what I was trying reproduce.

4 Q. And have you reviewed Mr. Fleming's appraisal?
05:52 5 You said you had, right?
6 A. Yes.
7 Q. Do you have an opinion as to whether his
8 harvest rates comply with the requirements of the state
9 regulation?
05:52 10 A. Yes, I do. His modeling or his analysis, which
11 it's not really modeling, would not stand the test for
12 any sustained yield plan by the state of California, so
13 it's really not a feasible harvest level.
14 Q. Now, there was some discussion of costs, and
05:52 15 the Judge instructed me to ask you a question, so I'm
16 going to do that. You were asked about the fixed cost.
17 And can you just pull up in your report what page that
18 was on.
19 A. Let me just see. My detail DCF output is on
05:53 20 page 88, which is just after page 87, but there's no
21 number on it. For run 1 I break out the operating
22 expenses and the total costs towards the bottom of my
23 DCF. And you'll see that my total expense is about \$17
24 million for the first year, and then it trends down.
05:53 25 And part of the reason it's trending down is

AK/RET REPORTING, RECORDS & VIDEO, INC.

356

1 that we're working off that backlog of THP property. And
2 so you'll notice that the total cost actually goes down,
3 too. But particularly the expense line, which is sort of
4 a fixed cost of management. I'm actually less dollars
05:53 5 than Fleming is in those early years.
6 Q. Now, I just want to go back to the question you
7 were being asked. You have a number of \$476 for four
8 foot. Do you recall that, fixed costs?
9 A. Yeah.
05:54 10 Q. Now, you said that was true only in year one.
11 Can you explain how that changes over time in your model?
12 A. Right. Because they're using the current

13 harvest level, which is lower, which makes my average
14 fixed cost per unit higher. So as you go out over time,
05:54 15 my fixed cost per unit is actually going to be getting
16 lower as the harvest rate steps up. And so it will
17 actually be lower than Mr. Fleming's estimate.
18 Q. Were your total expenses over the course of the
19 50 years higher or lower than Mr. Fleming's?
05:54 20 A. Generally they were similar, but lower.
21 Q. In talking about the prices, you indicated that
22 the last ten years was the relevant time period to look
23 at in terms of price trends. Can you explain why that's
24 your view?
05:55 25 A. There's been a lot of economic changes to the

AK/RET REPORTING, RECORDS & VIDEO, INC.

357

1 marketplace. And in all wood products, a cost of a board
2 is based on what it sells for in the marketplace, okay.
3 So whether it's fencing or decking. And so after you
4 convert it, you go back to a log price, and so the log
05:55 5 price is always based on what that end product eventually
6 sells for, okay.
7 And so in the last ten years, there have been
8 many more replacements for specialty products in decking.
9 We have Trex and treated wood and all sorts of other
05:55 10 replacement products, so the price of -- as soon as the
11 price increases high enough, these alternative uses come
12 in. And so it keeps -- it's basically flattened out the
13 price of the redwood on the long haul.
14 And so if you look at the last ten years where
05:55 15 there's been a lot more competition for especially
16 products like decking and fencing, the pricing has been
17 virtually flat. And so in an economic forecast going
18 forward, I don't anticipate redwood prices -- again, they
19 recover in the first three years, but then they stay flat
05:56 20 because there's no real demand on the other side to
21 increase product prices.

22 Q. So if I understand, you're going back more than
23 ten years. There weren't sufficient competitive
24 prices -- competitive products to keep the prices down?
05:56 25 A. Yeah. If you look back at the previous prices,

AK/RET REPORTING, RECORDS & VIDEO, INC.

358

1 there were a lot of specialty products and other things
2 that were not competitive, but now with the second growth
3 redwood, there's lots of competitive products, which
4 keeps that price flat.
05:56 5 Q. I want to look at the comparable sales
6 approach. Did your comparative sales analysis reach a
7 similar conclusion as to value as your income approach?
8 A. Yes, it did.
9 Q. Now, Mr. Clement suggested that you were double
05:56 10 counting by taking a deduction in your sales comparison

11 approach?

12 A. Yes.

13 Q. Do you agree with that?

14 A. No.

05:56 15 Q. Can you explain why that's not correct?

