

No. 08-27

**IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

**The Bank of New York Mellon Trust Company, N.A. (f/d/a The Bank of
New York Trust Company, N.A.), as Indenture Trustee, *et al.***

Appellant-Petitioner,

v.

**Marathon Structured Finance Fund L.P., Mendocino Redwood Company
LLC, and The Official Committee of Unsecured Creditors,**

Appellees-Respondents.

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

**CALIFORNIA STATE AGENCIES' OPPOSITION
TO EMERGENCY MOTION FOR STAY AND INJUNCTION
FILED BY INDENTURE TRUSTEE**

Michael W. Neville (CA SBN 96543)
Deputy Attorney General
Office of the Attorney General
455 Golden Gate Avenue, Suite 11000
San Francisco, CA 94102-7004
Telephone: 415.703.5523
Facsimile: 415.703.5480
Email: Michael.Neville@doj.ca.gov

Steven H. Felderstein (CA SBN
056978)
Paul J. Pascuzzi (CA SBN 148810)
Felderstein Fitzgerald
Willoughby & Pascuzzi LLP
400 Capitol Mall, Suite 1450
Sacramento, CA 95814-4434
Telephone: 916.329.7400
Facsimile: 916.329.7435
Email: sfelderstein@ffwplaw.com
ppascuzzi@ffwplaw.com

Attorneys for Appellees-Respondents the California Resources Agency,
California Department of Fish and Game, the California Department of Forestry
and Fire Protection, the California Regional Water Quality Control Board,
North Coast Region, the California State Water Resources Control Board, and
the California Wildlife Conservation Board

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

(1) 08-27: *The Bank of New York Mellon Trust Company, N.A. (f/k/a The Bank of New York Trust Company, N.A.), as Indenture Trustee, et al. vs. Marathon Structured Finance Fund L.P., Mendocino Redwood Company LLC, and The Official Committee of Unsecured Creditors*

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

Appellees-Respondents

Counsel

Marathon Structured Finance Fund L.P.

David Neier
William Brewer
Steven M. Schwartz
Carey D. Schreiber
Winston & Y Strawn, LLP
New York, New York

Eric E. Sagerman
Los Angeles, California

John D. Penn
Haynes & Boone, LLP
Fort Worth, Texas

Trey Monsour
Haynes & Boone, LLP
Dallas, Texas

Mendocino Redwood Company LLC

Craig P. Druehl
Allan S. Brilliant
Brian D. Hail
Goodwin Procter LLP
New York, New York

Patrick Thompson
Goodwin Procter LLP
San Francisco, California

The Official Committee of Unsecured Creditors

Maxim B. Litvak
John D. Fiero
Kenneth H. Brown
Pachulski Stang Ziehl Young Jones & Weintraub
San Francisco, California

Appellant-Petitioner

Counsel

The Bank of New York Mellon Trust Company, N.A., as Indenture Trustee (f/k/a The Bank of New York Trust Company, N.A.)(publicly held parent company of The Bank of New York Mellon Corp., a Delaware corporation)

William Greendyke
Zack A. Clement
R. Andrew Black
Johnathan C. Bolton
Fulbright & Jaworski LLP
Houston, Texas

Louis R. Strubeck, Jr.
O. Rey Rodriguez
Toby L. Gerber
Fulbright & Jaworski LLP
Dallas, Texas

Noteholder Appellants¹

Counsel

Angelo, Gordon & Co. L.P.

Aurelius Capital Management, LP

Davidson Kempner Capital Management LLC

Isaac M. Pachulski
Jeffrey H. Davidson
Eric D. Winston
Stutman Treister & Glatt P.C.
Los Angeles, California

No publicly held company directly or indirectly owns, controls, or holds, with power to vote, 10 percent or more of the outstanding voting securities of any of these Noteholder Appellants

Appellants

Counsel

Scotia Pacific Company, LLC

Kathryn A. Coleman
New York, New York

Craig H. Millett
Eric J. Fromme
Irvine, California

Aaron G. York
Dallas, Texas

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

Other Interested Parties

Bank of America, N.A., as agent for secured lenders to Scotia Pacific Company LLC

The California Resources Agency, California Department of Fish and Game, the California Department of Forestry and Fire Protection, the California Regional Water Quality Control Board, North Coast Region, the California State Water Resources Control Board, and the California Wildlife Conservation Board

Counsel

Evan M. Jones
Emily R. Culler
Brian M. Metcalf
Ana Acevedo
O'Melveny & Myers LLP
Los Angeles, California

Michael W. Neville
Deputy Attorney General
Office of the Attorney General
San Francisco, CA 94102-7004

Steven H. Felderstein
Paul J. Pascuzzi
Felderstein Fitzgerald
Willoughby & Pascuzzi LLP
Sacramento, CA 95814-4434

/s/ Paul J. Pascuzzi
Paul J. Pascuzzi
Attorney for The California State
Agencies

TABLE OF CONTENTS

TABLE OF AUTHORITIES	ii
INTRODUCTION	1
THE COURT SHOULD DENY THE STAY MOTION	6
A. Legal Standards for a Stay Pending Appeal.....	6
B. Substantial Harm Would Result to Third Parties if a Stay is Granted.	7
C. The Public Interest Would Not Be Furthered by the Granting of a Stay.	11
D. The Indenture Trustee is Not Likely to Succeed on the Merits of Any Appeal.....	13
E. The Indenture Trustee Will Not Suffer Irreparable Injury Without a Stay.	15
CONCLUSION.....	16

