

1 UNITED STATES BANKRUPTCY COURT  
2 SOUTHERN DISTRICT OF TEXAS  
3 CORPUS CHRISTI DIVISION

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

6 \* \* \* \* \*

7 CONFIRMATION HEARING

8  
9 TAKEN ON APRIL 11, 2008

10  
11  
12 \* \* \* \* \*

13  
14  
15 On the 11 day of April, 2008, the above entitled and  
16  
17 numbered cause came on to be heard before said Honorable  
18  
19 Court, RICHARD S. SCHMIDT, United States Bankruptcy  
20  
21 Judge, held in Corpus Christi, Nueces  
22  
23 County, Texas.

24  
25 Proceedings were reported by machine shorthand.

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           BANK OF NEW YORK TRUST CO.:

10          MS. ALLISON BYMAN  
11          MR. IRA HERMAN  
12          Thompson & Knight, LLP  
13          1700 Pacific Avenue, Suite 3300  
14          Dallas, TX 75221  
15          (Appearing telephonically)

16          BANK OF NEW YORK INDENTURED TRUSTEE:

17          MR. WILLIAM GREENDYKE  
18          MR. ZACK A. CLEMENT  
19          MR. TOBY L. GERBER  
20          MR. RICHARD KRUMHOLZ  
21          Fulbright & Jaworski, L.L.P.  
22          1301 McKinney, Suite 5100  
23          Houston, TX 77010

24          BANK OF NEW YORK INDENTURED TRUSTEE:

25          MR. MARK A. WORDEN  
26          Fulbright & Jaworski  
27          (No address given)

28          THE BLACKSTONE GROUP:

29          MR. PETER LAURINAITIS  
30          (No address provided)  
31          (Appearing telephonically)

32          BLOOMBERG, LLP:

33          MR. STEVEN H. CHURCH  
34          Bloomberg, LLP  
35          (No address provided)  
36          (Appearing telephonically)

37          CALIFORNIA STATE AGENCIES:

38          MR. PAUL PASCUZZI  
39          Felderstein Fitzgerald & Pascuzzi  
40          400 Capitol Mall, Suite 1450  
41          Sacramento, CA 95814

1 CALIFORNIA STATE ENTITIES:  
MR. MICHAEL NEVILLE  
2 (No address provided)

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

6 CSG INVESTMENTS:  
MR. JEFFREY JACOB CHERNER  
7 CSG Investments  
(No address provided)

8

DEUTSCH BANK:  
9 MR. JAMES A. DELAUNE  
(No Address Provided)  
10 (Appearing telephonically)

11 DK PARTNERS:  
MR. EPHRAIM DIAMOND  
12 (No address provided)  
(Appearing telephonically)

13

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

16

LEHMAN BROTHERS:  
17 MR. DAN KAMENSKY  
Lehman Brothers  
18 No address provided)  
(Appearing telephonically)

19

MARATHON FUNDING:  
20 MR. CRAIG P. DRUEHL  
MR. ALLEN GLENN  
21 Goodwin Procter, LLP  
(No address provided)  
22 (Appearing telephonically)

23 MARATHON STRUCTURED FINANCE FUND:  
MR. STEVEN SCHWARTZ  
24 Winston & Strawn, LLP  
200 Park Ave.  
25 New York, NY 10166

1 MR. DAVID NEIER  
Winston & Strawn, LLP  
2 200 Park Ave.  
New York, NY 10166  
3

MARATHON STRUCTURED FINANCE FUND:

4 MR. JOHN PENN  
Haynes & Boone, L.L.P.  
5 201 Main Street, Suite 2200  
Fort Worth, TX 76102  
6

MAXXAM, INC.:

7 MS. JOLI PECHT  
Maxxam, INC.  
8 (No address provided)  
(Appearing telephonically)  
9

MAXIM, INC.:

10 MR. JEFFREY E. SPIERS  
Andrews Kurth  
11 (No address provided)

12 MENDOCINO FOREST:

MR. KEN CRANE  
13 Perkins Cole, LLP  
(No address provided)  
14 (Appearing telephonically)

15 MURRAY CAPITAL MANAGEMENT, INC.:

MS. FRANCINE BRODOWICZ  
16 Murray Capital Management, Inc.  
(No address provided)  
17 (Appearing telephonically)

18 NATURE CONSERVENCY:

MR. DAVID F. STABER  
19 Akin, Gump, Strauss, Hauer & Feld, L.L.P.  
(No address provided)  
20 (Appearing telephonically)

21 OFFICIAL COMMITTEE OF UNSECURED CREDITORS:

MR. MAXIM LITVAK  
22 Pachulski Stang Ziehl & Jones  
150 California St., 15th Floor  
23 San Francisco, CA 94111  
24 MR. JOHN D. FIERO  
Pachulski Stang Ziehl & Jones  
25 150 California St., 15th Floor San Francisco, CA 94111

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

PACIFIC LUMBER COMPANY:

MR. SHELBY JORDAN  
MR. NATHANIEL PETER HOLZER  
Jordan, Hyden, Womble & Culbreth  
500 N. Shoreline, Suite 900  
Corpus Christi, TX 78471  
MR. FRANK BACIK  
The Pacific Lumber Company  
(No address provided)  
(Appearing telephonically)

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

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

PENSION BENEFIT GUARANTY CORPORATION:

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

PLAINFIELD ASSET MANAGEMENT, LLC:

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

ROPES & GRAY, LLP:

MS. HEATHER J. ZELEVINSKY  
Ropes & Gray, LLP  
(No address provided)  
(Appearing telephonically)

SCOTIA PACIFIC:

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

1 MR. CHRISTOPHER D. JOHNSON  
MR. KEN WILLIAM  
2 MS. WENDY LAUBACH  
Diamond, Mccarthy, Taylor & Finley  
3 (No address provided)

4 STEPHEN BUMAZIAN:  
MR. STEPHEN BUMAZIAN  
5 Avenue Capital Group  
(No address provided)  
6 (Appearing telephonically)

7 STEVE CAVE:  
MR. WILLIAM BERTAIN  
8 Law Office of William Bertain  
(No address provided)  
9 (Appearing telephonically)

10 THE TIMES-STANDARD:  
MR. JOHN DRISCOLL  
11 The Times-Standard  
(No address provided)  
12 (Appearing telephonically)

13 U.S. DEPARTMENT OF JUSTICE:  
MR. ALAN TENEBBAUM  
14 U.S. Department of Justice  
Environment and Natural Resources Division  
15 P.O. Box 7611  
Washington, D.C. 20044  
16 (Appearing telephonically)

17 WATERSHED ASSET MANAGEMENT:  
MS. ERIN ROSS  
18 Watershed Asset Management  
(No address provided)  
19 (Appearing telephonically)

20 COURT RECORDER:  
Janet Ezell

21  
CERTIFIED SHORTHAND REPORTER:  
22 Sylvia Kerr, CSR, RPR, CRR  
23

\* \* \* \* \*

24  
25

## I N D E X

## PAGE

Appearances 2

## JEFFREY BARRETT

Cross-Examination by Mr. Krumholz	13
Cross-Examination by Mr. Schwartz	62
Cross-Examination by Mr. Pascuzzi	90
Redirect Examination by Mr. Doren	96
Recross-Examination by Mr. Krumholz	106

## JACOB CHERNER

Direct Examination by Mr. Gerber	113
Cross-Examination by Mr. Hale	119
Voir Dire Examination by Mr. Gerber	200
Cross-Examination by Mr. Neier	202
Cross-Examination by Mr. Brown	235
Cross-Examination by Mr. Jones	250
Cross-Examination by Mr. Pascuzzi	251
Cross-Examination by Mr. Doren	256
Redirect Examination by Mr. Gerber	263

## EXHIBITS

NUMBER	DESCRIPTION	PAGE
144		45
IT 207		119

1                   THE CLERK: Good morning. I'm going to go  
2 ahead and call the docket regarding the telephone court  
3 conference. Alan Gover.

4                   MR. GOVER: Yes, here.

5                   THE CLERK: Brian Metcalf -- I mean,  
6 Metcalf. Steven Hoort.

7                   MR. HOORT: I'm here.

8                   THE CLERK: Eric Waters.

9                   MR. WATERS: Present.

10                  THE CLERK: Ira Herman.

11                  SPEAKER: He'll be joining shortly.

12                  THE CLERK: Thank you. Martha Romero.

13                  MR. NEIER: She sent an e-mail yesterday  
14 that she would no longer be attending the trial.

15                  THE CLERK: Thank you, sir. Ana Acevedo.

16                  MS. ACEVEDO: Present.

17                  THE CLERK: Thank you. Allison Byman.

18                  MS. BYMAN: Present.

19                  THE CLERK: Thank you. Robert Black.

20 Wendy Laubach.

21                  MS. LAUBACH: Present.

22                  THE CLERK: Thank you. Alan Tenebaum.

23                  MR. TENEBAUM: Present.

24                  THE CLERK: Thank you. Christopher  
25 Johnson.



1 MR. JOHNSON: Present.

2 THE CLERK: Thank you. Marti Murray.

3 Marti Murray. Brett Young.

4 MR. DAMSON: Rob Damson in his place.

5 THE CLERK: I'm sorry?

6 MR. DAMSON: Rob Damson is present in his

7 place.

8 THE CLERK: Thank you. Wei Wang. Matt

9 Underwood.

10 MR. UNDERWOOD: Present.

11 THE CLERK: Thank you. Joli Pecht.

12 MS. PECHT: Present.

13 THE CLERK: Thank you. Nathan Rushton.

14 MR. RUSHTON: Present.

15 THE CLERK: Thank you. Stephen Bumazian.

16 Heather Miller.

17 MS. MILLER: Good morning.

18 THE CLERK: Thank you. Jacob Cherner.

19 MR. ADAMS: Mark Adams sitting in for

20 Mr. Cherner.

21 THE CLERK: Thank you. Francine

22 Brodowicz. Mark Worden.

23 MR. WORDEN: Present.

24 THE CLERK: Thank you. Dan Kamensky.

25 Ephraim Diamond.

1 MR. DIAMOND: Good morning.

2 THE CLERK: Could you repeat your name  
3 again, sir?

4 MR. DIAMOND: This is Ephraim Diamond.

5 THE CLERK: Sorry. Thank you. Erin Ross.

6 MR. ROSS: Present.

7 THE CLERK: Thank you. David McLaughlin.  
8 Mitchell Sockett. Daniel Zazove.

9 MR. CRANE: He's not here. This is Ken  
10 Crane in his place.

11 THE CLERK: Can you repeat your name once  
12 again, sir. Sorry.

13 MR. CRANE: Ken Crane, C-R-A-N-E.

14 THE CLERK: Oh, thank you. Clara Strand.  
15 Is there anybody by telephone that's on by telephone that  
16 I didn't call your name?

17 MS. BRODOWICZ: Fran Brodowicz with Murray  
18 Capital.

19 THE CLERK: I'm sorry, once again, please.

20 MS. BRODOWICZ: Fran Brodowicz with Murray  
21 Capital.

22 THE CLERK: Okay. Thank you.

23 THE COURT: Be seated. Okay. Do we have  
24 any players in the courtroom?

25 MS. COLEMAN: Good morning, Your Honor,

1 Kathryn Coleman, Rich Doren, and Eric Fromme and Erin  
2 York with Gibson, Dunn & Crutcher for Scotia Pacific.

3 MR. HOLZER: Pete Holzer, Shelby Jordan,  
4 along with Lucky McDowell and George Lamb, Baker Botts,  
5 for Pacific Lumber.

6 MR. FIERO: John Fiero, Ken Brown and Matt  
7 Litvak, Pachulski Stang, for the committee, Your Honor.  
8 Good morning.

9 MR. PENN: Good morning, Your Honor, John  
10 Penn, David Neier, and Steve Schwartz all for Marathon  
11 Structured Finance.

12 MR. BRILLIANT: Alan Brilliant and Brian  
13 Hale, Mendocino Redwoods.

14 MR. GREENDYKE: Good morning, Judge. Bill  
15 Greendyke, Richard Krumholz and Jack Clement for the Bank  
16 of New York Indentured Trustee. Mr. Gerber will join us  
17 later this morning.

18 MR. JONES: Good morning, Your Honor.  
19 Evan Jones for Bank of America.

20 MR. PASCUZZI: Good morning, Your Honor.  
21 Paul Pascuzzi for the California State Agencies along  
22 with my co- counsel, Michael Neville from the California  
23 Attorney General's office.

24 MR. STERBACH: Good morning, Your Honor.  
25 Charles Sterbach for the United States Trustee.

1                   MR. SPIERS: Good morning, Your Honor.  
2 Jeff Spiers along with Alan Gover on the phone for  
3 Maxxam.

4                   THE COURT: Thank you. All right. What's  
5 up?

6                   MR. KRUMHOLZ: Judge, our next witness is  
7 Jeffrey Barrett.

8                   THE COURT: All right.

9                   (The witness is sworn in.)

10                  THE COURT: Are you just calling him on  
11 cross?

12                  MR. KRUMHOLZ: Yes, Your Honor.

13                  THE COURT: Do we have -- has anyone  
14 discussed whether or not the debtor is going to just take  
15 him on direct afterwards?

16                  MR. DOREN: Your Honor, we will --

17                  THE COURT: Or are we going to come back  
18 and go through --

19                  MR. DOREN: We will likely redirect on the  
20 issues that are raised today, but we will bring him back  
21 during our case in chief.

22                  THE COURT: Okay.

23                                 JEFFREY BARRETT,  
24 having been duly sworn, testified as follows:  
25

## 1 CROSS-EXAMINATION

2 BY MR. KRUMHOLZ:

3 Q. Good morning, Mr. Barrett. How are you doing?

4 A. I'm very good, Mr. Krumholz. How are you  
5 doing?6 Q. Good. Thanks. We've met once before; is that  
7 right?

8 A. Yes, sir.

9 Q. And that was in connection with your deposition  
10 taken a few weeks ago?

11 A. Yes, sir.

12 Q. Could you go ahead and state your full name for  
13 the record.

14 A. Jeffrey Charles Barrett.

15 Q. And could you tell us your position with the  
16 debtors?

17 A. I am vice president of Scopac.

18 Q. And as vice president of Scopac, could you just  
19 give us a little flavor for your responsibilities?20 A. I oversee the science forestry and GIS groups  
21 of the company and also oversee the logging and roadwork  
22 that's done on Scopac's behalf. An easier way to put it  
23 is I essentially run the day-to-day operations of the  
24 timberlands, Scopac timberlands.

25 Q. Okay. You feel like you run Scopac?

1           A.    I certainly feel like I'm responsible for the  
2 majority of the day-to-day operations at Scopac, yes.

3           Q.    And as I understand it, you've been an officer,  
4 a vice president of Scopac since April of 2005; is that  
5 right?

6           A.    Yes, sir.

7           Q.    And at that same time you actually became a  
8 vice president and an officer of Palco as well; is that  
9 right?

10          A.    As I would subsequently learn, that's true,  
11 sir.

12          Q.    You didn't know immediately at the time, but I  
13 guess Mr. Clark told you that?

14          A.    Yes, some months after I had become an officer  
15 in Scopac, I was surprised to find out I had also been  
16 made an officer of Palco.

17          Q.    But regardless, what you did know is that once  
18 you became an officer of the company and you realized it,  
19 you owed a fiduciary duty to those -- to the companies?

20          A.    Yes, sir.

21          Q.    And that fiduciary duty, as you understood it,  
22 ran to the noteholders, right?

23          A.    Yes, sir.

24          Q.    It ran to the owners of Scopac?

25          A.    Yes, sir.

1 Q. And it also ran to Palco, as you understood it?

2 A. Yes, to the extent those last two groups aren't  
3 the same group.

4 Q. And -- well, you understand that they're  
5 separate companies; we talked about that?

6 A. Right. We're probably getting into nuance.  
7 Scopac is wholly owned by Palco which, in turn, is wholly  
8 owned by an equity group.

9 Q. You understood because you looked into your  
10 legal duties when you first became an officer of Scopac  
11 that those were separate companies?