16 A. In that first table, I'm trying to show --

17 Q. Can you indicate what page?

18 A. On page 64, which was the table that

19 Mr. Clement was showing. The green line there says

05:57 20 subject property. It shows the site class two in

21 regional one using a --

22 THE COURT: What page are you on?

23 THE WITNESS: 64, sir.

24 THE COURT: Go ahead. Gotcha.

05:57 25 A. Again, the sale date, the available volume in

AK/RET REPORTING, RECORDS & VIDEO, INC.

359

1 acres and volume per acre. Because really that's what a

2 buyer is going to look at when they buy this property.
3 This extra volume that's not harvestable doesn't have the
4 same significant value. So the statistic I really was
05:57 5 looking at particularly is that 13.8. That's what
6 someone is going to go and operate this farm and the
7 volume per acre, average volume per acre.

8 So the adjustments I'm making are based on --
9 and also the species mix of the 2.8 billion feet, that's
05:58 10 the other significant portion there, is the species mix
11 of the 2.8 is really what you're going to get, not the
12 species mix from the total forest. Because, again, that
13 restricted no harvest volume is primarily like an old
14 growth redwood, so it's a higher percentage of redwood,
05:58 15 which is not really representative of what a potential
16 buyer is going to get. They're going to be living on
17 those available acres.

18 Q. Now, you also took an adjustment for the fact
19 that the current property -- the subject property of
05:58 20 Scopac is subject to an HCP, correct?

21 A. Correct.

22 Q. Now, were there any other deductions in your
23 modeling for that same fact of the HCP?

24 A. Comparable sales approach, no. I go through
05:58 25 and derive a price and then apply this HCP reduction to

AK/RET REPORTING, RECORDS & VIDEO, INC.

360

1 get my final conclusion of value.

2 Q. Why is it necessary in a comparable sales
3 approach to do an HCP adjustment?

4 A. Because the properties -- all the other
05:59 5 properties weren't subject to HCPs, and particularly the
6 large properties that were sold, quite as many as ten
7 years ago, were not in the same regulatory environment as
8 this property is today. So to make it more -- to make it
9 comparable, you've got to make some adjustment.

05:59 10 Q. Now, you were also asked at the very end of

11 your cross-examination about whether somebody came in
12 with a quote "rock solid offer" of \$603 million, whether
13 that would be a likely price -- or likely buyer and a
14 probable price. Do you remember that testimony?

05:59 15 A. Yes.

16 Q. Now, I think you said that that would not be,
17 in your opinion as an expert appraiser, a market value
18 price; is that correct?

19 MR. CLEMENT: Objection, Your Honor,
05:59 20 that's completely leading.

21 THE COURT: What is your objection?

22 MR. CLEMENT: Leading.

23 THE COURT: He's what?

24 MR. CLEMENT: Leading, Your Honor.

06:00 25 THE COURT: Don't lead the witness.

AK/RET REPORTING, RECORDS & VIDEO, INC.

361

1 MR. SCHWARTZ: Thank you, Your Honor.

2 Q. (By Mr. Schwartz) Why did you testify that
3 that would not be a market value price?

4 A. Again, it wouldn't be a market price because
06:00 5 it's not an arm's length transaction between
6 disinterested parties. So it would be a value, it would
7 be a data point out there. But if I was doing a
8 comparable sales analysis, I would go look at the terms
9 and circumstances and related parties, and I would most
06:00 10 likely have to make an adjustment of that sales price to
11 a market price because I think Mr. Clement was referring
12 to the Biel offer.

13 Q. And you testified just now that it wasn't a
14 disinterested party. Can you explain what you meant by
06:00 15 that?

16 A. Well, the fact that Biel has a significant
17 ownership of the notes means that his value that he's
18 buying is to protect the value of his timber notes, and
19 not necessarily the true value of the property. It's all

06:01 20 based on this transaction of bankruptcy. So it's not a
21 disinterested or arm's length transaction.

22 Q. What impact, if any, would it have in your
23 determination of whether it's a market price if there
24 were contingencies that would allow the potential buyer
06:01 25 to walk away from the transaction?

AK/RET REPORTING, RECORDS & VIDEO, INC.

362

1 A. It would discount the price significantly.

2 MR. SCHWARTZ: I have no further
3 questions, Your Honor.

4 THE COURT: All right. You can step down.

06:01 5 MR. CLEMENT: Your Honor, I believe your
6 ruling is you don't want recross?