TABLE OF AUTHORITIES

Cases

<i>Arnold v. Garlock Inc.</i> 278 F.3d 426 (5 th Cir. 2001)	6
<i>In re Adelpia Communications Corp.</i> 361 B.R. 337 (S.D.N.Y. 2007)	6, 15
<i>In re Baldwin United Corp.</i> 45 Bankr. 385 (S.D. Ohio 1984)	15
<i>In re Blackwell</i> 162 B.R. (E.D. Pa. 1993).....	7
<i>In re Burkett</i> 279 B.R. 816 (Bankr. W.D. Tex. 2002)	14
<i>In re Calpine Corp.</i> 2008 WL 207841 (Bankr. S.D.N.Y. Jan. 24, 2008)	6
<i>In re Charter Co.</i> 72 Bankr. 70 (M.D. Fla. 1987)	15
<i>In re Delaware & Hudson Ry. Co.</i> 90 B.R. 90 (Bankr. D. Del. 1988).....	2
<i>In re First South Sav. Ass'n</i> 820 F.2d 700 (5 th Cir. 1987)	6, 7
<i>In re Great Barrington Fair and Amusement, Inc.</i> 53 B.R. 237 (Bankr. D.Mass. 1985).....	2
<i>In re Irwin</i> 338 B.R. 839 (E.D. Cal. 2001)	6, 7, 15
<i>In re Jet 1 Center</i> 2006 U.S. District LEXIS 9180 (M.D. Fla. 2006)	6
<i>In re Permian Producers Drilling, Inc.</i> 263 B.R. 510 (W.D. Tex. 2000)	7

<i>In re Sullivan</i>	
2006 U.S. Dist. LEXIS 43734 (E.D. Cal. 2006)	7
<i>In re Target Graphics, Inc.</i>	
372 B.R. 866 (E.D. Tenn. 2007)	6, 7
<i>In re Wymer</i>	
5 B.R. 802 (9 th Cir. BAP 1980)	6
<i>In the Matter of 203 North LaSalle Street Partnership</i>	
190 B.R. 595 (N.D. Ill. 1995).....	15
<i>Lynch v. Cal. PUC</i>	
2004 U.S. Dist. LEXIS 6022 (N.D. Cal. 2004).....	6, 7
<i>S.C. of Okaloosa, Inc. v. Brignac</i>	
2006 U.S. Dist. LEXIS 57187 (W.D. La. Aug. 14, 2006)	15
<i>Sierra Club, Lone Star Chapter v. Cedar Point Oil Co.</i>	
73 F.3d 546 (5 th Cir. 1996)	7
<i>Smith v. Schmidt</i>	
2007 U.S. Dist. LEXIS 41901 (S.D. Tex. June 8, 2007)	14
<i>United States v. Texas</i>	
523 F. Supp. 703 (E.D. Tex. 1981)	6
<i>Universal Life Church, Inc. v. United States</i>	
191 B.R. 433 (E.D. Cal. 1995)	6

Statutes

11 U.S.C. § 1129	14
28 U.S.C. § 959	5, 12
Cal. Wat. Code section 13340.....	4

The California Resources Agency, the California Department of Forestry and Fire Protection, the California Department of Fish and Game, the California Wildlife Conservation Board, the California Regional Water Quality Control Board, North Coast Region, and the State Water Resources Control Board (collectively, the “California State Agencies”) hereby file this opposition to the Indenture Trustee’s emergency motion for a stay of the confirmation order pending appeal, which has already been denied by the Bankruptcy Court and the District Court, based on the following.

INTRODUCTION

1. After almost two weeks of trial on the confirmation of competing plans for these cases, the Bankruptcy Court came to the correct result: confirmation of the MRC/Marathon Plan and denial of confirmation of the Indenture Trustee Plan. The Bankruptcy Court recognized the relatively straightforward issue in this case, the value of the timberlands, and made its ruling based on the factual testimony presented. The unsuccessful parties, the Indenture Trustee, Scopac and certain noteholders, now seek a stay pending appeal after being denied a stay for good reasons by the Bankruptcy Court and the District Court. See Findings of Fact and Conclusions of Law on the Emergency Motion of the Indenture Trustee for Stay Pending Appeal and the Petition for Direct Appeal to the Fifth Circuit Court of Appeals (“Stay Motion Decision”) (Bankruptcy Court Docket No. 3381); and Order Denying Motion for Stay Pending Appeal (“District Court Denial”) (District Court Docket No. 53).¹ The California State Agencies respectfully submit that no stay should issue and the MRC/Marathon Plan should be implemented as soon as possible.

¹ The District Court denied the Indenture Trustee’s stay motion because the Indenture Trustee obtained certification of a direct appeal to this Court and believed it “presumptive and inconsistent” for the District Court to “intrude itself in the appellate process.” See District Court Denial at page 2-3.

2. California Governor Arnold Schwarzenegger filed a statement of position prior to the filing of competing plans in these cases outlining why the outcome of this case is of great importance to the people of the state of California:

“My administration, through the California Resources Agency, the California Environmental Protection Agency and their boards and departments, has been active in the Pacific Lumber Company bankruptcy case to protect the investment that California made in the historic 1999 Headwaters Forest Agreement and to protect the environment and all of our state’s natural resources. As California’s Governor, I have an interest in the future of the debtors’ lands and related assets located in Humboldt County, California. These lands and assets represent a unique public trust for the people of California. Pacific Lumber Company made assurances in 1999 for the future management of its lands that, as part of the Headwaters Agreement, included the expenditure of nearly \$500 million of federal and state public funds. The United States and the people of California have a strong interest in a successful reorganization of a Pacific Lumber Company that will result in sound management practices for the future of these lands.”