12 A. Yes, sir.

13 Q. And you actually looked into that a little bit,  
14 didn't you, because that was important to you?

15 A. Yes. Once I understood that I was also an  
16 officer of Palco, I went through the documents that  
17 established the business relationship between Scopac and  
18 Palco, and then I also had conversations with Gary Clark,  
19 our CFO, to try to understand what my duties were.

20 Q. And you actually skimmed through the indenture  
21 that we talked about earlier in this trial, right?

22 A. Yes, I skimmed through it. It was terribly  
23 uninteresting to a non-lawyer for in-depth reading.

24 Q. It actually is terribly uninteresting to even  
25 lawyers from time to time. But regardless, you

1 understood it was an important legal document?

2 A. Yes, sir.

3 Q. And you understood that it created certain  
4 legal obligations in connection with your role as an  
5 officer of both Palco and Scopac?

6 A. Yes, sir.

7 Q. In fact, it was important to keep those  
8 companies separate when it came to the books and records?

9 A. Yes, sir.

10 Q. And when it came to their assets?

11 A. Yes, sir.

12 Q. Because you understood the reason why Scopac  
13 was created as a separate entity was to keep the  
14 collateral for the noteholders -- of the noteholders  
15 separate and apart from the assets of Palco?

16 A. Yes, sir.

17 Q. And you've done your level best to keep those  
18 companies separate in that respect?

19 A. In that respect, yes, sir.

20 Q. And in some other respects that we talked about  
21 in the deposition?

22 A. Yes, sir.

23 MR. DOREN: Objection, Your Honor. I'm  
24 not sure what he's referring to.

25 THE COURT: What's that?



1 MR. DOREN: I'm not sure what he's  
2 referring to there.

3 THE COURT: Is that an objection, or do  
4 you just want him to clarify for you?

5 MR. DOREN: Objection. It's a bad  
6 question, Your Honor.

7 MR. KRUMHOLZ: It's all right. I'll move  
8 along.

9 THE COURT: Okay.

10 Q. (By Mr. Krumholz) Let's talk about those  
11 fiduciary duties just for a moment. On the one hand, you  
12 understood that you owed a fiduciary duty to Scopac to do  
13 what's in its best interest, right?

14 A. Yes.

15 Q. And on the other hand, you knew that it was  
16 important to do what was in the best interest of Palco  
17 and do what was in its best interest?

18 A. Yes.

19 Q. Okay. And you also understood that you were  
20 supposed to do your best to make Scopac profitable?

21 A. Yes.

22 Q. And likewise, you were going to do your best to  
23 make Palco profitable?

24 A. Yes, sir.

25 Q. And likewise, you understood it was important

1 to do your best to assure that -- the best you could  
2 anyway -- that Scopac had sufficient cash flow to pay its  
3 obligations?

4 A. Yes, I understood that.

5 Q. And to be as liquid as it could or needed to  
6 be?

7 A. I didn't know. The issue of liquidity is  
8 really more a Gary Clark CFO thing. I would reaffirm my  
9 previous answer, as I understood, that we had to try and  
10 satisfy our financial obligations to the noteholders.

11 Q. And to everyone else?

12 A. And to everyone else that the company had  
13 obligations to, yes.

14 Q. You knew that you wouldn't want to take actions  
15 that would negatively impact cash flow such that they  
16 couldn't pay their obligations; that's not something you  
17 would intend to do?

18 A. That's correct, yes.

19 Q. And likewise, over on the Palco side, you felt  
20 the same way in that regard. You needed to assure that  
21 because you were an officer and had a fiduciary duty, you  
22 were trying to keep Palco -- to have sufficient cash flow  
23 so that they could pay its obligations?

24 A. In whatever ways I could help the Palco  
25 business, I understood that was my responsibility and a

1 goal, yes.

2 Q. And you're not the only one in April of 2005  
3 and thereafter who had these sort of dual obligations  
4 that we've been talking about?

5 A. No, sir, I was not.

6 Q. In fact, from some time in August of 2006 all  
7 the way up until today, Mr. O'Brien, the CEO of Scopac is  
8 also the CEO of Palco, right?

9 A. Yes, sir.

10 Q. And that's been true with respect to Mr. Clark,  
11 right?

12 A. He hasn't been CEO, but he has been a joint  
13 officer as the CFO of both Palco and Scopac, yes, sir.

14 Q. Mr. Clark is the CFO?

15 A. Yes, sir.

16 Q. And he has the same dual obligations, as you  
17 understand them?

18 A. Yes, sir.

19 Q. And likewise, Mr. Bacik, who is the general  
20 counsel of the companies has similar dual obligations in  
21 that respect, as you understand it?

22 A. Yes, sir.

23 Q. In fact, no one on the senior management team  
24 from the time you began with the companies up until  
25 somewhere in September, late September of 2007, was

1 independent of Palco? No one on the executive team of  
2 Scopac is independent of Palco?

3 A. If you define independence as was not a joint  
4 officer, then yes, sir.

5 Q. Now, in connection with this bankruptcy,  
6 you-all have hired some experts in this case; is that  
7 right?

8 A. Yes, sir.

9 Q. And you've hired some valuation experts, true?

10 A. Yes, sir.

11 Q. And I guess their names are Mr. Yerges and  
12 Mr. Iles and Mr. Reimer; is that right?

13 A. Yes, sir.

14 Q. And I guess you've gotten to know them over  
15 time; is that true?

16 A. Yes, I've known Dr. Reimer for several years  
17 antecedent to the bankruptcy. I had met Kim Iles once or  
18 twice. And certainly, I've worked with all three of them  
19 in some regard as our expert since the bankruptcy.

20 Q. Now, before you know that this courtroom became  
21 relevant for purposes of Scopac and Palco. And let me  
22 just rephrase that a little bit. Before this cloud of  
23 bankruptcy or litigation started hovering over the  
24 companies, you-all actually -- you-all actually hired a  
25 different valuation expert, did you not, to do some

1 valuation work in 2005?

2 A. When you say "we hired," you need to define  
3 that for me. I certainly wasn't involved in the hiring  
4 decision, but there was, you know, a team that did work  
5 with us.

6 Q. The person you looked to back then before this  
7 courtroom was filled with lawyers who were talking about  
8 Scopac and Palco, you looked to Mr. Fleming to do  
9 valuation of some of the timberlands; is that right?

10 A. He was an individual that was involved in  
11 valuing some timberlands, yes.

12 Q. And Mr. Boyd is one of your senior management  
13 people at Scopac; is that right?

14 A. Yes, sir.

15 Q. And can you describe what his background is?

16 A. Sam has worked in the forest products industry  
17 throughout the Pacific northwest for 20-plus years. He  
18 actually in his current capacity leads our GIS and  
19 database groups, but his background involves an extensive  
20 set of duties in forestry, including inventory analysis  
21 and validation, timber stand valuation, and other kinds  
22 of forestry-related tasks.

23 Q. Mr. Boyd is someone who you highly respect; is  
24 that right?

25 A. Yes, sir.

1 Q. You have a high regard for his judgment?

2 A. I do.

3 Q. Very competent person?

4 A. In his current set of duties, absolutely.

5 Q. In fact, I asked you in your deposition, I  
6 think, if he was as competent as you are in terms of  
7 running a timberland, and what was your response?

8 A. I don't remember my exact response. I'm sure  
9 it was generally positive.

10 Q. You said that -- I'll just ask you now. The  
11 truth is you feel like he's as qualified as you are?

12 A. I think that's largely true.

13 Q. And were you in the courtroom the last day or  
14 two during Mr. Fleming's remarks, testimony?

15 A. Yes, sir.

16 Q. And you heard that Mr. Boyd turned to  
17 Mr. Fleming to do a valuation of the assets of the  
18 companies, true, back in '05?

19 A. I'm not sure I heard it that way. I heard that  
20 they had worked together --

21 Q. Okay.

22 A. -- is my recollection of the testimony, sir.

23 Q. Do you recall that Mr. Fleming said that  
24 Mr. Boyd called him and asked him to do a valuation of  
25 the MMCAs?

1           A.    I'm sorry, I don't remember that testimony.

2           Q.    But what we do know is that the experts which  
3   Scopac and Palco have hired in this case, Mr. Yerges,  
4   Mr. Reimer, and Mr. Iles were not the folks they turned  
5   to back in 2005 for that purpose, right?

6           A.    That is my understanding, yes.

7           Q.    And what we do know is that Scopac and Palco  
8   didn't turn to any of these Marathon or MRC witnesses,  
9   that is, Mr. LaMont or Mr. Johnston for that purpose,  
10   right?

11          A.    That is correct.

12          Q.    So when the cloud of litigation wasn't hovering  
13   everybody, Scopac and Palco went to Mr. Fleming, who was  
14   the registered forester in California who's done this for  
15   over 30 years, right?

16          A.    I think you misspoke slightly. We went to  
17   Mr. Fleming as someone who had extensive experience.

18          Q.    Now, your experts have come up with a value of  
19   these entities something along the lines of \$1.4 billion;  
20   is that right?

21          A.    That's my understanding, yes, sir.

22          Q.    And what is the value of the timberlands,  
23   according to your experts, do you know?

24          A.    It depends on whether or not the acreage  
25   associated with the redwood preserve proposal is included

1 or not included. If it is included in the timberlands  
2 valuation, I believe it's approximately \$943 million. If  
3 it's excluded from the valuation, I believe that drops to  
4 somewhere around 850.

5 Q. Now, you've heard some testimony, I guess, from  
6 Mr. Dean back here. Do you remember him?

7 A. Yes, sir.

8 Q. That one.

9 A. Yes, sir, I recognize Mr. Dean without his  
10 raising his hand.

11 Q. Okay. And Mr. Dean testified about what they  
12 were willing to pay for these assets; do you recall that?

13 A. Yes, sir.

14 Q. And we went back and forth about what they were  
15 giving up and my recollection is -- and I don't want to  
16 quibble with the lawyers, but they were putting an  
17 entity, that is, MRC and Marathon together, somewhere  
18 around \$350 million of consideration for these -- for  
19 Newco. Do you recall that?

20 A. Well, I think the issue of the value of the  
21 bonds was disputed, so I'm going to go on your  
22 representation that that's the collective value of their  
23 consideration.

24 Q. Well, let me ask it a different way. I assume  
25 that as a fiduciary of Scopac and Palco, that you and



1 your executive team have looked into whether it would be  
2 appropriate to sell Palco and Scopac for various sums of  
3 money. Is that something you-all have assessed from time  
4 to time?

5 A. We have certainly had some discussions as a  
6 senior management team, yes, sir.

7 Q. And you've concluded, have you not, that you  
8 wouldn't be willing to sell these properties anywhere  
9 near \$350 to \$500 million, is that right, given your \$1.4  
10 billion valuation?

11 A. Certainly based on the expert reports we've  
12 received, we would view that as substantially below its  
13 real value, yes, sir.

14 Q. And one of the reasons why you wouldn't want to  
15 do that sort of thing is because you have a fiduciary  
16 obligation to the noteholders to get the highest value,  
17 right?

18 A. That's exactly right, sir. Yes.

19 Q. And others?

20 A. And others, yes, sir.

21 Q. And so you simply feel like it would be a  
22 breach of your fiduciary duty, and that of your executive  
23 team, to ever even think about doing something like that,  
24 right?

25 A. Breach of fiduciary duty sounds like a pretty

1 loaded term. Let's just say that I clearly understand we  
2 need to do our best to return as much value as possible  
3 to the noteholders and other creditors.

4 Q. And Mr. Dean testified about various  
5 environmental regulations in California and relationships  
6 in that regard. Do you recall just generally that  
7 testimony?

8 A. Yes, sir.

9 Q. And the truth is is that timberland companies  
10 all over the country must comply with governmental  
11 regulations, true?

12 A. Yes, sir.

13 Q. And the truth is that there are dozens of  
14 timberland companies all over the country each and every  
15 day who do exactly that, right?

16 A. Yes, sir.

17 Q. And, in fact, there are a host of timberland  
18 companies who could do that with respect to Scopac's  
19 timberlands?

20 A. I'm sorry, I'm not going to agree with that in  
21 a blanket sense. The regulatory regime that applies to  
22 all redwood lands is tough. The one that applies to the  
23 Scopac lands with the HCP and certain water quality  
24 regulations is very challenging. So I would say that it  
25 would be difficult for many timber companies in America

1 to come into these timberlands and adjust to the  
2 regulatory regime. I think they would be very surprised  
3 how difficult it is based on what we've seen when we have  
4 hired employees from other parts of the world -- or other  
5 parts of the country, and they come in.

6 Q. They could hire somebody like you, right?

7 A. There are certainly people that have experience  
8 managing timberlands and working within the regulatory  
9 regime, yes. Yes, sir.

10 Q. And others like you, like Mr. Boyd?

11 A. Yes, sir.

12 Q. And so there are options in that regard, right?

13 And let me ask it a different way. The truth of the  
14 matter is that anybody who ultimately buys these  
15 properties to the extent they're sold are going to have  
16 to comply with the regulatory environment that they work  
17 in?

18 A. Yes, sir.

19 Q. Now, we've been talking about this number, 55  
20 million board feet, that is, I think, the harvest rate  
21 that Marathon and MRC have proposed in connection with  
22 their valuation, at least initially. Have you seen that?

23 A. Yes, sir.

24 Q. And why haven't you -- do you believe that  
25 that's an appropriate rate -- harvest rate for the Scopac

1 timberlands if your goal was to optimize the utilization  
2 of those lands?

3 A. No, sir.

4 Q. And why is that?

5 A. It's significantly below the amount of timber  
6 growth on the ownership. And it is significantly below  
7 the amount of harvest that I believe could be reliably  
8 and consistently permitted and authorized for harvest  
9 over time.

10 Q. Now, but we've heard testimony, sir, that they  
11 need to rest, that these timberlands need to rest. Have  
12 you heard that?

13 A. I've heard that, yes, sir.

14 Q. Okay. So why don't you believe that?

15 A. Well, two levels. As a scientist, there is  
16 this theory that is promulgated that if you go beyond a  
17 certain level of disturbance in a watershed, that bad  
18 things necessarily have to happen. And I don't buy into  
19 that as a scientist. I think how you manage the lands  
20 really dictates the level of impact, not the percentage  
21 land based disturbed. But, also just in terms as a  
22 manager, you have to understand these timberlands are  
23 managed more rigorously with respect to environmental  
24 regulations than any other timberlands between the HCP  
25 and the water quality regulations and just the normal

1 rules everybody else has to do. They're managed very  
2 well with respect to environmental protection, so I don't  
3 think they need a rest.

4 Q. We talked a moment ago about conflicts of  
5 interest or at least dual responsibilities. But I just  
6 want to shift our focus and talk about sort of what  
7 conflicts can arise in that context, okay?

8 When you have dual responsibilities as officers  
9 of a company -- of companies like Palco and Scopac, it's  
10 important to look at intercompany transactions to make  
11 sure that they are based on fair market terms, true?

12 A. It's important to look at them with respect to  
13 fair market terms, true, unless the terms are covered by  
14 those documents that establish the business relationships  
15 between the companies.

16 Q. For example, the new master purchase agreement  
17 was something that was actually created during the time  
18 that the noteholder's notes were created, and that was --  
19 that created a price or set a price based upon SBE, is  
20 that right?

21 A. Yes, it established the pricing mechanism by  
22 which Scopac would sell its timber to Palco, yes, sir.

23 Q. But other than with respect to contractual  
24 requirements or obligations that may exist, it's  
25 important, is it not, to assure that intercompany

1 transactions are on fair market terms between the two  
2 companies?

3 A. I would generally say that's true, yes, sir.

4 Q. And that -- and to assure that the transactions  
5 between Palco and Scopac are in Scopac's best interest?

6 A. Yes, sir.

7 Q. And that -- that transactions between Palco and  
8 Scopac do not unfairly burden Scopac?

9 A. I do not want to be evasive, but I do need you  
10 to sort of help me understand what you mean by the word  
11 "burden."

12 Q. Well, you just want them to be fair so that  
13 Scopac doesn't have to pay for things it shouldn't have  
14 to pay for, given its economic condition?