7 THE COURT: Right.

8 MR. CLEMENT: I will be happy to do more,
9 but I will abide by the rule.

06:01 10 THE COURT: You can step down. We have
11 reached a point of saturation with me so it's 6 o'clock.

12 MR. HALE: Your Honor, before we lose you
13 for the evening, can we address one issue? And that
14 would be the deposition of Mr. Dean very quickly.

06:01 15 THE COURT: So I can tell that -- I mean,
16 how much -- how many hours do you think you need to
17 depose Mr. Dean? You've already deposed him once, so
18 you're the -- you're the man. What do you think.

19 MR. KRUMHOLZ: Well, it's all the opinions
06:02 20 that we've never deposed him on. I think it's going to
21 take six hours.

22 MR. HALE: Your Honor, they already had a
23 full day. That was after the disclosure statement had
24 come out.

06:02 25 THE COURT: Why don't you start tomorrow

AK/RET REPORTING, RECORDS & VIDEO, INC.

363

1 at 8:00.

2 MR. HALE: Your Honor, our preference
3 would be to get it done tonight and start at 8:00 and go
4 until midnight.

06:02 5 THE COURT: You want to start tonight?

6 MR. HALE: Your Honor, we don't want to
7 break it up. That's the only thing we don't want to do.

8 THE COURT: You don't want to break it up?

9 MR. KRUMHOLZ: Tell me when it's my turn.

06:02 10 MR. HALE: Between tonight and tomorrow
11 morning. And also, Mr. Cherner is coming in tomorrow
12 morning, the Biel deposition, so we'd like to be able to
13 do Mr. Biel tomorrow.

14 THE COURT: Can't we divide up the lawyers
06:02 15 on those two depositions tomorrow morning? I think
16 everybody is well enough represented. I would think -- I
17 don't know. The other thing that probably ought to be
18 done starting tomorrow is to see if there's some way that
19 these two tables can come to some agreement. I don't
06:03 20 know that there is. But there are risks on both sides of
21 this table.

22 There's a great deal of pressure to
23 confirm this plan, no question about that. On the other
24 hand, there are some legal arguments that you can have
06:03 25 why they're not confirmable. And if you persuade me on

AK/RET REPORTING, RECORDS & VIDEO, INC.

364

1 those, of course, then perhaps your plan is confirmable,
2 perhaps there are other ways it can go. But if you don't
3 persuade me on those, then we've got a bunch of
4 litigation that continues on at different levels, I
06:03 5 suspect.

6 And if your -- I mean, the two appraisals
7 apparently -- not the two appraisals. The purchase price
8 from your Biel Bank is it's not that far from the

9 appraisal price of the experts on this side. I don't --
06:03 10 I don't know if there's room for you-all to somehow
11 negotiate and figure out a way to settle between these
12 two tables. I don't know. I'm not suggesting the debtor
13 is totally out of this, but it doesn't look like there's
14 a lot of equity in this case.

06:04 15 MR. KRUMHOLZ: Your Honor, just to --

16 THE COURT: So some discussion about that
17 ought to happen. I don't know if it will get anywhere,
18 but some discussion about that ought to happen. So
19 there's no way that you're going to start the deposition
06:04 20 and finish it tonight. I can't imagine you're going to
21 do that. I mean, unless you guys are just made of steel.
22 I can't imagine. You've sat through this all day and now
23 you're going to go depose somebody for eight hours
24 tonight or six hours tonight or three hours tonight.

06:04 25 MR. KRUMHOLZ: Can I make a suggestion,

AK/RET REPORTING, RECORDS & VIDEO, INC.

365

1 Your Honor? I would like to start after an hour break
2 for dinner essentially, hour and a half break for dinner,
3 and then go until a reasonable hour tonight and then
4 begin in the morning. The reason why I suggest is
06:04 5 because we need to use some of the transcript in
6 connection with the cross-examination of this gentleman
7 tomorrow. You can't really use a transcript that you get
8 tomorrow late morning in a cross-exam for tomorrow
9 afternoon. So if we can have a reasonable amount of time
06:05 10 tonight and then start back early tomorrow, then that
11 would work best.