See State of California’s Position by Governor Arnold Schwarzenegger for Proposed Plans of Reorganization, Bankruptcy Court Docket No. 2201, attached as Exhibit 1 to the California State Agencies’ Appendix to Opposition to Emergency Motion for Stay and Injunction Filed by Indenture Trustee (“CSA Appendix”).

3. An enormous problem for the Indenture Trustee is that irreparable injury would occur if the MRC/Marathon Plan is not implemented as soon as possible. There is a significant risk that the MRC/Marathon Plan would be withdrawn if a stay is issued since the plan fails if it does not go effective within 60 days of confirmation. Stay Motion Decision ¶ 20. If the MRC/Marathon Plan is withdrawn, the most likely outcome is that the Debtors would be liquidated. Where the debtor’s ability to reorganize is threatened, public policy would not be served by granting a stay. See, e.g., *In re Delaware & Hudson Ry. Co.*, 90 B.R. 90, 91-92 (Bankr. D. Del. 1988) (finding that public harm would result from a stay pending appeal because the stay would foreclose the debtor’s ability to reorganize); *In re Great Barrington Fair and Amusement, Inc.*, 53 B.R. 237, 240-41 (Bankr.

D.Mass. 1985) (“[I]f a stay is granted, the other interested parties, as well as the public, will suffer harm. The chief harm which will be caused by a stay is the delay which will be suffered by the other creditors.”). This result would allow the Indenture Trustee to obtain the relief it seeks, blocking the implementation of the MRC/Marathon Plan, without winning on the merits of the appeal.

4. A further stay also will have disastrous consequences because of the Debtors’ financial situation. The evidence at the confirmation trial from testimony of the Debtors’ Chief Financial Officer showed that there will be continuing operating cash shortfalls through the summer months. See Trial Transcript May 1, 2008, pages 83-85, CSA Appendix 3 (noting Palco deficit of \$7 million for May-July; Scopac deficit of \$4 million in May and \$3 million per month from July to October). These shortfalls have come to fruition, as shown by the testimony at the stay motion hearing. Stay Hearing Transcript July 11, 2008, beginning page 309, lines 4-23, CSA Appendix 4 (“Absent free logs and a free DIP [debtor-in-possession loan], these debtors are cratering Palco may crater Scopac runs out of cash”).

5. The lack of sufficient operating funds during any stay means that the environment will be threatened by a stay. The Debtors are already failing to comply with their environmental obligations. See MMX 130, CSA Appendix 5 (Notice of Violation of Forest Practice Act with water overtopping railroad tracks and roads). **The California State Agencies are very concerned about this issue.** The loan offered by the Indenture Trustee simply does not work because it does not specifically include any funds for existing or future environmental law violations.

6. Further, the testimony at trial showed that there is a backlog of roadwork in the amount of \$14 million required by the Environmental Obligations (as defined in the MRC/Marathon Plan), including Timber Harvest Plans, the

Habitat Conservation Plan, and Water Board orders and permits. See Trial Transcript May 1, 2008, beginning page 95, line 13 to page 96, line 10, CSA Appendix 6. As noted above, this backlog is resulting in real harm to the environment and in violations of law. Until the MRC/Marathon Plan is implemented, it is unlikely that Scopac or any other party will begin clearing the \$14 million backlog of roadwork.

7. The public interest weighs heavily against a stay. The public interest, as stated by Governor Schwarzenegger, U.S. Senator Dianne Feinstein, other state and federal legislators, and county officials is furthered by immediate implementation of the MRC/Marathon Plan. The consequences of a stay are very disturbing. Palco's cash crisis is likely to result in the shutdown of the mill, the loss of valuable employees, the likely shutdown of the cogeneration plant and drastic effects on the local community from their shutdowns, the inability to perform Palco's environmental obligations, the harm to public health and safety, and the harm to Scopac. See Stay Motion Decision ¶ 23.²

8. The Indenture Trustee also fails on a key factor needed to obtain a stay pending appeal. Here, the Indenture Trustee cannot show the likelihood of success on the merits. While the outcome of this case is of great public importance to California, there were no novel legal issues involved in the Bankruptcy Court's

² Palco owns and operates a municipal wastewater treatment facility, and a steam electric power plant (power plant) for the town of Scotia that are regulated by Waste Discharge Requirements and National Pollution Discharge Elimination System (NPDES) permits for point source discharges to surface waters of the United States. These permits require Palco to at all times properly operate and maintain all facilities and systems of treatment and control (and related appurtenances) to assure compliance with water quality standards on the Eel River. Failure to treat discharges from these facilities would create a condition of pollution or nuisance, constituting an emergency requiring immediate action to protect the public health, welfare and safety. See Cal. Wat. Code section 13340. While discharges of toxic pollutants may not occur if the power plant halts operations, the threat of raw sewage discharge is likely if the people of the town of Scotia continue to flush their toilets. In that event, the Water Boards would request the Attorney General, under Water Code section 13340, to seek an immediate injunction.

ruling on the MRC/Marathon Plan or the Indenture Trustee Plan. As the Bankruptcy Court found, the decision turned primarily on the value of the Indenture Trustee's collateral. A factual finding, where the trial court observed the evidence firsthand and judged the credibility of witnesses, is rarely overturned on appeal. Thus, the Indenture Trustee cannot show a likelihood of success on the merits of any appeal of the confirmation order.