15 A. I think that's fair, yes, sir.

16 Q. Now, inevitably you have conflicts of interest  
17 that arise between companies like this, right?

18 A. Sure.

19 Q. And you deal with those somewhat frequently?

20 A. Yes, sir.

21 Q. And sometimes you handle them if they're not  
22 too significant, too important? In other words, kind of  
23 lower level operational issues, you make decisions on  
24 your own, right?

25 A. If it's a low enough level operational issue,

1       yeah, sometimes I make the decision on my own, yes, sir.

2           Q.     And then if it's a significant issue, potential  
3       conflict of interest, then you'll bring it up to the  
4       executive team; is that right?

5           A.     It's kind of a sliding scale, so -- or maybe a  
6       tiered structure.  If it really seems like it's a pretty  
7       simple operational issue, I might make the decision  
8       myself.  If it's a little bit more of an operational  
9       issue, I might just deal with it one-on-one with one of  
10      the Palco managers like Hughey Long, for example, who  
11      runs our sawmill.  But if it appears to be an issue  
12      that's bigger, you know, potentially a larger consequence  
13      or more difficult to fix to the benefit of both parties,  
14      then absolutely I would bring it to the senior management  
15      team or directly to George O'Brien.

16          Q.     Other than these ordinary course of business  
17      conflicts, when there were significant potential  
18      conflicts, it was important to call in the independent  
19      managers, wasn't it?

20          A.     I think -- let me qualify an answer of yes,  
21      which is that I think virtually all operational issues or  
22      conflicts between the company can be and have been  
23      resolved with the senior management team level or less.  
24      But there are major issues beyond operational that  
25      involve the independent board, yes, sir.

1 Q. And you understand -- and the reason for that  
2 independent board of managers -- and just so everybody  
3 understands here, Scopac's board of managers, which is  
4 like a board of directors of sort, right?

5 A. Yes, sir.

6 Q. All right. Has two independent folks on it,  
7 right?

8 A. Yes, sir.

9 Q. And then one insider, so to speak, or somebody  
10 who is an officer with the company, right?

11 A. I don't believe the third person is an officer  
12 of Scopac, no, sir. In fact, I know he's not.

13 Q. Fair enough. But he's not an independent  
14 manager?

15 A. That is true, yes, sir.

16 Q. And who is that?

17 A. Kenny Friedman.

18 Q. And why isn't he independent or considered  
19 independent, as you understand it?

20 A. He's also on the Palco board.

21 Q. Okay. And so you have two folks who are  
22 supposedly independent and one who is not; is that right?

23 A. Yes, sir, as I understand it.

24 Q. And when they make these decisions regarding  
25 potential conflicts of interest, it's important for them



1 to be fully informed of the facts relating to the issues  
2 that they must deal with in that regard?

3 A. It's important that they have a thorough  
4 understanding of the facts related to the issue they're  
5 deciding, yes, sir.

6 Q. And you understand that these folks who are  
7 independent managers, Mr. Weiss, Sid Weiss and Mr. Jack  
8 Webb, are not in the timber business?

9 A. Yes, sir; that is my understanding.

10 Q. And they have never been in the timber business  
11 other than as independent managers of Scopac?

12 A. That is my understanding, yes, sir.

13 Q. And so you understand that they are relying on  
14 you and your executive team and have done so since long  
15 before bankruptcy to provide them with all meaningful or  
16 relevant information concerning those sorts of decisions?

17 A. I don't mean to parse things out. I just want  
18 to make sure that I get good, accurate answers to you,  
19 Mr. Krumholz. With respect to operations issues, then I  
20 would say they absolutely are dependent on the officers  
21 of Scopac to give them the information they need.  
22 However, there are other matters, for example, pertaining  
23 perhaps to litigation or finances where they may  
24 necessarily need input from sources other than just the  
25 officers of the company.

1 Q. But you understand with respect to, for  
2 example, operations, cash flows, projections, how the  
3 companies are doing, what the management team thinks is  
4 going to happen if they make a decision one way or  
5 another, all the relevant information in that connection,  
6 in that regard with respect to these sorts of decisions  
7 needs to be provided to them?

8 A. To the extent the information is relevant to  
9 the decision being made, I would agree with that, yes,  
10 sir.

11 Q. And you understand that they're relying on you,  
12 sir, and your executive team to provide that information?

13 A. Yes, sir.

14 Q. Now, I just want to ask you one last question  
15 in that respect. If they're not given an important piece  
16 of information, you understand that that can impair their  
17 ability to make good decisions, right?

18 A. I would think that would be true, yes, sir.

19 Q. Now, as I understand it, in September of last  
20 year, you, first of all, resigned as vice president of  
21 Palco; is that right?

22 A. Yes, sir.

23 Q. Somewhere around September 26th of 2007, true?

24 A. Yes, sir.

25 Q. And the reason you did it was because the

1 company was concerned that there was an appearance of a  
2 conflict of interest, right?

3 A. No, sir.

4 Q. The reason they did it was because of a concern  
5 that third-parties may have a very real and genuine  
6 concern about conflicts of interest, and the company  
7 wanted to assure that those concerns could be dealt with,  
8 right?

9 A. Again, I'm not trying to be evasive, so in this  
10 case, let me be helpful. That was the concern. It was  
11 not raised by the company. It was raised by counsel,  
12 sir.

13 Q. Fair enough. Counsel for the companies?

14 A. Yes, sir.

15 Q. And as a result, you stepped down as an officer  
16 of Palco?

17 A. Yes, sir.

18 Q. You were still involved with Palco?

19 A. Yes, sir.

20 Q. You still had responsibilities at Palco?

21 A. Yes, sir.

22 Q. You were still providing services to Palco?

23 A. Yes, sir.

24 Q. And it concerned you that Mr. O'Brien and  
25 Mr. Clark and Mr. Bacik had this exact, same conflict or

1 dual issue, but they weren't asked to resign?

2 A. I understood that for someone that didn't  
3 recognize how day-to-day decisions were made, that there  
4 was the potential for an appearance of conflict of  
5 interest.

6 Q. We covered that. But that concern wasn't  
7 addressed with respect to Mr. O'Brien, Mr. Clark, and  
8 Mr. Bacik, true?

9 A. That is true, yes.

10 Q. And that concerned you at the time?

11 A. I was aware that that issue existed.

12 Q. And it concerned you? That was your testimony,  
13 right?

14 A. Yes, sir.

15 Q. Okay. In fact, you felt like you were singled  
16 out, right?

17 A. Yes, sir.

18 Q. Now, I want to turn our attention to a specific  
19 issue that arose in the summer of 2007, this change of  
20 business that occurred. You know generally what I'm  
21 talking about?

22 A. Yes, sir, the Scopac log deck motion.

23 Q. Yes. I think that's what it was called at the  
24 time or something similar.

25 A. If you and I want to agree, we can just call it

1 change of business here.

2 Q. That would be great.

3 A. We'll do it.

4 Q. All right. So before August 16 of 2007, Scopac  
5 and Palco operated under a master purchase agreement; is  
6 that right?

7 A. Yes, sir.

8 Q. It was called the new master purchase  
9 agreement; is that right?

10 A. Yes, sir.

11 Q. And just so we're all clear -- and many of the  
12 folks in this courtroom were probably there back then,  
13 but I'm going to go ahead and describe it so we're on the  
14 same page and hopefully get it right.

15 The way that Scopac and Palco did business  
16 together was that under the master purchase agreement,  
17 Palco would purchase logs from Scopac; is that right?

18 A. Yes, sir.

19 Q. And in doing so, Palco paid for the cost of  
20 harvesting?

21 A. Yes, sir.

22 Q. They were obligated to do so?

23 A. Yes, sir.

24 Q. By contract?

25 A. Yes, sir.

1 Q. And the cost of harvesting is the felling and  
2 hauling of logs, right?

3 A. Yes, the felling, trees are on the ground; the  
4 yarding, getting them up to a flat spot where there are  
5 trucks; and then the hauling, which is taking them to the  
6 mills.

7 Q. And that's a significant expense?

8 A. Yes, sir.

9 Q. It can be very expensive?

10 A. Yes, sir.

11 Q. It can be expensive, and there's a lot of ways  
12 to do it, right?

13 A. Yes, sir.

14 Q. From helicopters to -- what are the other ways?

15 A. Well, the three majors are helicopters, what  
16 are called yarding systems, which is basically like a sky  
17 crane, if you will, and then various kinds of ground  
18 equipment, like tractors.

19 Q. Okay. So -- all right, and what would happen  
20 before really any of that took place is Scopac would  
21 create a THP; is that right?

22 A. Yes, a timber harvesting plan or THP.

23 Q. And they would prepare to get governmental  
24 approval as appropriate?

25 A. Yes, sir.

1 Q. And once they got governmental approval as  
2 appropriate, then Palco, who was the sole customer of  
3 Scopac, right?

4 A. Yes, sir.

5 Q. Would sign what is called a log purchase  
6 agreement, correct?

7 A. Yes.

8 Q. And which was attached, actually, to the master  
9 purchase agreement, a form of it, right?

10 A. Yes.

11 Q. And incorporated all of the provisions of the  
12 master purchase agreement?

13 A. Yes, as I understood it.

14 Q. And one of those provisions in the master  
15 purchase agreement was that Palco had to pay for these  
16 hauling and harvesting costs?

17 A. If you call it log and haul, sure, that's easy.

18 Q. The log and haul cost?

19 A. Log and haul. That's nice shorthand.

20 Q. Thanks. But those were the costs that Palco  
21 had to pay before the change in business, right?

22 A. Yes, sir.

23 Q. But in the summer of 2007, early summer of  
24 2007, the executive team realized that there was a  
25 liquidity crisis at Palco, true?

1           A.    Crisis is a loaded term.  My recollection is we  
2           recognized that Palco was having liquidity problems and  
3           that Gary was projecting that those liquidity problems  
4           would get worse as the summer progressed.

5           Q.    And you said in your deposition -- I don't want  
6           to quibble over words -- but you said in your deposition  
7           that it was a crisis, a liquidity crisis in the early  
8           part of 2007 -- in the summer of 2007?

9           A.    Fair enough, sir.

10          Q.    Okay.  And as a result, it was important to  
11          reduce costs at Palco, right?

12          A.    Yes, sir.

13          Q.    And just to give us some context, this wasn't  
14          the first time that that kind of issue had come up for  
15          Palco, right?

16          A.    No, sir.

17          Q.    It had liquidity concerns.  Obviously it was in  
18          bankruptcy.  But in bankruptcy was the first time it kind  
19          of rose to that level of concern was the early part of  
20          summer of 2007?

21          A.    Well, there had been -- not quite true, sir.  
22          There had been previously -- there have been previous  
23          concerns when we did not have debt financing yet, but  
24          this certainly was a period of time in which our concerns  
25          were heightened.



1 Q. And one of the ways that Palco improved its  
2 cash flow in the past, prior to bankruptcy, were in a  
3 manner called lump sum sales? Now, I know there were  
4 multiple motivations. We're going to get into that,  
5 don't you worry?

6 A. Fair enough. The lump sum sale certainly could  
7 help Palco with some of its liquidity issues, yes, sir.

8 Q. So what they did in '06, for example, 2006, is  
9 that they -- Palco and Scopac entered into agreements  
10 with Maxxam, right?

11 A. Yes, sir.

12 Q. And Maxxam is the parent company of Palco,  
13 right?

14 A. Ultimately, yes, sir.

15 Q. And I'm talking about the whole group of Maxxam  
16 entities when I talk about Maxxam, okay?

17 A. Very good.

18 Q. Okay. And they actually entered into these  
19 agreements whereby Maxxam would pay up front for the  
20 logs, right?

21 A. Yes. They would essentially buy all of the  
22 logs for timber harvest plans that Scopac had obtained  
23 approval for on the Scopac timberlands.

24 Q. And I think this is what you wanted to say a  
25 second ago. That was a good thing for Scopac, right?

1 A. It was a very good thing for Scopac.

2 Q. Because they got money up front, right?

3 A. Yes, sir, and it helped us meet our obligations  
4 to the noteholders.

5 Q. And it also allowed Palco not to have to pay  
6 for harvesting costs, right, up front?

7 A. They didn't have to pay for it up front,  
8 although as the logs would ultimately be delivered to  
9 Palco, Palco would pay for them.

10 Q. Well, actually what happened with respect to  
11 these log purchase agreements was that Maxxam was  
12 obligated to pay for the harvest cost, right? They took  
13 on that obligation?

14 A. I believe that's true, yes, sir.

15 Q. All right. And Scopac got paid for the logs  
16 immediately, right?

17 A. Yes, sir.

18 Q. And then Palco -- the logs would be delivered  
19 to Palco's log deck, true?

20 A. Yes, sir.

21 Q. And Maxxam would actually hold those in  
22 inventory until Palco decided to purchase the logs?

23 A. Yes, I think that was largely how it worked  
24 out, only because the -- at the time -- let me back up.  
25 The way this worked fundamentally was Maxxam would buy a

1 THP. That doesn't mean that the logs from the THP were  
2 ready to be harvested right then. In many cases, the  
3 harvest on those THPs might not occur for several months,  
4 right, so essentially they bought trees in the forest, if  
5 you will, but trees that have all the permits to harvest  
6 them.

7 Q. Well, the good thing about this is it benefited  
8 both Palco and Scopac. It got cash flow to Scopac. It  
9 got cash flow to Palco. They didn't have to pay for  
10 costs up front, right?

11 A. If -- I'm trying to explain this because  
12 there's a nuance that's important for me to be able to  
13 say yes to what you're asking me. If it was just trees  
14 in woods, then Palco wouldn't have been out of any money,  
15 so it would not have helped Palco liquidity. To the  
16 extent that those lump sum THPs then were harvested and  
17 the logs were brought into the Palco log deck, and there  
18 was a delay between when Palco -- when they came in and  
19 Palco paid for them, then, yes, sir, the lump sum sales  
20 would also benefit Palco liquidity.

21 Q. Now, Maxxam refused, once bankruptcy began, to  
22 provide any additional funding in the form of lump sum  
23 sales?

24 A. I was told that by Gary Clark, our CFO, yes,  
25 sir.

1 Q. But Palco in the summer of 2007 had a liquidity  
2 issue or crisis as we discussed in your deposition,  
3 right?

4 A. Yes, sir.

5 Q. And so instead of having Maxxam provide this  
6 opportunity or this savings, what was decided by the  
7 executive team instead was to stick Scopac with the  
8 harvesting costs?

9 A. Well, I certainly don't like the adjective  
10 "stick."

11 Q. Neither did we?

12 A. But fair enough, sir, yes, we -- the decision  
13 was made that Scopac would bear the burden of the  
14 harvesting cost until the log sales to Palco were  
15 transacted.

16 Q. And that was decided at a board meeting on  
17 August 16 of 2007; is that right?

18 A. Yes. And, by the way, "stick" there was a  
19 verb, not an adjective. I want to correct myself on that  
20 one, Mr. Krumholz.

21 Q. Fair enough. If you could pull up Exhibit 144  
22 for us. And the exhibits are behind you in notebooks.

23 THE COURT: Or you can see them on the  
24 screen.

25 Q. (By Mr. Krumholz) You can see them on the

1 screen. But go back to the document as a whole. Exhibit  
2 -- IT Exhibit 144, as you see on the screen, appears to  
3 be a true and correct copy of the board meetings of  
4 August 16, 2007 of Scopac, right?

5 A. Yes, sir.

6 Q. It may be redacted a little bit for some  
7 reason, but other than that, it's a true and correct  
8 copy, right?

9 A. As best I can recall looking at the original  
10 and this copy, yes, sir.

11 MR. KRUMHOLZ: Your Honor, we move for  
12 admission of Exhibit 144.

13 MR. NEIER: No objection.

14 THE COURT: It's admitted.

15 Q. (By Mr. Krumholz) Well, first of all, let me  
16 ask you this: In making this important decision, given  
17 that it was a significant transaction between Palco and  
18 Scopac, this is one of those times where it was very,  
19 very important for the board of directors to be provided  
20 all the relevant information, right?

21 A. All relevant information relative to the  
22 decisions to be made, yes, sir, very important.

23 Q. Okay. And if you could highlight that, pull  
24 that up or draw that out, Jamie. It says here that,  
25 first of all, you were at this meeting, true?