12 MR. HALE: Your Honor, that presents lots
13 of logistical difficulties. Mr. Dean will probably
14 testify tomorrow afternoon. We have to get a court
06:05 15 reporter, make all those arrangements.

16 MR. KRUMHOLZ: We've got a court reporter.

17 THE COURT: They've got a court reporter.

18 So can you -- it looks like you're suggesting you start
19 at 7:30 tonight, if we get out of here quickly. And I
06:05 20 can't imagine going any later than 10:00 tonight.

21 MR. KRUMHOLZ: We'll go as late as
22 possible. We'll go as long as the Court will allow.

23 MR. BRILLIANT: Your Honor, Alan Brilliant
24 also on behalf of Mendocino. The first thing is, Your
06:05 25 Honor, a lot of people here aren't ordinarily on central

AK/RET REPORTING, RECORDS & VIDEO, INC.

366

1 time. Mr. Dean, you know, came from California, San
2 Francisco.

3 THE COURT: It's not nearly as late.

4 MR. BRILLIANT: Right now it's not as
06:06 5 late, but for him to be deposed tonight and then be
6 deposed again tomorrow morning, when it will be very
7 early, it will be very difficult for him.

8 THE COURT: I don't see how you can -- I
9 mean, I don't know how you can go very late tonight and
06:06 10 start early tomorrow. That's going to be very difficult.

11 MR. BRILLIANT: The other thing, Your
12 Honor, is Mr. Dean has never testified in court before.
13 Other than in this case, he's never been deposed. You
14 know, he is the chairman of the board, the former CEO of
06:06 15 Mendocino. He is not an expert witness, professional
16 witness. This is not, you know, something he does all
17 the time and we don't want to put him on the stand after,
18 you know, a lengthy period of time we've been deposing
19 him, tonight, tomorrow and then have to go on the stand.
06:06 20 It's just not going to work for us.

21 THE COURT: Well, I think those concerns
22 are probably less. I mean, we don't have a jury that
23 you're going to have to impress tomorrow. And I'll
24 probably be more impressed by the fact that he has taken
06:06 25 all those depositions and still here. So I don't know

1 that that hurts you, quite honestly. But that's your
2 call. But I think we've got to get the deposition done.
3 So you-all need to figure out the best way to get it done
4 between now and tomorrow morning so we can start up with
06:07 5 Mr. Dean at 2 o'clock. I think that's who you want to
6 call; isn't that right?

7 MR. BRILLIANT: It is, Your Honor. I
8 think the issue really is how many hours. He's already
9 sat for an entire day. And if they're saying they have
06:07 10 to have another seven hours, then logistically I don't
11 see how, Your Honor, he's going to be able to testify
12 tomorrow.

13 THE COURT: If you start at 7:30 tonight
14 and go until 10:00, that's two and a half hours. Then if
06:07 15 I give you another two and a half hours tomorrow morning
16 at a reasonable time period, that's a total of five
17 hours. I can't imagine you need more than that.

18 MR. KRUMHOLZ: I mean --

19 THE COURT: So go do that, make that work.
06:07 20 And start as late as you can tomorrow.

21 MR. HALE: Thank you, Your Honor.

22 THE CSO: All rise.

23

24

25

1 THE STATE OF TEXAS:

2 COUNTY OF NUECES:

3

4 I, SYLVIA KERR, Certified Shorthand Reporter in and
5 for the State of Texas, do hereby certify that the facts
6 stated by me in the caption hereto are true; that the

7 foregoing proceedings were taken by me in Stenograph and
8 later transcribed from Stenograph to typewriting under my
9 supervision.

10 I further certify that I am neither attorney or
11 counsel for, nor related to or employed by any of the
12 parties to the action in which this deposition is taken,
13 and further that I am not a relative or employee of any
14 attorney or counsel employed by the parties hereto, or
15 financially interested in the action.

16

17 WITNESS MY HAND, this the _____ day of
18 _____, 2008.

19

20

21

22

SYLVIA KERR, Texas CSR #4776
Date of Expiration: 12/31/08
Ak/Ret Reporting, Records & Video
555 North Carancahua, Suite 880
Corpus Christi, Texas 78478
(361) 882-9037

23

24

25

AK/RET REPORTING, RECORDS & VIDEO, INC.