9. Monetary interests do not qualify as irreparable injury. Since the Indenture Trustee's financial interest is the only thing at stake in this matter if a stay is not granted, the Indenture Trustee cannot satisfy the second factor needed for a stay pending appeal. There will be no irreparable injury to the Indenture Trustee if a stay is denied.

10. No grounds for a stay pending appeal exist, with or without a bond. In terms of a bond amount if a stay is even considered, the Bankruptcy Court's ruling is correct. The Bankruptcy Court properly included \$9.5 million for potential environmental harm, in addition to the amounts necessary to protect MRC, Marathon and the creditors. Certainly, the bond amount should include any amounts needed for both Palco and Scopac to operate during any stay in compliance with all Environmental Obligations (as defined in the MRC/Marathon Plan). A stay also should be conditioned on continued compliance with all Environmental Obligations, since the Debtors should not be allowed to continue to operate if they are not complying with all applicable non-bankruptcy law as required by 28 U.S.C. § 959(b) (debtors-in-possession must "manage and operate the property in [their] possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.").

///

///

THE COURT SHOULD DENY THE STAY MOTION

A. Legal Standards for a Stay Pending Appeal.

11. A party seeking a stay pending appeal must show: (a) a substantial likelihood of success on the merits of the appeal; (b) irreparable injury if the stay is not granted; (c) the granting of a stay will not substantially harm other parties; and (d) the granting of a stay would service the public interest. *Arnold v. Garlock Inc.*, 278 F.3d 426, 438 (5th Cir. 2001) (citing *In re First South Sav. Ass'n*, 820 F.2d 700, 709 (5th Cir. 1987)). The Indenture Trustee must satisfy each of these factors in order to obtain a stay. *Arnold v. Garlock Inc.*, 278 F.3d at 438-39. The Bankruptcy Court found that the Indenture Trustee failed to establish any of these factors.

12. A stay pending appeal, similar to a preliminary injunction, is an “extraordinary” remedy, which should be “sparingly” granted only in limited circumstances. See *United States v. Texas*, 523 F. Supp. 703, 729 (E.D. Tex. 1981) (a stay pending appeal of a decision granting equitable relief interrupts the ordinary process of judicial review and postpones relief for prevailing party). Bankruptcy Rule 8005 governs a request for a stay pending appeal of an order confirming a plan of reorganization, and the decision whether to grant such a stay is discretionary. See, e.g., *In re Calpine Corp.*, 2008 WL 207841, at *4 (Bankr. S.D.N.Y. Jan. 24, 2008); *In re Adelpia Communications Corp.*, 361 B.R. 337, 346 (S.D.N.Y. 2007).

13. The Bankruptcy Court’s decision denying a stay pending appeal is reviewed for “an abuse of discretion.” *In re Jet 1 Center*, 2006 U.S. District LEXIS 9180, at *4 (M.D. Fla. 2006); *In re Target Graphics, Inc.*, 372 B.R. 866, 870 (E.D. Tenn. 2007); *In re Irwin*, 338 B.R. 839, 844 (E.D. Cal. 2006); *Lynch v. Cal. PUC*, 2004 U.S. Dist. LEXIS 6022, at *5 (N.D. Cal. 2004); *Universal Life Church, Inc. v. United States*, 191 B.R. 433, 437 (E.D. Cal. 1995); *In re Wymer*, 5

B.R. 802, 807 (9th Cir. BAP 1980). As the Fifth Circuit stated in an analogous context, “[w]e review a district court’s orders under [Fed. R. Civ. P.] 62(c) for abuse of discretion.” *Sierra Club, Lone Star Chapter v. Cedar Point Oil Co.*, 73 F.3d 546, 579 (5th Cir. 1996) (citations omitted). Moreover,

[d]iscretion will be found to have been abused when the judicial action is arbitrary, fanciful or unreasonable which is another way of saying that discretion is abused only where no reasonable man would take the view adopted by the trial court. If reasonable men could differ as to the propriety of the action taken by the trial court, then it cannot be said that the trial court abused its discretion.

In re Irwin, 228 B.R. at 844 (emphasis added) (quoting *In re Blackwell*, 162 B.R. 117, 119 (E.D. Pa. 1993)). The abuse of discretion standard is “highly deferential.” *In re Target Graphics, Inc.*, 372 B.R. at 870.

14. Further, the Bankruptcy Court's Findings of Fact cannot be overturned unless “clearly erroneous.” Fed. R. Bankr. P. 8013; *In re Permian Producers Drilling, Inc.*, 263 B.R. 510, 514 (W.D. Tex. 2000); *In re Blackwell*, 162 B.R. at 119; *Lynch v. Cal. PUC*, 2004 U.S. Dist. LEXIS 6022 at *5; *In re First South Savings Assn*, 820 F.2d 700, 711 (5th Cir. 1987); *In re Sullivan*, 2006 U.S. Dist. LEXIS 43734, *5 (E.D. Cal. 2006). A finding is clearly erroneous only if “although there is evidence to support it, the reviewing court is left with the definite and firm conviction that a mistake has been committed.” *In re First South Savings Assn*, 820 F.2d at 711 (citation omitted). The Bankruptcy Court's conclusions of law are reviewed *de novo*. Fed. R. Bankr. P. 8013; *In re Blackwell*, 162 B.R. at 119 (E.D.Pa 1993); *In re Sullivan*, 2006 U.S. Dist. LEXIS 43734 at *5; *In re First South Savings Ass'n*, 820 F.2d at 711; *Lynch v. Cal. PUC*, 2004 U.S. Dist. LEXIS 6022 at *5.