1 A. I was participating by phone, yes, sir.

2 Q. And it says "no materials were used in the  
3 course of the meeting." Do you see that?

4 A. Yes, sir.

5 Q. And you don't recall ever providing the  
6 independent board of directors any materials in  
7 connection with this decision?

8 A. I don't, no, sir.

9 Q. Okay. And, in fact, you know of no one who did  
10 prior to this decision being made?

11 A. I don't know of any materials that were  
12 provided, no, sir.

13 Q. In other words -- and let's talk about that  
14 just for a moment. What might be really relevant to this  
15 decision, given that Scopac was all of a sudden going to  
16 have a log deck -- and I haven't gotten to that yet --  
17 but Scopac was going to pay for log and haul costs,  
18 right?

19 A. Yes, sir.

20 Q. And then it was going to actually have to  
21 create a new log deck, right?

22 A. Yes, sir.

23 Q. And those logs would be an inventory, and they  
24 never carried inventory before?

25 A. Is that a question?

1 Q. Is that right?

2 A. That is right, sir, yes.

3 Q. Okay. So they had to carry inventory for the  
4 first time, right?

5 A. Yes, sir.

6 Q. And so one thing you might want to know if you  
7 were an independent director is whether or not Palco had  
8 sufficient liquidity to pay for those logs, right?

9 A. I would think being assured that Palco would be  
10 able to ultimately buy those logs financially would be  
11 important, yes, sir.

12 Q. And, in fact, any time you were going to incur  
13 the cost of inventory such as that, especially when this  
14 is your sole customer, it's important to have that kind  
15 of information, right?

16 A. And, sir, you hit the key thing, which is if  
17 that's your sole customer. Building an inventory, of  
18 course, has the advantage that you do have logs that  
19 ultimately could be sold to other parties; but to the  
20 extent that Palco is your sole customer, then its  
21 financial condition is relevant to the decision, yes,  
22 sir.

23 Q. But the truth is that Palco's attorneys and  
24 Scopac's attorneys took the position that Scopac couldn't  
25 sell those logs to third parties, right?

1           A.    I certainly had heard that opinion, yes, sir.

2           Q.    And they took that position all the way  
3 throughout bankruptcy?

4           A.    Well, I don't know if that's ultimately true,  
5 Mr. Krumholz, since the log deck agreement included  
6 language that allowed Scopac to do sales to third parties  
7 under certain conditions.

8           Q.    But -- and you're talking about that 90 percent  
9 of purchase discussion we had?

10          A.    Yes, sir.

11          Q.    Okay. But the truth is even when you didn't  
12 hit the 90 percent, the companies took the position that  
13 Scopac still couldn't do so?

14          A.    Well, I certainly heard discussion from some of  
15 the attorneys that they believed that to be the case,  
16 yes, sir.

17          Q.    So it was important to find out if Palco was  
18 going to be able to pay for these logs, right?

19          A.    In any case it would have been important at  
20 that time to understand if Palco could pay for the logs,  
21 yes, sir.

22          Q.    No projection showing whether Palco could be  
23 able to pay for these logs were provided in this meeting?

24          A.    Well, sir, it says here no materials were used  
25 in the course of the meeting so I think from that we can



1 infer that no written materials were provided.

2 Q. And I asked you if any financial information  
3 about Palco was discussed at this meeting, remember that?  
4 And you couldn't recall any that was discussed at this  
5 meeting?

6 A. Well, I'm certainly -- if that's my testimony,  
7 then I said that at the time. I don't think that I meant  
8 to definitively say that none were presented, simply that  
9 I don't remember any being presented, sir.

10 Q. And you don't believe any was discussed, right?

11 A. At this point in my -- I just -- I don't  
12 remember one way or the other, sir. That's the easiest  
13 answer.

14 Q. And there was no independent consultant  
15 referenced in these meeting minutes who assessed whether  
16 or not this is going to be a good or a bad thing for  
17 Scopac, right?

18 A. That's correct, yes, sir.

19 Q. As a result of this decision that was made,  
20 Scopac has consumed cash by creating the inventory and  
21 paying the harvesting costs until the time Palco chose to  
22 purchase the logs, right?

23 A. Yes, within the constraints of the log deck  
24 agreement, sir.

25 Q. And up through February 29 of 2008, this year,

1 just a few weeks ago, \$6.37 million had been spent in  
2 harvesting costs by Scopac as a result of that decision,  
3 right?

4 A. I didn't know that until I was shown materials  
5 during the deposition; and my recollection is the  
6 materials I was shown did document that level, yes, sir.

7 Q. And on a projective basis through June of 2008,  
8 you project that the total will be somewhere in the  
9 neighborhood of \$13.9 million?

10 A. Again, according to the materials I was shown  
11 in my deposition, that appeared to be the case, yes, sir.

12 Q. And just to be fair, those weren't materials I  
13 created; those were company materials, right?

14 A. Yes, sir.

15 Q. Based on your own cash flow projections and  
16 your own cash flow actuals?

17 A. Sir, I don't prepare those documents, so they  
18 would have come from Gary Clark, our CFO; but otherwise,  
19 I understand your meaning, sir.

20 Q. And those costs significantly impacted Scopac's  
21 cash flow, right?

22 A. Yes, sir.

23 Q. And it's also resulted in Scopac having to dip  
24 into the SAR account?

25 A. In part, yes, sir.

1 Q. And, in fact, that SAR account is the cash  
2 collateral for the noteholder, right?

3 A. Yes, sir, and for Bank of America, as I  
4 understand it, sir.

5 Q. And did you know that Gary Clark had assured  
6 this Court that that wouldn't happen in connection with  
7 the change in business or in connection with this --  
8 these proceedings?

9 A. I recall that Gary had submitted budgets that  
10 showed that we would not need to dip into the SAR account  
11 at some point in these bankruptcy proceedings, yes, sir.

12 Q. Do you recall that that was in the fall of 2007  
13 that he said that?

14 A. I'm sorry, I'm not sure I'm clear on the  
15 timing. My apologies.

16 Q. If you could go to page 7, Exhibit 105. It  
17 says: "Scopac is expected to have sufficient cash to  
18 fund operations and pay administrative expenses through  
19 June 30, 2008 without having to access the SAR account."  
20 Do you see that?

21 A. Yes, sir, I do.

22 Q. And I'll represent to you that this affidavit  
23 was provided in September of 2007 to this Court. By  
24 December of 2007, you-all had already dipped into the SAR  
25 account, true? That was just three months ago.

1           A.    I'm not sure of the exact timing, but we  
2           certainly did eventually dip into the SAR account and  
3           before June 30th obviously.

4           Q.    Well before, just almost a couple of months  
5           after this was said to the Court, right?

6           A.    Again, I don't know the timing of when we  
7           dipped into it. I'm sorry.

8           Q.    And in part, that's the reason for the request  
9           by Scopac to get a new dip facility because of these cash  
10          problems at Scopac?

11          A.    That was one of the issues that led us to be  
12          interested in a dip, as I understand it, sir.

13          Q.    And you agree that the cash flow projections  
14          produced by Scopac during the pendency of the bankruptcy  
15          have not proved reliable when compared to the ultimate  
16          results, true?

17          A.    Well, just like in my deposition, that's a  
18          loaded question. I think my answer than is the one I  
19          like now, which is that when one compares the actuals to  
20          the projections, there are variances. And I think I --  
21          I'll leave it at that for now.

22          Q.    Well, you said -- those weren't my words, were  
23          they? I just said your words in the deposition.

24          A.    If so, I don't remember saying exactly that.

25          Q.    Let's go ahead and bring it up.

1                   (Expert from videotaped deposition  
2 played.)

3           Q.    (By Mr. Krumholz) Do you recall that  
4 testimony?

5           A.    Yes, sir.

6           Q.    And that's not the only unreliable projections  
7 that this company has made during the course of the  
8 bankruptcy; is that right?

9           A.    I think that's true, yes, sir.

10          Q.    If we can pull up Exhibit 117. Do you see this  
11 is an affidavit of Gary Clark in support of Scopac's  
12 emergency motion authorizing the company's continued use  
13 of cash collateral?

14          A.    Yes, sir, I do see that.

15          Q.    And if you could turn to paragraph 14. And the  
16 second sentence of paragraph 14, do you see where it says  
17 "Scopac's management projects that the log deck will be  
18 depleted through sales by the end of May, 2008." Do you  
19 see that?

20          A.    Yes, sir, I do.

21          Q.    And that was a statement made by Mr. Clark to  
22 this Court under oath, right?

23          A.    As an affidavit, I believe that would be true,  
24 yes, sir.

25          Q.    But the reality has turned out far different

1 than the projection, true?

2 A. Well, we're not really at the end of May yet,  
3 sir, but so far it appears that there will be some --  
4 there may be some Scopac log deck left as of that date,  
5 yes.

6 Q. You-all project 6.5 million board feet to be on  
7 the board -- on the log deck in May of 2008. Do you  
8 remember that?

9 A. I do remember you showing me a financial  
10 document that said that, yes, sir.

11 Q. That's you-all's latest and best judgment as to  
12 that issue?

13 A. I can't say whether or not it is, sir. I'm  
14 sorry.

15 Q. But you do know that that document showed the  
16 \$6.25 million worth of timber was going to be sitting on  
17 the Scopac log deck at the end of May 2008?

18 A. Yes, sir.

19 Q. And you know that Palco is unable to pay for  
20 logs for which it has taken delivery now, right?

21 A. I know that Palco did not make a payment in  
22 February for logs that it received from Scopac in the  
23 month of January, yes, sir.

24 Q. And that's exactly what the noteholders were  
25 concerned about back in August of 2007, right?

1           A.    I'm sorry, I certainly couldn't testify to what  
2           the noteholders concerns were.

3           Q.    Well, actually, you were made very aware that  
4           the noteholders objected to this change in business,  
5           true?

6           A.    Yes, sir.

7           Q.    And that they objected to it because of the  
8           very concern that they would -- Scopac may run out of  
9           cash and because of Palco's inability to pay, right?

10          A.    I think there were a variety of concerns.  I  
11          recall that that was one of them, yes, sir.

12          Q.    And it turns out the noteholders were exactly  
13          right on that issue, true?

14          A.    In February they were.

15          Q.    And just to be fair, what Scopac has done is  
16          fund Scopac -- Palco by relieving it of some of its  
17          obligations under the master purchases agreement, right?

18          A.    Yes.

19          Q.    And as a result, the noteholders collateral has  
20          been reduced in terms of cash?

21          A.    The cash portion of their collateral has been  
22          reduced, yes, sir.

23          Q.    Was any interest paid to the noteholders at all  
24          for this funding?

25          A.    Not that I'm aware of, no, sir.

1           Q.    You do remember that when the lump sum sales  
2           agreements with Maxxam were entered into, the question  
3           was raised by one of the independent managers, well, are  
4           we going to have to pay for some interest for this? Do  
5           you recall that when we talked about it?

6           A.    Yes, sir.

7           Q.    And that made sense to you at the time, that  
8           that question might be at issue because this was a  
9           funding up front of capital, right?

10          A.    Yes, sir.

11          Q.    But that wasn't provided to Scopac or the  
12          noteholders, right?

13          A.    No, sir.

14          Q.    Is that correct?

15          A.    To the best of my understanding, that is  
16          correct, sir.

17          Q.    Did you ever analyze or did the company ever  
18          analyze whether this change in business was a breach of  
19          the indenture between the noteholders and the company?

20          A.    I know that some analysis was done, but I  
21          didn't know any of the details, sir. I'm sorry.

22          Q.    You did understand that this change in business  
23          was inconsistent in your mind, with the obligations that  
24          Palco had under the new master purchases agreement?

25          A.    Yes, sir.



1 Q. Okay. And go ahead and pull up 112-A. If you  
2 could go to page 20, section 4.19. Under this section it  
3 says "the issuer," which is, of course, Scopac, true?

4 A. Yes, sir.

5 Q. "Will not take any action that would release  
6 any person from any of the person's material covenants or  
7 obligations to the issuer." Do you see that?

8 A. Yes, sir.

9 Q. And in your mind, that's exactly what this  
10 change in business did?

11 A. Well, I don't want to get trapped here. I'm  
12 not sure what the operative document that's being  
13 referred to in the indenture is.

14 Q. Assume that it's -- one of the operative  
15 documents is the master purchases agreement?

16 A. Under that representation, then, yes, that is  
17 what Scopac did, sir.

18 Q. I want to turn your attention to the plans of  
19 reorganization in this case. You're familiar with those  
20 that have been proposed by the debtors, right?

21 A. Yes, sir.

22 Q. And we talked extensively about the ranch  
23 development project. Do you recall that?

24 A. Yes, sir.

25 Q. And you have a substantial amount of experience

1 in selling timberlands to various entities for various  
2 purposes, right?

3 A. I don't think I would call it substantial, but  
4 I do have some experience, sir.

5 Q. You fell like you had some expertise in that  
6 regard during your deposition, right?

7 A. We have sold some timber properties at the  
8 company during my tenure there, yes, sir.

9 Q. And you understand that the Humboldt County --  
10 Humboldt County what you-all first came up with this  
11 ranch development idea, said, no, you can't do it and  
12 passed an ordinance that enforced that decision?

13 A. Just to be specific, that would be the Humboldt  
14 County board of supervisors.

15 Q. Thank you for that.

16 A. And, yes, they did pass that resolution saying  
17 that they did not believe the development as proposed was  
18 consistent with their planning.

19 Q. And you've dealt with those folks from time to  
20 time over the years on a host of issues, true?

21 A. I don't generally work the political end of our  
22 business, but, certainly, in my two years I've had some  
23 interaction with individual board members and made  
24 presentations to the board. Yes, sir.

25 Q. And in your analysis, it's unlikely that ranch

1 development project will get approved as proposed by the  
2 debtor's plans?

3 A. Well, I think my testimony then as now is that  
4 it will be difficult, it will take a lot of work, and  
5 that given the current political situation in the county,  
6 that it will be difficult.

7 Q. And that it's unlikely; that was your  
8 testimony, right?

9 A. That was my testimony, yes.

10 Q. And that's what you believe?

11 A. I believe it will be unlikely without a lot of  
12 work and a lot of collaboration with the county and  
13 probably with other stakeholders yes, sir.

14 Q. Actually, it will be unlikely in light of all  
15 that, right? That's what you said in your deposition?

16 A. Well, I think the position that I have sitting  
17 here today is that it will be unlikely without a great  
18 deal of work and probably a willingness to adapt the  
19 proposal to the input that we get from the county, yes,  
20 sir.

21 Q. And the debtor's plan also says that the MMCAs  
22 are worth somewhere along the line of -- is it -- the  
23 valuation expert says it's worth \$300 million. Is that  
24 right?

25 A. I believe something like that, yes, sir.

1 Q. And in 2005, UBS also actually tried to sell  
2 these properties and came up with their estimate of  
3 value; do you recall that?

4 A. I remember some discussion of that, yes, sir.

5 Q. And they actually came up with a price that was  
6 something like 10 percent of your number back at that  
7 time? That is 15 --

8 A. Again, the 300 is not my number. And I can't  
9 attest directly to UBS's exact amount, but my  
10 understanding is that it was somewhere in the  
11 neighborhood of about 10 percent of the \$300 million.

12 Q. And you heard that from the folks at the  
13 debtors?

14 A. Yes, sir.

15 MR. KRUMHOLZ: Pass the witness, Your  
16 Honor.

17 THE COURT: All right. Here's the --  
18 traditionally in cases when things like this happen, I  
19 now just have him sit down and then when you take him on  
20 direct, you put him on direct and they cross and we do  
21 all that stuff. I don't want to cross him three times on  
22 the same stuff. So I am willing to allow people to take  
23 some questions now, but you're not going to ask the same  
24 questions after he puts him on the stand. And I'm not  
25 sure exactly how everybody wants to do this, but I'm more

1 than willing to entertain whatever you want to do as long  
2 as you can assure me that it's an efficient and  
3 reasonable, rational way of addressing this witness since  
4 he's sort of out of order.