B. Substantial Harm Would Result to Third Parties if a Stay is Granted.

15. In an attempt to avoid addressing the important element of substantial harm to third parties and without citing any relevant authority, the Indenture

Trustee argued to the Bankruptcy Court and the District Court that only harm to Scopac's creditors should be considered. As the Bankruptcy Court correctly concluded, Scopac's creditors are not the only "third parties" affected by the MRC/Marathon Plan (i.e., Palco, Scopac, the people of the town of Scotia, the environment, the employees of Palco and Scopac, the vendors of Palco and Scopac, the people of Humboldt County, and the people of the State of California). Stay Motion Decision ¶ 19. By limiting its argument, the Indenture Trustee fails to address at all the substantial harm to third parties if a stay of the MRC/Marathon Plan confirmation order is granted.

16. As the Bankruptcy Court concluded, there is little question that a stay would create substantial harm not only to the Debtors' estates but also to the many third parties affected by the outcome of these cases. Stay Motion Decision ¶ 19. The immediate harms include:

- **Potential loss of the best solution for the Palco and Scopac estates.** Irreparable harm to the estates would result if MRC and Marathon either cannot or will not move forward with the plan if a stay is issued. The MRC/Marathon Plan provides that MRC has an absolute right to withdraw from the plan if a stay is in place 60 days following confirmation. Such a provision is not unusual or surprising since MRC has agreed to put over \$200 million into the plan. It cannot be put in abeyance for an uncertain period of time. Moreover, the Marathon DIP loan matures on August 6th, meaning Marathon can exercise its rights and remedies against Palco. Currently, the MRC/Marathon Plan provides a workable solution to these cases, providing for payments to creditors to which they have agreed (except the noteholders), management of the timberlands in accordance with all state and federal laws and permits, long term sustainable harvest levels while preserving and enhancing watershed and wildlife, minimal adverse impacts on the local economy and jobs, and maximizing greenhouse gas reduction benefits. In addition, the MRC/Marathon Plan provides for substantial distributions to creditors, which if the plan is lost, are unlikely to be obtained under a future plan or liquidation sales.
- **Irreparable harm to the environment.** Irreparable harm to the environment because of Scopac's and Palco's inability to fund their operations, including their obligations

to comply with all environmental laws, the Habitat Conservation Plan (“HCP”), the Timber Harvest Plans (“THPs”), and Regional Water Quality Control Board orders and permits. The evidence at confirmation demonstrated the enormous backlog in roadwork. Scopac’s CEO, Dr. Barrett, testified to \$14 million of roadwork backlog required by the Environmental Obligations. See Trial Transcript May 1, 2008, beginning page 95, line 13 to page 96, line 10 (CSA Appendix 6). The evidence at the stay hearing showed that this backlog is resulting in real harm to the environment, health and safety concerns, and in violations of law that could result in fines of over \$500,000. Stay Hearing Transcript July 10, 2008, beginning page 179, line 14 to page 183, line 8 (CSA Appendix 7). None of these costs are in the budget for the proposed DIP loan. Stay Hearing Transcript July 11, 2008, beginning page 181, line 24 to page 183, line 18 (CSA Appendix 8); MMX 130 (Notice of Violation of Forest Practice Act with water overtopping railroad tracks and roads) (CSA Appendix 5). Until the MRC/Marathon Plan is implemented, it is unlikely that either Scopac or any other party will begin clearing the \$14 million backlog of roadwork.

- **Real harm to real people in the Humboldt County community.** Palco and Scopac are out of money. Scopac may be able to operate by selling its logs on the open market, but not without further financing. Palco, however, cannot survive and has no ability to obtain further financing. The shutdown of the Palco mill would result in hundreds of people losing their jobs, with uncertain prospects for other employment. With the Humboldt County unemployment rate already higher than the state or national averages, the harm to the local community is substantial. Unemployment aside, if the Palco power plant is closed the impact is substantial. Not only will California’s electrical grid lose approximately 4 megawatts of available power in the crucial high demand summer time, but the integrated steam lines will not operate. This will leave hospitals, schools, churches, and many homes without steam to provide heat and operate key equipment. Moreover, Palco owns the town of Scotia, so it is obligated to provide water and sewer treatment and fire protection to the residents. Without water and sewer treatment and fire protection, substantial health and safety functions for an entire town will be gone. Stay Motion Decision ¶ 23.
- **Real harm to both the Palco and Scopac estates.** Palco reports that it is likely to run out of cash by the week of July 25. If a stay is imposed, Palco is likely to have to shut down the mill operations immediately, which would cause it to lose valuable employees. Palco might not be able to recover from such a loss. Palco also would lose many of its existing contracts and leases, causing a substantial amount of damages and potential claims against the Palco estate.

Palco's demise will affect Scopac significantly. Stay Motion Decision ¶ 25.

17. The certain fact of substantial harm to the environment, to the people of Humboldt County, to the state and local economy, and to the bankruptcy estates is clear. The Indenture Trustee cannot show otherwise. Instead, the Indenture Trustee offers a \$25 million Debtor in Possession loan ("DIP loan") over a year period and a "discount log" program to allegedly keep the status quo. There are numerous problems with the DIP loan and discount log program, including the following:

- Even with the DIP loan, the budget does not cover specifically the anticipated \$500,000 agreed fine for the Debtors' violations of several Clean Up and Abatement Orders. Stay Hearing Transcript July 11, 2008, beginning page 181, line 24 to page 183, line 18 (CSA Appendix 8).
- Even with the DIP loan, the budget does not cover specifically violations of the South Scotia Flats, which have caused water to overtop railroad tracks and a road. Stay Hearing Transcript July 11, 2008, beginning page 181, line 24 to page 183, line 18 (CSA Appendix 8); see also MMX Exhibit 130 Notice of Violation (CSA Appendix 5).
- Even with the DIP loan, the budget does not contain any cushion for environmental violations, fines, or emergencies. Stay Hearing Transcript July 11, 2008, beginning page 181, line 24 to page 183, line 18 (CSA Appendix 8).
- The Indenture Trustee's proposal covers only six months. There was no evidence at all presented of what happens to these Debtors, and how much further in loans they would require, during the additional time needed for the appeal route to run its course for longer than six months. Stay Motion Decision ¶ 41.
- The Indenture Trustee's proposal does not protect the plethora of interests that will be harmed if the MRC/Marathon Plan goes away during a stay. Stay Motion Decision ¶ 41. The Indenture Trustee argued that MRC's interest did not need to be protected from losing the plan, but did not address the other parties harmed if that happens. As discussed below, the MRC/Marathon Plan is the only solution for these cases that provides management of California's most precious natural resources in a sustainable manner while preserving and enhancing watershed and wildlife, minimizes adverse impacts on the local economy and jobs, and maximizes greenhouse gas reduction benefits.

Liquidation sales of the Palco mill and the timberlands do not achieve any of these public interest goals. Thus, it is not only MRC's interests that need to be protected, the interests of creditors, other parties in interest and the public interest need to be protected as well.

C. The Public Interest Would Not Be Furthered by the Granting of a Stay.

18. Throughout this bankruptcy case, the California State Agencies have voiced the public's interest. Governor Schwarzenegger clearly outlined for all plan proponents the public interest factors in his statement of position dated January 29, 2008. See CSA Appendix 1. After the lifting of exclusivity and the filing of all competing plans, Governor Schwarzenegger spoke out in favor of the MRC/Marathon Plan because that plan best preserves the state and federal governments' interests in Pacific Lumber's timberlands and best satisfies all five principles set forth in his January 29 letter which the Bankruptcy Court recognized are consistent with goals of chapter 11. See State of California's Position by Governor Arnold Schwarzenegger in Support of MRC/Marathon Plan of Reorganization, Bankruptcy Court Docket No. 2601 (CSA Appendix 2).

19. The public interest is clearly served by providing for management of the timberlands in accordance with all state and federal laws and permits, long term sustainable harvest levels while preserving and enhancing watershed and wildlife, minimal adverse impacts on the local economy and jobs, and maximizing greenhouse gas reduction benefits. Those goals are only met by the immediate implementation of the MRC/Marathon Plan. See CSA Appendix 2. As the Bankruptcy Court found, this is particularly important given the contentious environmental history of the Scopac timberlands and because there are currently environmental violations and millions of dollars of backlogged road work that must be completed to comply with existing regulations. Stay Motion Decision ¶ 28.

20. If a stay is imposed preventing the MRC/Marathon Plan from being

implemented immediately, the Debtors will not have the financial capability to manage the timberlands in accordance with all state and federal laws and permits even with the DIP. **This is a serious concern of the California State Agencies.** While in bankruptcy, 28 U.S.C. § 959(b) requires debtors-in-possession to “manage and operate the property in [their] possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.” Palco is likely to run out of money by July 25. Scopac is in similar financial difficulty. The Debtors’ ability to comply with and perform their environmental obligations would be threatened by a stay. Loading the Debtors with further debt is not a viable option. Immediate implementation of the MRC/Marathon Plan is the only option that is in the public interest and the interest of the creditors.

21. The loss of the MRC/Marathon Plan, if the delay from an appeal causes the MRC/Marathon Plan to fail, would eliminate the only solution to these cases that ensures compliance with state and federal law and all regulations protecting the environment. It would also eliminate the only solution that preserves the timberlands by maintaining a level of harvest that will ensure sustainable production, protects wildlife and watershed and maximizes greenhouse gas reduction benefits. The MRC/Marathon Plan obtained the support of the Governor of the State of California, the California State Agencies that regulate the Debtors’ day-to-day operations, the federal regulators, state and federal legislators, and local county officials. See Confirmation Findings ¶¶ 78-91.

22. The uncontroverted evidence at the confirmation trial showed that not only does the MRC/Marathon Plan provide for compliance with all non-bankruptcy environmental laws and Environmental Obligations, the post-

confirmation operator of the timberlands has knowledge, experience and a proven track record of environmental compliance. Confirmation Findings ¶¶ 46-61.

23. Clearly a stay would not minimize adverse impacts to the local economy, the other principle outlined by Governor Schwarzenegger in his statements. As discussed above, the harm to the local economy would be substantial if a stay is imposed. The uncertainty alone that a stay pending appeal would create is major harm to the people of Humboldt County and the local economy. To the contrary, immediate implementation of the MRC/Marathon Plan will eliminate all the harms and uncertainty that the people of Humboldt County suffer the longer these cases continue.

24. While the Indenture Trustee argues that the public interest is served by allowing it an opportunity to appeal the Court's decision, that opportunity is very likely to be a fatal blow to these cases. The Indenture Trustee had its opportunity to propose a workable solution for these cases given the termination of the exclusivity period. As the Bankruptcy Court noted repeatedly, for whatever reasons, the Indenture Trustee declined.

25. The public interest is not served by imposing a stay of the Confirmation Order. In fact, the public interest would be substantially harmed by a stay.