5 MR. SCHWARTZ: Your Honor, Steve Schwartz  
6 for Marathon. I spoke to Mr. Doren earlier today about  
7 this. And at his request, I would ask questions first  
8 and then he would go. If they recall him on their direct  
9 case, which they've indicated they will, I certainly will  
10 not ask the same questions. We did not call Mr. Barrett  
11 on our direct case, as we indicated earlier to the Court,  
12 because we thought it was more efficient to do it at one  
13 time.

14 THE COURT: Right.

15 MR. SCHWARTZ: So that's why we're doing  
16 it now.

17 MR. DOREN: To be clear, Your Honor, I  
18 suggested Mr. Schwartz go next should he want to ask  
19 questions today. I'm also happy to have him do it when  
20 we recall Mr. Barrett on direct.

21 THE COURT: Do you want to ask today or do  
22 you want to wait until we're on direct?

23 MR. SCHWARTZ: I think I would rather do  
24 it today.

25 THE COURT: All right.

1 MR. SCHWARTZ: Thank you.

2 MR. KRUMHOLZ: Just so I'm clear, Your  
3 Honor, I assume I'll have a chance to recross given the  
4 Court's rule.

5 THE COURT: Well, I mean, if we do that,  
6 you're going to get to question him three times, I guess,  
7 because they're go to put him on direct, and I'm not sure  
8 that -- you've seen this proffer. Have you asked all the  
9 questions about his proffer that you wanted to?

10 MR. KRUMHOLZ: I'll tell you, if they are  
11 going to call him in direct for sure, in their case in  
12 chief, that won't be an issue unless something comes up  
13 with respect to Marathon.

14 THE COURT: We can address that. If they  
15 don't call him, you can always call him at that time.

16 MR. FIERO: Your Honor, the committee will  
17 defer its cross until the debtor's case in chief.

18 CROSS-EXAMINATION

19 BY MR. SCHWARTZ:

20 Q. Good morning, Mr. Barrett.

21 A. Good morning, Mr. Schwartz.

22 Q. I just want to follow up on a couple of  
23 questions that Mr. Krumholz asked you. He asked you a  
24 little bit about the Maxxam agreement to purchase logs.  
25 Do you recall that?

1 A. Yes, sir.

2 Q. And that it was around January of 2008 that  
3 Maxxam said it would not purchase logs; do you recall  
4 that?

5 A. I want to make sure I'm not getting confused.  
6 Are you talking about lump sum sales, or are you talking  
7 about the purchases of logs, such as the Moratia  
8 transaction with Palco?

9 Q. I guess I'll ask you. Either one?

10 A. My understanding -- fair enough. The easiest  
11 way to put it is my understanding is that sometime in  
12 February of this year, that Maxxam indicated they were no  
13 longer interested in making log purchases.

14 Q. And do you have any understanding as to why  
15 Maxxam took that position?

16 A. No, sir.

17 Q. Now, Mr. Krumholz asked you a little bit about  
18 the work Mr. Fleming had done for the company. Do you  
19 recall that?

20 A. Yes, sir.

21 Q. The work Mr. Fleming had done was limited to  
22 the MMCAs, correct?

23 A. That is my understanding.

24 Q. He didn't do any work for the company in  
25 respect to valuing the commercial timberlands?

1           A.    Not that I know of, no, sir.

2           Q.    Now, I want to clarify a few things.  You were  
3 here when Mr. Fleming testified, right?

4           A.    Yes, sir.

5           Q.    And there were a couple of questions I had  
6 asked Mr. Fleming that he could not recall the answers  
7 to.  And I think you're probably in the best position to  
8 answer those.  The Elk and Freshwater watersheds, can you  
9 explain briefly what those are for the court.

10          A.    Yes, sir.  The Scopac timberlands are divided  
11 into a series of watersheds which, in turn, are  
12 aggregated into the water analysis areas that Mr. Fleming  
13 testified to.  So I want to -- I want to differentiate  
14 what I'm about to say in the word "watershed" relative to  
15 a wall, as you recall.

16                 These are watersheds as a scientist would find  
17 them.  They are the catchment area that collectively  
18 feeds all of its water, if you will, into a single stream  
19 system.  The Freshwater watershed is the most northerly  
20 of the Scopac timberlands.  Our ownership there is  
21 approximately 15,000 acres of the entire 20,000-acre  
22 watershed.

23                 The Elk River watershed is immediately south  
24 below it.  It's composed of two sub watersheds, north  
25 fork and south fork, collectively about 35,000 acres, of



1 which I believe we own right around 23- or 25,000.

2 Q. And isn't it true that in 2007 there were  
3 significant restrictions on the ability of the company to  
4 harvest in the Elk and Freshwater watersheds?

5 A. Yes, sir.

6 Q. And do you recall approximately how many -- how  
7 much board feet the company was able to harvest in 2007  
8 from those areas?

9 A. I believe right around 11 million board feet  
10 out of Freshwater and a little bit over 17 million in the  
11 combined north and south fork Elk River, sir.

12 Q. And that was the after harvest in 2007,  
13 correct?

14 A. Yes, sir. Forgive me if I give you a nuance  
15 you may not be interested in. Relative to the  
16 permitting, one of the issues is when does the faller put  
17 the tree on the ground. The numbers I gave you reflect  
18 the time period when the trees were actually yarded,  
19 brought up to the landing, if you will, and brought into  
20 the mill. So in terms of the quantity of logs that were  
21 brought into the mill, those 11 million and 13 million  
22 board foot estimates are about right.

23 Q. Thank you. Now, would you agree that for the  
24 future of Palco and Scopac, it would be beneficial for  
25 the mill, the Palco mill and the Scotia mill and the

1 timberlands to be combined into one entity?

2 A. Would you define beneficial for me. Or is that  
3 just a generic sort of beneficial?

4 Q. Generic. We'll get into the specifics.

5 MR. KRUMHOLZ: Your Honor, I'll just  
6 object as I asked that exact, same question.

7 THE COURT: Okay.

8 MR. KRUMHOLZ: I don't even know what the  
9 generic beneficial means.

10 MR. SCHWARTZ: We'll rephrase.

11 THE COURT: Go ahead. Reask the question.

12 Q. (By Mr. Schwartz) In your view, would it be  
13 good for business if the Scopac timberlands and the  
14 Scotia mill were owned by the same entity?

15 THE COURT: Now you're -- that -- that's  
16 assuming there's some, you know, thing called business  
17 out here that's some sort of a public good that we can --  
18 I think you have to be far more specific. Would it be  
19 good for your client if it was one, the business of your  
20 client? I think you all -- would it be good for the  
21 noteholders? They think it wouldn't be good for the  
22 noteholders. Would it be good for the employees of the  
23 mill? It probably would be good for the employees of the  
24 mill. Would it be good for -- so we're sort of asking  
25 semi-rhetorical questions. But if you want those

1 questions, I would be very specific about who you're  
2 talking about who's going to benefit.

3 MR. KRUMHOLZ: And, Your Honor, we'll  
4 stipulate that it's not good for the noteholders.

5 THE COURT: Okay. I don't think everybody  
6 else would stipulate to that, but I understand that's  
7 your position.

8 Q. (By Mr. Schwartz) Currently the Palco mill and  
9 timberlands are operated separately, correct?

10 A. They -- effectively, yes, sir.

11 Q. And when -- when was it that that started to be  
12 the case, that they were operated separately, do you  
13 know?

14 A. Well, I think you can argue -- my  
15 understanding -- forget arguing. My understanding is  
16 that from its creation, Scopac as an entity has had  
17 operations that were independent of the operations of the  
18 mill.

19 Q. And you are essentially, as you testified,  
20 responsible for running the day-to-day operations of the  
21 timberlands, correct?

22 A. Yes, sir.

23 Q. Would it be easier for you in operating the  
24 timberlands if the Palco mill were not separated from the  
25 timberlands?

1 A. Yes, sir.

2 Q. Can you explain why?

3 A. First of all, some of the efforts required to  
4 transfer ownership of the logs from one entity to another  
5 would go away. So it would be, from a paperwork  
6 administrative, financial tracking point of view, easier.  
7 And I think that the, if you will, the corporate  
8 governance, how do you run these two entities, would be  
9 simplified since there would be only one entity to run.

10 Q. Now, what -- as the operator of the Scopac  
11 timberlands, what would happen from an operational  
12 standpoint to timberlands if the Palco mill were shut  
13 down for any lengthy period of time?

14 A. That would depend on the wishes of whoever was  
15 running the Scopac timberlands. To the extent that you  
16 wanted to continue to harvest timber, I think those  
17 operations would proceed relatively normally. What would  
18 change is that you would have to deck all of your own  
19 logs and arrange for sales of all of your own logs to  
20 third parties.

21 Q. And based on your experience, would it be more  
22 costly to the Scopac timberlands to be selling the logs  
23 to third parties rather than to Palco?

24 A. It certainly could be the case. The other  
25 timber mills to whom we would presumably sell our logs

1 are by and large further away from the Scopac  
2 timberlands, and so what are called your haul costs would  
3 increase. And so, for example, if we sold logs in  
4 Mendocino County, that would involve higher hauling  
5 costs. Those higher hauling costs would reduce the  
6 return to Scopac in all probability.

7 Q. And are you familiar with the prices that Palco  
8 pays Scopac for the timber?

9 A. Yes, sir.

10 Q. And do you know how those prices are  
11 determined?

12 A. Yes. They are set up in the new master  
13 purchase agreement and they're based on state board of  
14 equalization prices, which represents essentially the  
15 stumpage payment to Scopac. And then Palco pays for the  
16 logging and hauling costs.

17 Q. Now, currently how do the state board of  
18 equalization or SBE prices compare to market prices?

19 A. I don't want to be dodging with you either,  
20 counselor. This is the time of year when a lot of log  
21 sales start coming onto the market. There have not been  
22 many log sales over the last, say, four or five months,  
23 so it's a little hard to get an accurate picture of where  
24 the market is relative to SBE. With those caveats in  
25 mind, I would say generally the data suggests that the

1 market price for Douglas Fir logs is below SBE, and that  
2 the same is true for at least small redwood logs.

3 Q. Would the same be true for young growth redwood  
4 logs?

5 A. Generally speaking, yes, sir.

6 Q. Now, if Scopac had to sell -- I'm sorry. Yes,  
7 if Scopac had to sell to third parties rather than Palco,  
8 it wouldn't be selling under SBE prices; it would be  
9 selling based on market prices?

10 A. Yes, sir.

11 Q. Now, have you or anyone at the company, to your  
12 knowledge, done any analysis of the ability of Scopac to  
13 sell its logs to third parties?

14 A. Well, there have been some general discussions  
15 among the senior management team, but whether or not  
16 there's been a market analysis or some financial  
17 analysis, I'm not aware of it, sir.

18 Q. You weren't asked to be involved in any such  
19 analysis, correct?

20 A. No, sir.

21 Q. Now, I want to ask you briefly about the  
22 current operations of the mill. Are you familiar with  
23 those?

24 A. Only in my position as someone who participates  
25 in the senior management team. But some knowledge

1 perhaps, sir.

2 Q. Well, let's see if we can just get through this  
3 very limited questions on this topic. Is the mill  
4 currently operating Douglas Fir?

5 A. I'm safe on that one, Mr. Schwartz. No, it's  
6 not currently milling Douglas Fir.

7 Q. Do you know why?

8 A. I think I understand at least some of the  
9 important reasons, yes, sir.

10 Q. Can you explain them?

11 A. The current lumber market for Douglas Fir is  
12 significantly depressed, meaning that the prices that any  
13 mill would receive for Douglas Fir lumber are much lower  
14 than they have been in a long, long time. And our mill,  
15 given its -- the way it's set up and also its cost for  
16 Douglas Fir logs, does not generally -- I believe it can  
17 mill Douglas Fir into lumber and make a profit on that  
18 lumber.

19 Q. I want to talk briefly about the MRC/Marathon  
20 plan. You are familiar with that plan, are you not?

21 A. I have some familiarity, yes, sir.

22 Q. You reviewed a disclosure statement that was  
23 filed in this case, a joint disclosure statement that  
24 described all the plans?

25 A. Yes, sir.

1 Q. Now, you understand that as part of the plan --  
2 the MRC/Marathon plan, MRC has committed up to \$7.5  
3 million for capital improvements on the mill?

4 A. Yes, sir.

5 Q. Do you believe that those capital -- such  
6 capital improvements are necessary?

7 A. No, they're not necessary. The mill is  
8 operating without them.

9 Q. Has the mill -- has Palco been interested in  
10 providing capital improvements to the mill over the past  
11 two years and been unable to do so?

12 A. I know from my discussions in the senior  
13 management team that they do have capital improvements  
14 that they would like to make, yes, sir.

15 Q. And they haven't made those, correct?

16 A. They certainly haven't made all of them that  
17 they would like to make, sir.

18 Q. Do you think it's a good thing for the mill to  
19 have those capital improvements?

20 A. Based on the discussions in the senior  
21 management team, I would say that it would be beneficial  
22 to the mill, yes, sir.

23 Q. You're familiar with the cash distribution  
24 process that is discussed in the disclosure statement  
25 that MRC would bring to the company if it -- if its plan



1 was approved by the court?

2 A. I certainly have read through it. Hopefully my  
3 memory won't fail me, sir.

4 Q. And I think you agreed at your deposition that  
5 you felt that that would be very beneficial to the  
6 operations of Scopac?

7 A. The cash distributions?

8 Q. The distribution -- I'm sorry. I misspoke. I  
9 apologize for that. The distribution program that MRC  
10 has, are you familiar with that?

11 A. Yes, sir. I visited their distribution center  
12 and have some familiarity with it.

13 Q. Okay. And I think you agreed at your  
14 deposition that having that distribution center would be  
15 beneficial to operations of Scopac; is that correct?

16 A. Well, again, I just -- I want to get my  
17 testimony very accurate, sir. The distribution center  
18 doesn't distribute logs and logs are Scopac's business.  
19 So I don't think it would be fair to say that it would  
20 benefit Scopac directly. However, to the extent that you  
21 could use a distribution system to the benefit of whoever  
22 was making the Scopac logs into lumber, yes, I think that  
23 would be positive leverage and would be beneficial.

24 Q. And under the MRC/Marathon plan, it would be  
25 the same entity that was making the logs into lumber,

1 correct?

2 A. Yes, sir.

3 Q. Now, are you familiar with MRC's philosophy  
4 towards operating timberlands?

5 A. As put forward in the disclosure statement and  
6 certain filings on their website, sir.

7 Q. And you've also had discussions with some of  
8 the members of the MRC staff?

9 A. Yes, sir.

10 Q. And you're familiar with them based on your  
11 experience in the industry?

12 A. With a number of them, yes, sir.

13 Q. And what is your general view on their ability  
14 to operate timberlands?

15 A. I think that their timberlands management team  
16 is competent and does a reasonable job of managing their  
17 timberlands.

18 Q. And I think you also said in your deposition  
19 that they had a long-term philosophy to operating  
20 timberlands; do you recall that?

21 A. That certainly appears to be the case from  
22 what's been written and has been put forward in some of  
23 my discussions, yes, sir.

24 Q. And you agreed in your deposition that that is  
25 an appropriate and positive way to operate timberlands

1 with a long-term view, correct?

2 A. It's certainly a positive way to do it. And it  
3 is, I would say, an appropriate way to view the  
4 management of timberlands. There's not anything  
5 inherently wrong with having a shorter term perspective,  
6 but it's certainly beneficial or can be very beneficial  
7 to also be thinking about the long-term, sir.

8 Q. Now, I want to turn briefly to the general  
9 operations of the forest for some questions that came up  
10 during Mr. Fleming's deposition testimony again. Does  
11 the species mix of the forest change over time?

12 A. Yes, sir.

13 Q. And do you account for that when you're doing  
14 your harvest forecast?

15 A. Again, I don't mean to split hairs. There are  
16 several levels of harvesting forecast that we do at  
17 Scopac. The most important operational forecasts are  
18 developed from the forester's ten-year plan. Within a  
19 ten-year time frame, we don't explicitly model changes in  
20 a species composition, even though the harvest units that  
21 we select are specific to species types or species  
22 groups. So we don't ignore it, but we don't try and  
23 model the changes in time and then use that in the  
24 decision-making process.