D. The Indenture Trustee is Not Likely to Succeed on the Merits of Any Appeal.

26. The issues at confirmation were primarily factual involving the value of the timberlands for the purpose of determining whether the payment to the Indenture Trustee constituted the indubitable equivalent of its collateral. The Bankruptcy Court specifically stated in its findings confirming the MRC/Marathon Plan: "The ultimate issue in this case is value." Findings of Fact and Conclusions of Law Regarding (A) Confirmation of MRC/Marathon Plan; (B) Denial of

Confirmation of the Indenture Trustee Plan and (C) Denial of the Motion to Appoint a Chapter 11 Trustee, page 8 of 119 (Bankruptcy Court Docket No. 3088) (“Confirmation Findings”); see also Stay Motion Decision ¶¶ 11-16.

27. The Indenture Trustee’s attempt to turn the purely factual issue into legal questions is unconvincing. When the issue on appeal is mostly a factual question over which the bankruptcy court has broad discretion, such discretion is unlikely to be overturned. *Smith v. Schmidt*, 2007 U.S. Dist. LEXIS 41901 at *12 (S.D. Tex. June 8, 2007); *In re Burkett*, 279 B.R. 816, 817 (Bankr. W.D. Tex. 2002). Thus, with respect to questions of fact, the movant usually fails to satisfy the first element of the test for a stay pending appeal. *Smith v. Schmidt*, 2007 U.S. Dist. LEXIS 41901 at *16; *In re Burkett*, 279 B.R. at 817.

28. The two main legal issues that were raised by the Indenture Trustee were not “serious legal questions” on plan confirmation. With respect to the Indenture Trustee’s argument that a cash payment cannot constitute the indubitable equivalent of their collateral, the Bankruptcy Court concluded, “Courts routinely find that cash or cash equivalent in an amount equal to the value of the secured creditors’ collateral are completely compensatory and constitute the indubitable equivalent.” Confirmation Findings at page 113 of 119 and cases cited therein; see also Stay Motion Decision ¶ 14. Further, the alleged right of the Indenture Trustee to credit bid also was rejected as inapplicable under the plain language of Bankruptcy Code sections 1129(b)(2)(A)(ii) and (iii). The Bankruptcy Court found that if the MRC/Marathon Plan complies with section 1129(b)(2)(A)(iii), no right to credit bid is required. Confirmation Findings at page 114 of 119. These issues do not present novel, substantial or serious legal questions. Since the appeal of the Confirmation Findings involves questions of fact and not serious legal issues, the Indenture Trustee fails to show a likelihood of success on the merits of any appeal.

E. The Indenture Trustee Will Not Suffer Irreparable Injury Without a Stay.

29. The Indenture Trustee cannot show irreparable harm will occur without a stay. As its sole ground for irreparable injury, the Indenture Trustee argues that its appeal could become moot without a stay. However, many courts have found that the risk of mootness alone does not constitute irreparable injury. *In the Matter of 203 North LaSalle Street Partnership*, 190 B.R. 595, 598 (N.D. Ill. 1995) (“It is well settled that an appeal being rendered moot does not itself constitute irreparable harm.”); *In re Irwin*, 338 B.R. 839 (E.D. Cal. 2001) (same); *In re Dakota Rail, Inc.*, 111 B.R. 818, 821 (D. Minn. 1990); *In re Charter Co.*, 72 B.R. 70, 72 (M.D. Fla. 1987); *In re Baldwin United Corp.*, 45 B.R. 385, 386 (S.D. Ohio 1984); see also, *In re Adelpia Communications Corp.*, 361 B.R. 337, 347-348 (S.D.N.Y. 2007) and cases cited therein.

30. Moreover, the MRC/Marathon Plan fairly and equitably treats the Indenture Trustee’s claim. Even if the Bankruptcy Court’s valuation of the collateral could be overturned on appeal, which it should not, the MRC/Marathon Plan pays the Indenture Trustee at least \$510 million. The Indenture Trustee’s contention was that the collateral was worth \$600 million. The difference of \$90 million might be a substantial sum, but it is a monetary injury at best. Monetary injuries do not constitute irreparable injury. By definition, “irreparable injury” is that for which compensatory damages are unsuitable. See *S.C. of Okaloosa, Inc. v. Brignac*, 2006 U.S. Dist. LEXIS 57187, *11 (W.D. La. Aug. 14, 2006). In any event, the alternative scenario that the Indenture Trustee proposed, a liquidation sale by auction, was found by the Bankruptcy Court to be highly speculative. Stay Motion Decision ¶ 18. The Indenture Trustee will not suffer irreparable injury without a stay.

31. The California State Agencies join in the oppositions to the stay motion filed by other parties.

CONCLUSION

32. The Indenture Trustee cannot satisfy each of the four factors for a stay pending appeal. Because the Indenture Trustee cannot establish all or any one of the factors in its favor, the stay motion must be denied.

Dated: July 22, 2008

Respectfully submitted,

/s/ Michael W. Neville
Michael W. Neville
Deputy Attorney General
Office of the Attorney General
455 Golden Gate Avenue, Suite 11000
San Francisco, CA 94102-7004
Telephone: 415.703.5523
Facsimile: 415.703.5480
Email: Michael.Neville@doj.ca.gov

/s/ Paul J. Pascuzzi
Steven H. Felderstein
Paul J. Pascuzzi
Felderstein Fitzgerald
Willoughby & Pascuzzi LLP
400 Capitol Mall, Suite 1450
Sacramento, CA 95814-4434
Telephone: 916.329.7400
Facsimile: 916.329.7435
Email: sfelderstein@ffwplaw.com
ppascuzzi@ffwplaw.com