25 Q. You also do 50-year harvest plans, do you not?

1 A. Yes, sir.

2 Q. And in doing the 50-year harvest plans, do you  
3 account for changing in species over time?

4 A. Yes, sir.

5 Q. There's also an age distribution effect on the  
6 forest, correct?

7 A. When you say effect, there are trees of many  
8 ages on the forest. And in doing harvest planning, one  
9 has to take that into account, if that's -- if that's how  
10 you want to define the effect.

11 Q. And why is it that you have to take that into  
12 account?

13 A. Well, trees that are too young are not  
14 generally harvestable or not harvestable on as favorable  
15 a terms commercially. And on the other end, when forest  
16 stands get beyond a certain age, one would want to know  
17 that so that you could try and target those areas for  
18 harvest.

19 Q. Now, in doing your harvest projections, do you  
20 recall what the projections of the company were in 2005?

21 A. Yes. I generally remember, sir.

22 Q. And what was the projection for the harvest in  
23 2005?

24 A. Right around 145 million board foot, as I  
25 recall, sir.

1 Q. And how much did the company actually harvest  
2 in 2005?

3 A. I believe it was about 144, 145.

4 Q. And in 2006, what was the projection?

5 A. I don't actually remember with precision, sir,  
6 over 140 million board feet.

7 Q. And do you recall what you actually harvested  
8 in 2006?

9 A. Right at about 100 million board feet.

10 Q. And in 2007, isn't it correct that you  
11 projected approximately 105 million board feet?

12 A. Yes, sir.

13 Q. And the actual harvest was approximately 74  
14 million board feet, correct?

15 A. 74.2 million, sir. Yes, sir.

16 Q. And you have projected approximately 75 million  
17 board feet for 2008, correct?

18 A. Yes, sir.

19 Q. And that projection, that 75 million, is, if I  
20 understood your deposition testimony correctly, is what  
21 you believe is the maximum allowable harvest, correct?

22 A. No, sir.

23 Q. Then can you explain that?

24 A. Yes. The basis for any year-to-year projection  
25 is, again, the forester's ten-year harvest plan, which we

1 update yearly, so I think it's fair to call it a rolling  
2 ten-year harvest plan. That harvest plan is the maximum  
3 possible harvest for the next decade. Those harvest  
4 levels are mostly in the low 90 million range. But  
5 relative to this year's harvest of 75, my group, with  
6 input from George O'Brien, netted down, if you will, that  
7 maximum possible harvest to try and account for  
8 uncertainties in, for example, the regulatory regime or  
9 the Douglas Fir market. So that's too many words to say  
10 the 75 million represents some kind of net down from what  
11 is the maximum possible harvest.

12 Q. And you did that because it's -- A, from what  
13 you said, it's not economical to harvest Douglas Fir at  
14 this point; and B, because there's some regulatory  
15 uncertainty that might reduce the harvest levels,  
16 correct?

17 A. There are -- let's take the easy part. There  
18 are regulatory uncertainties that I think make it prudent  
19 to revise your maximum possible harvest downward.

20 The issue with the Doug Fir market is a little  
21 more complex. If it's okay for your needs, I would say  
22 there are certainly Douglas Fir stands that at this point  
23 in time we do not think are economic to harvest, given  
24 the market conditions. But I wouldn't put a total  
25 prohibition on all such stands, sir.

1           Q.    Let me go back to the harvest projections for a  
2           second.  Do you recall back in 2004 that the company  
3           projected to harvest 160 million board feet for the  
4           period 2004 through 2008?

5           A.    I'm sorry, I don't have any direct memory of  
6           that level.  I'm sorry.

7           Q.    In general, the company hasn't been successful  
8           in predicting its harvest levels, has it, in the last few  
9           years?

10          A.    I'm going to disagree with that.

11          Q.    Why do you disagree with that?

12          A.    I'm going to use as my basis for disagreement  
13          the ten years since I took over the timberlands.  One of  
14          the first things that we did is we try to develop a  
15          ten-year harvest plan, which is something we had not done  
16          previously.  That ten-year harvest plan, I think,  
17          identified harvest levels that we could count on with  
18          some reliability.  So in '05, we came -- we were lower  
19          than the amount we were hoping to hit, but I think I  
20          advised management early on in my tenure -- and I took  
21          over the job in April of '05 -- that number would come in  
22          low.  So relative to the number that my group projected  
23          after we did the 10-year plan, my recollection is that we  
24          hit '05 pretty close.

25          Q.    I'm sorry to interrupt.  But just so it's

1 clear, the prior projection for '05, before you made some  
2 changes, was high and then you adjusted it down?

3 A. Yes, sir.

4 Q. Okay. Do you recall by how much you adjusted  
5 it down?

6 A. I believe about 15 million board feet.

7 Q. Thank you.

8 A. And then in '06 we predicted about 100, as I  
9 recall, and came close to it. I think the prediction  
10 might have been a little bit higher initially, but again,  
11 I generally felt pretty good about the harvest level that  
12 we generated. Oh, and, I'm sorry, then in '07, we  
13 certainly predicted 105 million board foot, but the  
14 understanding of that at the time was that was a very  
15 high level of harvest. It was done prior to us filing  
16 the bankruptcy when we still thought we were going to do  
17 everything we could to meet the noteholder obligations.  
18 And I would call that a stretch plan from the get-go. So  
19 between that and some market changes that led us not to  
20 harvest some Doug Fir, the 74.2 that we harvested last  
21 year, I actually think it's reasonable given what we were  
22 advising people.

23 Q. And you were advising people at first 105  
24 million?

25 A. I certainly advised people that that was the



1 maximum possible harvest as we understood it.

2 Q. Now, but you don't recall that in 2004 that the  
3 company was projecting to harvest 160 million board feet?

4 A. All I can do is tell you that that sounds  
5 reasonable, but I don't have a specific memory,  
6 Mr. Schwartz. I'm sorry.

7 Q. And then in September of 2005, you were  
8 projecting 100 million board feet; is that correct?

9 A. Yes, something like that, yes, sir.

10 Q. And then in '07, as you said, it was -- the  
11 actual as 74 million board feet?

12 A. Yes, sir.

13 Q. Let's turn a little bit to the costs that  
14 Scopac is incurring. What is the current status of  
15 roadwork that is necessary to be done to comply with the  
16 HCP applicable to Scopac timberlands?

17 A. I don't mean to be difficult, but you asked  
18 cost and then said the status of the roadwork. The  
19 status of the roadwork itself is we're in the wintertime  
20 period, so very little work is being done outside of road  
21 maintenance and road rocking.

22 Q. Is there a backlog of roadwork that needs to be  
23 done in order to comply with the HCP?

24 A. Yes, sir.

25 Q. Okay. And why is that backlog existing?

1           A.    Because for the past several years, excluding  
2   2007, the company chose to defer some of that roadwork.

3           Q.    And do you know why the company deferred that  
4   roadwork?

5           A.    To try and -- my understanding is to try and  
6   save funds so that we can meet our obligations to the  
7   noteholders and other parties.

8           Q.    Do you have an estimate about how much money  
9   needs to be spent to -- on the roadwork to make it  
10   compliant with the HCP?

11          A.    Yes, sir.

12          Q.    And what is that number?

13          A.    The total roadwork backlog is approximately 13  
14   million. It's important to understand a lot of that  
15   obligation to do that is not just the HCP. I don't want  
16   to spend too much time on it, but let's just say that  
17   we -- we've been trying to satisfy our HCP obligations by  
18   doing roadwork that under THP's and as part of those  
19   THP's we incur the obligation to do it. So there is a  
20   \$13 million backlog of roadwork. I think it's fair to  
21   say the majority of that is HCP-related but also now  
22   imbedded within THP's and thus a legal part of the  
23   contract of those documents.

24          Q.    And the fact that that's a backlog puts the  
25   company in violation of the HCP and those THPs, correct?

1 A. No, sir.

2 Q. Why not?

3 A. Because we haven't run out of time yet.

4 Q. When will you run out of time?

5 A. Well, that's -- that's a good question.

6 Basically a THP is good for a three-year period of time  
7 after time after its approval, and the state will allow  
8 you to extend it for two one-year periods. So the effect  
9 of that is a THP is good for five years. So as we put  
10 together a road plan every April, one of the things we  
11 obviously do is prioritize for completion in that year  
12 any roadwork that is in THPs that are coming to the end  
13 of their legal lives.

14 Q. And when will -- well, strike that. Right now  
15 the company doesn't have the funds to do that roadwork,  
16 correct?

17 A. I don't believe that's true, no, sir.

18 Q. And do you have an understanding under the  
19 MRC/Marathon plan as to how MRC plans to deal with the  
20 backlog of roadwork?

21 A. Based on their budgets, they appear to make a  
22 commitment to fund higher levels of roadwork over the  
23 first two years of their plan, sir. And so I would  
24 assume that they intend to catch up on that backlog.

25 Q. And that would be a good thing for the

1 timberlands, wouldn't it?

2 A. Yes, sir.

3 Q. Let's talk briefly about the regulatory  
4 environment that Scopac is currently facing. You talked  
5 a little bit about -- in your questioning by Mr. Krumholz  
6 about science first, the regulators. And so I want to  
7 make something very clear in my mind.

8 Isn't it correct that the regulators will often  
9 put on restrictions on the property such that the harvest  
10 levels will be less than what science would allow?

11 A. Yes, sir.

12 Q. Is that currently true with respect to Scopac  
13 property?

14 A. Sometimes.

15 Q. And do you know why the regulators do that? Do  
16 you have any understanding?

17 A. The -- on the Palco HCP, Scopac, Palco HCP, a  
18 lot of the areas that are to be restricted have already  
19 been delineated so the individual agency people don't  
20 have as much discretion to ask for set-asides or no  
21 harvest areas as they might in other ownerships.  
22 Nonetheless, the way the permitting in the state works is  
23 regulators can ask for additional protections if they  
24 think there's a concern, an environmental concern that's  
25 not being addressed in a proposed plan.

1           Q.    And part of that is because the regulators have  
2           -- in their jobs, they have to protect the public  
3           interest and not just focus on the operations of the  
4           timberlands, correct?

5           A.    Yes, sir.

6           Q.    Now, are the regulations for harvesting  
7           redwoods different in some way than the regulations for  
8           harvesting others -- other species?

9           A.    I'm sorry, sir, you mean on our timberlands?

10          Q.    Well, we can start there, yes.

11          A.    I don't know that the actual rules differ very  
12          much, depending on species.  However, the rules that  
13          apply differ depending on, for example, how steep slopes  
14          are or how many streams there are.  And our redwood  
15          dominated and Douglas Fir dominated timberlands tend to  
16          have different kinds of conditions; and therefore, the  
17          application of a uniform set of rules to those two areas  
18          can lead to different results.

19          Q.    And do they all lead to more strict  
20          regulations?

21          A.    They can, yes, sir.

22          Q.    Now, redwoods are predominantly located in  
23          California, correct?

24          A.    I think there's a very small population in  
25          Oregon, some in Chile and New Zealand, but respectively

1 certainly the commercial timberlands are a California  
2 entity.

3 Q. So regulations regarding timberlands in other  
4 states that don't relate to redwoods would be very  
5 different than the regulations in California relating to  
6 redwoods, correct?

7 A. Not necessarily, no, sir.

8 Q. Are you familiar with the regulations of  
9 timberland properties in other states?

10 A. I have been an employee of Scopac for ten  
11 years. Prior to that, I worked in the timber industry in  
12 a couple of other states. So between that and keeping  
13 your ears open when you talk to colleagues, I have some  
14 knowledge, but I would not profess to be an expert in  
15 other states' regulations.

16 Q. Is it your understanding generally that the  
17 regulatory environment in California is stricter than in  
18 other states?

19 A. Yes, sir.

20 Q. Now, I want to go back on this regulation  
21 relating specifically to the Elk and Freshwater  
22 watersheds that we talked about. Now, the restrictions  
23 limited -- the regulatory restrictions limited the  
24 harvest from those areas, correct?

25 A. Yes, sir.

1 Q. And do you know by what percentage your ability  
2 to harvest was reduced because of the regulatory  
3 restrictions in the Elk and Freshwater watersheds?

4 A. Partially, yes. And partially no. The first  
5 set of restrictions were instituted by CDF in 1998. And  
6 they were the first restrictions to impose a limit on the  
7 total number of acres that could be harvested each year.  
8 I have never seen an analysis of how much that restricted  
9 or harvest versus if those had not been imposed.  
10 Subsequently the regional water board would impose its  
11 own acreage restrictions. And those would reduce the  
12 harvest allowed -- the acreage allowed for harvest about  
13 a 25 percent below what CDF had permitted.

14 Q. So that -- if I understood your answer, there  
15 was -- based on whatever you would project to harvest  
16 from those two watersheds, your actual was 25 percent  
17 less due to the regulatory restrictions?

18 A. Yes, that's fair.

19 Q. Are you familiar with the headwaters agreement?

20 A. Generally, yes, sir.

21 Q. Can you give us your general understanding?

22 A. It was an agreement between the state and  
23 federal governments and the parent company of the Scopac  
24 timberlands. It had three major components. The first  
25 was a sale of land to the state and federal government's

1 old growth headwaters reserve. So it was a land  
2 transaction, if you will, cash for land. It gave the  
3 state certain authorities to -- and the federal  
4 government to work with the company to develop what's  
5 called a sustained yield plan, which was primarily a  
6 state-driven process. And then also both the feds and  
7 the states involved in developing a habitat conservation  
8 plan.

9 Q. And do you have any recollection of the amount  
10 of money that was paid by the state and federal  
11 governments as part of that agreement?

12 A. The amount of money is -- I don't know. I know  
13 that the total consideration was over \$350 million. That  
14 included both land and cash.

15 Q. And the result of that payment of \$350 million  
16 and the other factors, the HCP that led to extensive --  
17 in part is what led to regulation on the Scopac  
18 timberlands, correct?

19 A. Yes, sir.

20 Q. Do you know how the regulations on the Scopac  
21 timberlands compared to regulations on other timberlands  
22 in California?

23 A. I have some understanding, yes, sir.

24 Q. And what is that understanding?

25 A. That they are more restrictive on the Scopac



1 timberlands than on other timberland ownerships in the  
2 state.

3 Q. Do you know why that is?

4 A. Yes.

5 Q. Why?

6 A. The habitat conservation plan and also the --  
7 with respect to five watersheds on the Scopac  
8 timberlands, there are a special set of regulations from  
9 the North Coast Regional Water Board.

10 Q. Now, you are not an appraiser, are you?

11 A. No, sir.

12 Q. You're not an expert in valuation?

13 A. No, sir.

14 Q. You're not an expert in using discount rates to  
15 derive valuations?

16 A. No, sir.

17 MR. SCHWARTZ: Thank you, Mr. Barrett. I  
18 have no further questions.

19 THE COURT: All right.

20 MR. PASCUZZI: Your Honor, I have a few  
21 questions if it might be appropriate right now.

22 THE COURT: Would you like to go now? Go  
23 right head.

24 MR. PASCUZZI: Paul Pascuzzi for the  
25 California state agencies.

## 1 CROSS-EXAMINATION

2 BY MR. PASCUZZI:

3 Q. Good morning, Dr. Barrett.

4 A. Good morning, Mr. Pascuzzi.

5 Q. Just a couple of questions about what  
6 Mr. Krumholz had asked you about. He asked you about  
7 other timber companies in the United States having to  
8 comply with the environmental laws. Do you remember that  
9 question?

10 A. Yes, sir.

11 Q. Kind of a rhetorical question. Of course, they  
12 would have to comply with the environmental laws?

13 A. Yes, sir.

14 Q. And I think he asked you whether any timber  
15 company could come in and purchase the Scopac timberlands  
16 and comply with the environmental laws that the Scopac  
17 timberlands have to comply with. Do you remember that  
18 question?

19 A. Yes, sir.

20 Q. And if I recall your testimony, you said it  
21 would be difficult; is that how you described it?

22 A. That's my belief, sir. Yes.

23 Q. And you believe it would be difficult because  
24 of the requirements of the HCP?

25 A. Yes.

1 Q. That would be one factor?

2 A. That would be one factor, yes, sir.

3 Q. And because of the requirements of the  
4 implementation agreement for the HCP?

5 A. By extension, yes, sir.

6 Q. And probably because of the requirements for  
7 the agreement relating to the enforcement of AB 1986?

8 A. Yes, sir.

9 Q. And because of the water board requirements you  
10 testified to that are particular to the Scopac  
11 timberlands?

12 A. Yes, sir, both those specific to -- yes, sir.

13 Q. And I thought you had said, and I want to get a  
14 little more information about this, that you might have  
15 some experience hiring people from other timber companies  
16 at Scopac that would come in and work at Scopac? Have  
17 you done that before?

18 A. Yes, we have certainly hired outside parties to  
19 come into the company, yes.

20 Q. And would it be fair to characterize that  
21 there's a steep learning curve for those people?

22 A. Very much so, yes, sir.

23 Q. Okay. And a learning curve that if you don't  
24 know what you're doing, there could be serious  
25 consequences?

1 A. It's certainly a possibility, yes, sir.

2 Q. It could cost the company money?

3 A. Yes, sir.

4 Q. There are penalty provisions for violations of  
5 the HCP, its own permits and things like that?

6 A. Yes, sir.

7 Q. And there could be harm to the environment?

8 A. It's possible, yes, sir.

9 Q. It could be a loss of political capital; it  
10 could get in the papers, things like that?

11 A. Yes, sir.

12 Q. And would it be even worse if a buyer came in  
13 that had absolutely no experience operating timberlands  
14 at all?

15 A. Well, I think it's fair to say such a buyer  
16 would be extremely dependent upon expertise that they  
17 don't have to make sure that the timberlands were run  
18 well. I would think if you had no understanding of  
19 timberland management, that would be a disadvantage.

20 Yes, sir.

21 Q. And do you have any thoughts about the likely  
22 public reaction to an inexperienced buyer come in as an  
23 owner of the Scopac timberlands? Do you think it would  
24 be favorable?

25 MR. KRUMHOLZ: I'll object as lack of

1 foundation.

2 THE COURT: You need to establish a  
3 foundation if you're going to ask the question.

4 Q. (By Mr. Pascuzzi) Dr. Barrett, you've been  
5 employed here with Scopac for over ten years?

6 A. Yes, sir.

7 Q. And you're familiar with Humboldt County and  
8 when things -- the high scrutiny that the company has as  
9 far as its environmental compliance?

10 A. Yes, sir.

11 Q. And some of that comes out in the newspapers;  
12 is that correct?

13 A. Yes, sir.

14 MR. PASCUZZI: Your Honor, I think that's  
15 a sufficient foundation that he would know.

16 THE COURT: Ask the question.

17 Q. (By Mr. Pascuzzi) Do you have any thoughts  
18 about the likely public reaction to an inexperienced  
19 buyer coming in and owning these Scopac timberlands?

20 MR. KRUMHOLZ: Objection, the same.

21 THE COURT: I'll let him answer. Go  
22 ahead.

23 A. I think there would be -- I think the general  
24 reaction would be concern and -- and probably a  
25 heightened level of scrutiny to look at the actions of

1 this new entity, sir.

2 MR. PASCUZZI: Thank you, Your Honor.

3 I'll pass the witness.

4 THE COURT: All right. Now the debtor.

5 THE WITNESS: Your Honor, I'm sorry to be  
6 inconvenient, but can we take a small break?

7 THE COURT: We can. I was going to say  
8 that I was thinking that we were just going to go  
9 straight to 3:00. Is that what everybody else was  
10 thinking? No lunch? Okay. So we'll take our morning  
11 break now, say, 15 minutes.

12 (A recess was taken.)

13 THE CLERK: All rise.

14 THE COURT: Be seated.

15 MR. DOREN: Your Honor, one point on  
16 scheduling, if I may, before we begin.

17 THE COURT: Go ahead.

18 MR. DOREN: Thank you, sir. Having had  
19 discussions with the noteholders and Marathon, the  
20 noteholders apparently are not going to call Mr. O'Brien.  
21 After that, they will have Mr. Cherner.

22 THE COURT: Okay.

23 MR. DOREN: And at that point, I think  
24 they're not formally resting because they have, I think,  
25 Mr. Matthews who is sent home. They will be done with

1 witnesses for the day. We, in turn, had intended to  
2 begin with our valuation experts, but we're concerned  
3 that they not be separated across a couple of weeks. And  
4 I think that others also wish to take them on cross in a  
5 more -- in a tighter time frame. So the consensus, with  
6 the Court's permission, would be to finish these two  
7 witnesses and then come back and start with the debtor's  
8 case at the next trial date.

9 THE COURT: Okay.

10 MR. DOREN: Thank you, Your Honor.

11 THE COURT: Fine.

12 MR. GREENDYKE: Except the fact that we  
13 would call Mr. Matthews as the first witness and then  
14 begin the debtor's case on the 29th.

15 THE COURT: Okay.

16 MR. GREENDYKE: Thank you.

17 THE COURT: That's assuming that somehow  
18 you-all haven't settled it between now and then.

19 MR. GREENDYKE: That's correct.

20 THE COURT: Which we'll talk about that  
21 before we leave today.

22 MR. DOREN: And my only other comment,  
23 Your Honor, is after the comments that we only show sunny  
24 days in Humboldt County. Today we have a beautiful foggy  
25 morning.

## 1 DIRECT EXAMINATION

2 BY MR. DOREN:

3 Q. Mr. Barrett, if we could --

4 MR. DOREN: And, Your Honor, I just want  
5 to pick out a few topics that were touched upon and that  
6 we will not need to return to again, and then we'll deal  
7 with the balance when we call Mr. Barrett in our case in  
8 chief or on rebuttal.9 Q. (By Mr. Doren) Mr. Barrett, you recall your  
10 discussion generally of Maxxam lump sum purchases?

11 A. Yes, sir.

12 Q. Do you recall, first of all, on how many  
13 occasions that occurred?14 A. I know that there was one set of lump sum  
15 purchases, and then I believe there was a second  
16 follow-up set of purchases.17 Q. Okay. So to the best of your knowledge, it  
18 occurred on two occasions?

19 A. As I recall now, yes, sir.

20 Q. And what was the nature of those sales or of  
21 the purchases by Maxxam; do the purchase on a stumpage  
22 basis?

23 A. Yes, sir.

24 Q. Can you please describe what stumpage is.

25 A. When you purchase on a stumpage basis,



1 essentially what you're buying is the right to have a set  
2 of trees that are out on a piece of forest land. So in  
3 the case of lump sum sales, they bought specific -- they  
4 bought the stumpage on specific harvest units on specific  
5 THPs, and so metaphorically you could drive out in a car  
6 and point out and say those are Maxxam's trees. They  
7 bought them.

8 Q. Or as was explained to me, they're standing  
9 trees?

10 A. Yes, sir.

11 Q. Okay. And what did Palco agree then to  
12 purchase from Maxxam?

13 A. The -- Palco agreed that as the trees were  
14 harvested and brought into the mill, that they would take  
15 possession, scale the trees to find out the correct  
16 volume, and then compensate Maxxam accordingly.

17 Q. And would Palco in those lump sum sale  
18 purchases ultimately be paying Maxxam for hauling and  
19 harvesting?

20 A. Yes, sir.

21 Q. There was some discussion this morning about  
22 the log deck. Do you recall that?

23 A. Yes, sir.

24 Q. And you know that the log deck protocol has  
25 been approved by this Court?

1 A. Yes, sir.

2 Q. You've described a meeting of August 19, 2007  
3 that you attended with the independent managers. Do you  
4 recall that generally?

5 A. Yes, sir.

6 Q. What sorts -- and while no written materials  
7 were provided, as I understand it, what sort of  
8 information did you provide?

9 A. I gave an overview of the proposal to build a  
10 Scopac log deck. I gave an explanation of some of the  
11 plusses and minuses of creating that Scopac log deck from  
12 a Scopac perspective. And ultimately, I was asked to  
13 make recommendations relative to the proposal.

14 Q. And did you offer your personal recommendation  
15 on the proposal?

16 A. Yes, I did, sir.

17 Q. And what was your recommendation?

18 A. I recommended that the independent managers  
19 approve the formation of a Scopac log deck.

20 Q. And did you explain to them the basis for your  
21 recommendation?

22 A. Yes, sir.

23 Q. And what -- what was the basis for your  
24 recommendation?

25 A. This is occurring in August, and you have to

1 understand the nature of Scopac's business is that we  
2 harvest more trees in August, September, and October than  
3 we do in any other five- or six-month period of the year.  
4 So if we had not built the Scopac log deck, we would have  
5 had to forego that harvest. And in many cases, we would  
6 have had to wait as much as a year later to clear certain  
7 either weather-related restrictions or animal-related  
8 restrictions. So I very much thought it was in Scopac's  
9 interest to get that harvest, so that we'd have it  
10 available for sale.

11 In addition, we have a relatively small and  
12 specialized group of logging contractors in Humboldt  
13 County. They also make the majority of their money  
14 during that three-month period. And so I was very  
15 fearful that if we were to cut off the harvesting, that  
16 we would cause great economic harm to these independent  
17 contractors. And many of them might go out of business.  
18 And I ultimately will lose the ability to use them for  
19 future harvesting activities on the company.

20 Q. And did the independent managers approve the  
21 log deck?

22 A. Yes, sir.

23 Q. And there was discussion earlier about the --  
24 whether or not the independent managers had ever been  
25 involved in running timber businesses. Do you recall

1 that?

2 A. Yes, sir.

3 Q. Do you know when Mr. Webb joined the board of  
4 independent managers of Scopac?

5 A. I don't know precisely, but it's been many  
6 years.

7 Q. Do you recall that he joined the board in  
8 approximately 1998?

9 A. Yes, sir.

10 Q. And do you recall that Mr. Weiss joined the  
11 board in 2001?

12 A. That sounds about right, sir. He's also been  
13 on the board for quite a while.

14 Q. From your perspective, though they may not have  
15 been involved in other timber companies, is it fair to  
16 say they've been involved in evaluating issues for this  
17 timber company for many years?

18 A. Yes, sir.

19 Q. I believe you testified that you did not know  
20 whether financial information regarding Palco's financial  
21 condition had been provided to the independent managers.  
22 Do I have that correct?

23 A. I believe so, yes, sir.

24 Q. Do you know whether or not Mr. Clark ever  
25 provided any information of that nature?

1           A.    My recollection is that Gary provided some  
2 verbal information about financial situations.

3           Q.    And this was in that same August time frame?

4           A.    Yes, I believe that's the case, sir.

5           Q.    One of the documents you were shown was a  
6 declaration of Mr. Clark stating that the log deck would  
7 be depleted by the end of May 2008. And then you were  
8 asked some subsequent questions about why the log deck  
9 was larger than anticipated. Do you recall that general  
10 topic?

11          A.    Yes, sir.

12          Q.    Do you know why as of February 2008 the log  
13 deck was -- or March 2008, why the log deck was larger  
14 than anticipated?

15          A.    Yes, sir. We had a -- we had a fairly wet  
16 period there during the winter. It suddenly turned dry  
17 in February. During wet weather you can still bring logs  
18 up to the landings, but you can't bring them out of the  
19 woods. And so our contractors had taken advantage of the  
20 wet weather to continue logging, but they had not been  
21 able to bring the logs in.

22                   That dry weather allowed us to bring a large  
23 amount of volume in that was ready to bring in, plus it  
24 also facilitated additional logging. So that's a lot of  
25 words to say we were able to harvest more in February

1 than we had anticipated due to the turn in weather.

2 Q. Was it a particularly dry February this year?

3 A. Yes, it was, sir.

4 Q. And so in this instance was the fact that the  
5 log deck was larger than anticipated good news?

6 A. It's always good news to have a bigger than  
7 expected log deck.

8 Q. Do you know when the log deck is currently  
9 expected to be depleted?

10 A. My understanding from discussions with the  
11 senior management team is that all Scopac logs will be  
12 consumed by the mill and be off the log deck by late May.

13 Q. Late May of 2008?

14 A. Yes, sir.

15 Q. And who told you that?

16 A. That would be our vice president.

17 MR. KRUMHOLZ: Objection, hearsay, Your  
18 Honor.

19 THE COURT: Excuse me?

20 MR. KRUMHOLZ: Objection, hearsay. I  
21 think he's calling for testimony, an out-of-court  
22 statement by one of the debtor employees. It's hearsay.

23 THE COURT: Well, I agree it's hearsay,  
24 but I think you can ask the question.

25 MR. DOREN: Thank you, Your Honor.

1 Q. (By Mr. Doren) And who told you that?

2 A. Hughey Long. He's our vice president for  
3 operations.

4 Q. Thank you. You-all also discussed the fact  
5 that Palco did not pay in February for logs taken in  
6 January. Do you recall that?

7 A. Yes, sir.

8 Q. Has that -- has an agreement been reached  
9 between Palco and Scopac to address that issue?

10 A. Yes, sir.

11 Q. And can you -- are you familiar with that  
12 agreement?

13 A. Generally I am, sir.

14 Q. Can you generally describe that agreement?

15 A. Yes. In lieu of a cash payment, Scopac will  
16 receive work in progress, which is a fancy way of saying  
17 unfinished boards, of equivalent value to what was owed.  
18 And, in turn, Scopac will go ahead and pay for the  
19 road-related costs that it had previously withheld.

20 Q. And has -- did Palco make payments in March for  
21 logs taken in February?

22 A. That's my understanding, yes, sir.

23 Q. You also had a brief discussion about the sale  
24 of the MMCAs. Do you recall that topic generally?

25 A. Yes, sir.

1 Q. And again, you're not an appraiser, are you?

2 A. No, sir.

3 Q. You don't consider yourself an expert -- or do  
4 you consider yourself an expert in any respect in terms  
5 of the appraisal of higher and better use properties?

6 A. No, sir.

7 Q. Do you consider yourself an expert in  
8 appraising or valuing conservation properties?

9 A. No, sir.

10 Q. Have you ever been involved in the sale of any  
11 conservation properties on behalf of Scopac?

12 A. Yes, sir.

13 Q. And have you been involved in any of the  
14 transactions that have closed?

15 A. Yes, sir.

16 Q. How many?

17 A. One, sir.

18 Q. And can you please describe that transaction  
19 for the Court.

20 A. Yes. It was a 24.1 acre parcel called Horse  
21 Collar. And it was a stand of largely old growth trees  
22 adjacent to Humboldt Redwood State Park. It was sold in  
23 a back-to-back transaction to the Save the Redwoods  
24 League which transferred ownership to the state park  
25 system.



1 Q. And do you know what amount was paid for that  
2 parcel?

3 A. About \$68,000 per acre, a total transaction  
4 price 16 million and change.

5 Q. Do you know how long that transaction took from  
6 beginning to end?

7 A. A long time. Probably the better part of 18  
8 months.

9 Q. 18 months --

10 A. Yes.

11 Q. -- is what you consider to be a long time?

12 A. Yes, sir.

13 Q. Now, do you recall when you were asked by  
14 Mr. Krumholz in your deposition whether you considered  
15 the sale of the MMCAs to be unlikely? You responded: "I  
16 am less comfortable sort of positing a strong word like  
17 unlikely, again, giving my lack of sort of appraisal  
18 sorts of experience. Based on the work that I did on  
19 behalf of Scopac selling land, I would think it would be  
20 unlikely that it could be effected in any kind of a short  
21 period of time." Do you recall that testimony?

22 A. Yes, I do.

23 Q. When you made that statement, did you have a  
24 view on how long you thought such a transaction would  
25 take?

1           A.    Yes, sir.  Based on my efforts to sell Horse  
2   Collar and also some work that was undertaken but not  
3   successfully completed to try and do a conservation sale  
4   on another parcel, I anticipated it would take a year and  
5   a half to maybe as much as two years.

6           Q.    And do you have any personal view on what price  
7   per acre or how much the MMCAs could draw as value?

8           A.    No, sir.

9           Q.    You're leaving that to the experts?

10          A.    Yes, sir.

11                   MR. DOREN:  Your Honor, with the  
12   understanding that we will be recalling Mr. Barrett, I  
13   will pass the witness.