Attorneys for Appellees-Respondents the California Resources Agency, California Department of Fish and Game, the California Department of Forestry and Fire Protection, the California Regional Water Quality Control Board, North Coast Region, the California State Water Resources Control Board, and the California Wildlife Conservation Board

CERTIFICATE OF SERVICE

I, Lori N. McCleerey, declare:

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

On July 22, 2008, served the foregoing:

CALIFORNIA STATE AGENCIES' OPPOSITION TO EMERGENCY MOTION FOR STAY AND INJUNCTION FILED BY INDENTURE TRUSTEE

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

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

Executed on July 22, 2008, at Sacramento, California

/s/ Lori N. McCleerey
Lori N. McCleerey

SERVICE LIST

Debtor

Gary L. Clark
Scotia Pacific LLC
125 Main Street
Scotia, CA 95565
gclark@palco.com

Attorneys for Debtor Scotia Pacific LLC

Kathryn Coleman
Gibson Dunn & Crutcher LLP
200 Park Avenue, 47th Floor
New York, NY 10166-0193
kcoleman@gibsondunn.com

Attorneys for Debtor Scotia Pacific LLC

Eric J. Fromme
Gibson Dunn & Crutcher LLP
3161 Michaelson Drive
Irvine, CA 92612-4412
efromme@gibsondunn.com

Attorneys for Debtor Scotia Pacific LLC

Kyung S. Lee/Wendy Laubach/Chris Johnson
Diamond McCarthy Taylor
Finley & Lee L.L.P.
909 Fannin, Suite 1500
Houston, TX 77010
klee@diamondmccarthy.com; wlaubach@diamondmccarthy.com;
cjohnson@diamondmccarthy.com

Counsel for Debtors: Scotia Development et al.

Shelby A. Jordan/Harlin C. Womble, Jr./
Nathaniel Peter Holzer/Kevin J. Franta
Jordan, Hyden, Womble, Culbreth & Holzer P.C.
500 N. Shoreline Drive, Suite 900
Corpus Christi, TX 78471
sjordan@jhwclaw.com; hwomble@jhwclaw.com; kfranta@jhwclaw.com;
pholzer@jhwclaw.com

Counsel for Debtors: Scotia Development et al.

Jack L. Kinzie/James Prince II/

C. Luckey McDowell

Baker Botts LLP

2001 Ross Avenue

Dallas, TX 75201-2980

jack.kinzie@bakerbotts.com; jim.prince@bakerbotts.com;
luckey.mcdowell@bakerbotts.com

Counsel for Bank of New York Trust
Company, N.A.

Zack A. Clement/William R. Greendyke/

R. Andrew Black/Jason L. Bolland/

Mark A. Worden

Fulbright & Jaworski L.L.P.

1301 McKinney Street, Suite 5100

Houston, TX 77010-3095

zclement@fulbright.com; wgreendyke@fulbright.com; ablack@fulbright.com;
jbolland@fulbright.com; mworden@fulbright.com

Counsel for Marathon Structured Finance Fund. LP

David Neier/William Brewer

Winston & Strawn, LLP

200 Park Avenue

New York, NY 10166

DNeier@winston.com; wbrewer@winston.com

Counsel for Marathon Structured Finance Fund. LP

John D. Penn/Trey Monsour

Haynes & Boone, LLP

201 Main Street, Suite 2200

Fort Worth, TX 76102

John.penn@haynesboone.com; Trey.monsour@haynesboone.com

U.S. Trustee

Charles R. Sterbach

United States Trustee

606 N. Carancahua, Suite 1107

Corpus Christi, TX 78476

Charles.r.sterbach@usdoj.gov

Counsel for Official Committee of Unsecured Creditors

John D. Fiero/Maxim B. Litvak/
Kenneth H. Brown

Pachulski Stang Ziehl & Jones, LLP

150 California Street, 15th Floor

San Francisco, CA 94111

jfiero@pszjlaw.com; mlitvak@pszjlaw.com; kbrown@pszjlaw.com

Counsel for Bank of America

Evan M. Jones/Brian M. Metcalf

O'Melveny & Myers LLP

400 South Hope Street

Los Angeles, CA 90071-2899

ejones@omm.com; bmetcalf@omm.com

Counsel for Maxxam Group, Inc.

Alan Gover

White & Case, LLP

1155 Avenue of the Americas

New York, NY 10036-2787

agover@whitecase.com

Counsel for Bank of New York

Tony L. Gerber

Louis R. Strubeck, Jr.

Richard S. Krumholz

Fulbright & Jaworski L.L.P.

2200 Ross Avenue, Suite 2800

Dallas, TX 75201-2784

tgerber@fulbright.com; lstrubeck@fulbright.com; rkrumholz@fulbright.com

Mendocino Redwood Company, LLC

Allan S. Brilliant

Craig P. Druehl

Goodwin Procter LLP

599 Lexington Avenue

New York, NY 10022

abrilliant@goodwinprocter.com

United States Department of Justice

Alan.Tenenbaum@usdoj.gov

County of Humboldt, California

Martha E. Romero

Romero Law Firm

BMR Professional Building

6516 Bright Avenue

Whittier, CA 90601

romero@mromerolawfirm.com

Counsel for Angelo, Gordon & Co. L.P., Aurelius Capital Management, LP and

Davidson Kempner Capital Management LLC

STUTMAN TREISTER & GLATT P.C.

Isaac M. Pachulski

Jeffrey H. Davidson

Eric D. Wnston

1901 Avenue of the Stars, 12th Floor

Los Angeles, CA 90067

IPACHULSKI@stutman.com; jdavidson@stutman.com; EWinston@Stutman.com