14                   THE COURT:  All right.  Any other debtor,  
15   any questions?  All right.  Anyone else?

16                   MR. KRUMHOLZ:  Your Honor, I just have a  
17   few more questions.

18                   THE COURT:  All right.

19                                REXCROSS-EXAMINATION

20   BY MR. KRUMHOLZ:

21           Q.    Mr. Barrett, I just want to clean up a couple  
22   of loose ends.  First of all, counsel for the debtor  
23   talked to you about the word "unlikely" in the context of  
24   MMCAs.  It's not exactly where we discussed it early  
25   today, is it?

1           A.    I don't know.  That's true, but let's go there.

2           Q.    Okay.  What we talked about as being unlikely  
3   is the ranch project, preserve project.  Do you recall  
4   that?

5           A.    Yes, sir.

6           Q.    And you were very clear about that in your  
7   deposition, were you not, that you did not think it was  
8   likely the ranch reserve project would be approved by the  
9   Humboldt County supervisors, true?

10          A.    Given where the county currently is, yes, sir.

11          Q.    Okay.  That really didn't have anything to do  
12   with the MMCA testimony you just talked about; is that  
13   right?

14          A.    Thank you.  Yes.

15          Q.    And I guess now we've talked about what you  
16   talked about with Mr. Clark about what he talked about  
17   with the board of managers, right?  Kind of double  
18   hearsay there.  You don't have any personal knowledge of  
19   Mr. Clark telling Mr. Weiss, for example, anything, do  
20   you?

21          A.    Well, I was on the phone call, but I understand  
22   your point.

23          Q.    Well, and you don't recall any Palco  
24   projections discussed at all during that phone call of  
25   August 16, 2007?

1           A.    As I said in my previous testimony, I don't  
2 recall.

3           Q.    And this is Mr. Weiss's testimony.  And who is  
4 Mr. Weiss?

5           A.    He is one of the independent managers for  
6 Scopac.

7           Q.    We took his deposition March 5th.  Do you see  
8 that at the top --

9           A.    Yes, sir.

10          Q.    -- 2008.  That wasn't very long ago, right?

11          A.    Yes, sir.

12          Q.    A month or so.  And then it says:  "Do you have  
13 any financial projections -- did you have any financial  
14 projections of Palco at any time?"  And what's that  
15 answer?

16          A.    "No."

17          Q.    And then it says:  "Did you ever request any  
18 financial projection for Palco at any time?"  What's the  
19 answer?

20          A.    "No."

21          Q.    And then it says:  "Did you ever review or have  
22 discussions with others regarding financial projections  
23 for Palco?"  Answer?

24          A.    "No."

25          Q.    "At any time?"  And what's the answer?

1           A.    "Other than comments that were made during  
2 board meetings about Palco's need for a DIP or need for  
3 financing."

4           Q.    And then it says "anything else," right?

5           A.    Yes, sir.

6           Q.    And the answer is "not to my recollection,"  
7 right?

8           A.    Yes, sir.

9           Q.    And you don't recall this being discussed --  
10 have you been told Mr. Weiss didn't recall it being  
11 discussed at any meeting approving this change in  
12 business?

13          A.    I'm sorry. Had I been told that?

14          Q.    Yeah.

15          A.    I'm sorry, as in what -- I have read --

16          Q.    What Mr. Weiss testified to?

17          A.    I have read Mr. Weiss' deposition.

18          Q.    Does it concern you, sir, that Mr. Weiss in his  
19 deposition clearly didn't even understand that the change  
20 in business was for anything other than some sort of one  
21 time event?

22          A.    Yes, I was concerned.

23          Q.    Because that would have been a failure by  
24 management to adequately inform Mr. Weiss about -- about  
25 a very important decision as between Palco and Scopac?

1           A.    I don't think you can say it would be due to  
2           that, but the concern would be that he had not been well  
3           enough informed by me in particular about what was being  
4           proposed during that meeting.

5           Q.    And so based on his testimony, it's your  
6           understanding that Mr. Weiss didn't understand this to be  
7           an ongoing relationship, that is, this change in  
8           business, an ongoing course of business?

9           A.    I'm not sure that's true.  I think at the time  
10          of the meeting in August I believed that Mr. Weiss and  
11          Mr. Webb both understood that this would be an ongoing  
12          business relationship.  When I subsequently found out  
13          that Mr. Weiss said that he thought it was only a  
14          one-time relationship, I was concerned.  And a good part  
15          of that concern is I was second-guessing whether or not I  
16          did a good enough job of explaining.

17          Q.    Because you were the primary person explaining  
18          whether it was a good or bad idea?

19          A.    Others have views, but I certainly played a  
20          large part in that presentation, yes, sir.

21          Q.    And you know you didn't provide any Palco  
22          projections of cash flow or any indications of risks  
23          associated with that?

24          A.    That's correct, yes, sir.

25          Q.    And the reality is immediately after --

1 immediately after the change in business, you immediately  
2 knew there was a problem with the liquidity of Palco?

3 A. Yes. Not to be flippant, but throughout the  
4 course of the bankruptcy there's been a continuing  
5 concern.

6 Q. But -- and you knew that there was a  
7 substantial risk of non-payment by Palco for logs  
8 purchased from Scopac between the time that the change in  
9 business was approved and before the beginning of the  
10 year?

11 A. Yes. By November of that year, Gary was  
12 informing us that liquidity at Palco was getting very  
13 tight and that there were issues related to that  
14 liquidity moving forward.

15 Q. And you never told the independent managers  
16 that there was a substantial risk of non-payment?

17 MR. DOREN: Your Honor, I'll object that  
18 we're now beyond the scope of either direct or redirect  
19 or cross.

20 THE COURT: I think he can finish this  
21 line of questioning. Go ahead.

22 A. I'm sorry. Could you ask the question again?

23 Q. Sure. And you never told the independent  
24 managers that there was a substantial risk of  
25 non-payment?

1 A. That's correct.

2 Q. And so they couldn't decide whether to move  
3 forward with the change in -- the change in business or  
4 not from that point forward with that information?

5 A. They had already made the decision, so what  
6 they would not have been able to do is re-evaluate that  
7 decision based on new information.

8 Q. And did you see in Mr. Weiss's testimony that  
9 had he known that there was that significant serious  
10 risk, he wouldn't have approved it going forward?

11 A. I won't attest that those were his exact words,  
12 but that certainly was, I think, the gist of what he  
13 said. Yes, sir.

14 MR. KRUMHOLZ: Pass the witness, Your  
15 Honor.

16 MR. DOREN: Your Honor, can I ask two  
17 questions in light of the last line of questioning?

18 THE COURT: Well, I think that since they  
19 called him -- now, you're going to have him on direct, so  
20 I think that's when you would do that.

21 MR. DOREN: Thank you, Your Honor.

22 THE COURT: So you may step down. Next  
23 witness.

24 MR. GERBER: Your Honor, Toby Gerber on  
25 behalf of the indenture trustee. The indenture trustee



1 calls Jacob Cherner.

2 THE COURT: All right.

3 (The witness is sworn in.)

4 THE COURT: So this is someone who there  
5 is no proffer?

6 MR. GERBER: There is a proffer, Your  
7 Honor. I believe you received it yesterday, but I have  
8 another one.

9 THE COURT: Oh, okay. It's not in my  
10 book. Maybe it is, and I just can't find it.

11 MR. GERBER: It may not be in the book.

12 MR. HOLZER: Your Honor, he was not in the  
13 original book. It was submitted just yesterday.

14 THE COURT: Okay. I know who he is, okay.

15 MR. JONES: Mr. Gerber, if you have  
16 copies.

17 JACOB CHERNER,  
18 having been first duly sworn, testified as follows:

19 DIRECT EXAMINATION

20 BY MR. GERBER:

21 Q. Mr. Cherner, will you please state your name  
22 for the record.

23 A. Jacob Cherner.

24 Q. And how are you employed?

25 A. Vice president of Scotia Redwood Foundation.

1                   MR. NEIER: Your Honor, okay, I did get  
2 this report, but this is not an expert witness, right?

3                   MR. GERBER: Correct, Your Honor.

4                   THE COURT: So you're telling me about his  
5 proffer?

6                   MR. GERBER: I just have a couple of  
7 corrections.

8                   THE COURT: Okay. You may do that.

9                   MR. GERBER: Thank you, Your Honor.

10                  Q. (By Mr. Gerber) Mr. Cherner, do you have your  
11 proffer before you?

12                  A. Yes, sir.

13                  Q. Have you read it?

14                  A. Yes, sir.

15                  Q. Is it true and correct in all respects?

16                  A. There's two typos and a correction to the term  
17 sheet.

18                  Q. The first typo is on the second line of  
19 paragraph two?

20                  A. Yes, sir.

21                  Q. And what is that typographical error?

22                  A. It should say "formally known" instead of  
23 "formally know."

24                  Q. We're missing an N there?

25                  A. Yes, sir.

1 Q. Then what is the next correction?

2 A. Paragraph four should say "current note  
3 holdings" instead of just "current holdings."

4 Q. So it's --

5 A. Timber notes.

6 Q. Timber notes. In paragraph four of that,  
7 current holdings refers to just the timber note holdings?

8 A. Yes, sir.

9 Q. Has the -- attached to the proffer is a  
10 document called Exhibit A. It's also the indenture  
11 trustee Exhibit 110, the finding term sheet; is that  
12 correct?

13 A. Yes, sir.

14 Q. Has that been amended?

15 A. Yes, sir.

16 Q. And we've served --

17 MR. GERBER: And, Your Honor, I represent  
18 to the Court that last night we served the amended  
19 binding term sheet on -- upon all of the parties. And  
20 we'd like to offer that into evidence as the proffer  
21 refers to the possibility that it would be amended and  
22 also it -- during the course of Mr. Cherner's deposition,  
23 we agreed to certain amendments that were either  
24 suggested or asked for. We'd like to offer indenture  
25 trustee Exhibit 207.

1                   THE COURT: Can I have a copy of it?

2                   MR. GERBER: Yes, sir.

3                   THE COURT: So this is not attached to his

4                   proffer, but now you've got another exhibit.

5                   MR. GERBER: Exactly.

6                   THE COURT: If you were redoing the

7                   proffer, you would put this -- attaching this to the

8                   proffer.

9                   MR. GERBER: Exactly.

10                  MR. JONES: Excuse me. Copies for the

11                  peanut gallery?

12                  THE COURT: So is there -- it's not red

13                  lined?

14                  MR. GERBER: No, I can go through.

15                  THE COURT: So tell me what's different.

16                  MR. GERBER: Okay. Your Honor, in the

17                  first box, which is entitled Purpose, right after the

18                  definition of indenture trustee in the middle of that is

19                  a line seven lines down that ends -- that starts with

20                  indenture trustee, unquote. There's a new insert. That

21                  next sentence is new. It reads as follows: "References

22                  to the indenture trustee herein shall apply to the plan

23                  agent under the plan to the extent necessary to

24                  effectuate the intent and purposes of this binding term

25                  sheet after confirmation of the plan."

1           Then at the top of page 2 of 4, there is a  
2 new parenthetical at the very end of the ending language  
3 at the very top of the parenthetical to read "but in all  
4 events, excluding the excluded assets and any proceeds,  
5 rents, products and profits of the excluded assets" to  
6 make sure we're not getting anything -- Mr. Cherner --  
7 his company is not getting anything from the excluded  
8 assets.

9           Next, in section 363, sale and timing, the  
10 fifth -- at the end of the fifth line down, we deleted  
11 the words "and non-appealable order." It used to say  
12 "final and non-appealable order." It just says "final  
13 order confirming the plan."

14           Then there are later on in the middle of  
15 that paragraph some deletions of language regarding the  
16 timing for the approval of the bids procedure motion so  
17 that it now -- there's a lot of language deleted, Your  
18 Honor, but it's now intended to make clear that the bid  
19 procedures motion needs to be entered no later than 30  
20 days following entry of the confirmation order.

21           Then at the end of that same box, section  
22 363, sale and timing, we've added language in the fourth  
23 to last line, third to last line, and second to last line  
24 that reads -- that begins "increment of \$3 million that  
25 shall be completed, including entry of a court order

1 approving the sale in form satisfactory to the buyer by  
2 no later than six months after entry of the confirmation  
3 order." That's how it now reads with the changes.

4 And I believe the last delete is on page 4  
5 of 5 in the confidentiality section in Subparagraph B.  
6 We've deleted seven or eight lines that were confusing  
7 about when the plan agent and indenture trustee shall  
8 conduct the marketing process. So we've deleted that  
9 language to hopefully clarify timing and obligations.

10 With that, Your Honor, we would offer IT  
11 Exhibit 207 as the amended binding term sheet.

12 THE COURT: Any objection?

13 MR. HALE: No, Your Honor. Just for the  
14 record, there is another change that I noticed last  
15 night. If you look at the MAE provision --

16 MR. GERBER: I didn't know that that  
17 wasn't in there, but in case it is. Yes, Your Honor, I  
18 thought that was in the earlier version, but perhaps not.  
19 In the MAE provision, there was some concern that the  
20 limitations on the material adverse effect that is  
21 described in here did not apply to all circumstances.  
22 And we added the words "in each of the cases one, two and  
23 three" to make sure it was clear of the intentions of  
24 Scotia Redwood Foundation, Inc. and the indenture  
25 trustee.

1                   THE COURT: Any objections? All right.  
2                   It's admitted.

3                   MR. GERBER: Your Honor, with that, we  
4                   offer Mr. Cherner's testimony and the proffer of Jacob  
5                   Cherner.

6                   THE COURT: All right.

7                   MR. GERBER: Oh, Your Honor, one more  
8                   thing. I'd like to introduce to the Court of Jonathan  
9                   Neerman of Hunton & Williams. He's Scotia Redwood  
10                  Foundation, Inc.'s attorney. We're not sure, but in case  
11                  there are any objections on behalf of that company.

12                  THE COURT: Who's going to cross first?  
13                  Do we have an agreement?

14                  MR. NEIER: Mendocino. You're up.

15                  MR. HALE: I'm Brian Hale representing the  
16                  Mendocino Redwood Company.

17                                   CROSS-EXAMINATION

18                  BY MR. HALE:

19                  Q. Mr. Cherner, you are the president of CSG,  
20                  correct?

21                  A. Yes, sir.

22                  Q. And CSG is an investment advisor in Beal Bank,  
23                  correct?

24                  A. Yes, sir.

25                  Q. You personally are also a lawyer, correct?

1 A. Yes, sir.

2 Q. You worked previously in your life as a lawyer  
3 with Mr. Jenkins -- I'm sorry, Mr. Gerber, didn't you?

4 A. Yes, sir.

5 Q. You were at the same law firm as he was,  
6 weren't you?

7 A. For a period of time, yes, sir.

8 Q. Beal Bank and the related entities are the  
9 largest noteholder of the timber notes, correct?

10 A. Yes, sir.

11 Q. And approximately how much of the timber notes  
12 do you hold in terms of face value?

13 A. \$283 -- or 281 million.

14 Q. And about how much percent of the overall  
15 class, of all the timber notes is that?

16 A. Between 37 and 38.

17 Q. You've been -- Beal Bank has been -- when I say  
18 Beal Bank, you understand I'm talking about all the  
19 entities affiliated with Beal Bank. Do you understand  
20 that?

21 A. Yes, sir, I do.

22 Q. And Beal Bank has been active in this  
23 bankruptcy, hasn't it?

24 A. Yes, sir.

25 Q. You are the largest noteholder on the committee



1 of noteholders -- or, well, is there a committee of  
2 noteholders?

3 A. Yes, sir.

4 Q. Are you on that committee?

5 A. Yes, sir.

6 Q. Okay. And you're the largest noteholder on  
7 that committee obviously since you're the largest  
8 noteholder, correct?

9 A. Yes, sir.

10 Q. Now, Beal Bank acquired its position in the  
11 timber notes over a period of years in the secondary  
12 market, correct?

13 A. Yes, sir.

14 Q. Okay. And did it purchase about \$100 million  
15 of those notes in 2001, 2002 from Citibank?

16 A. I don't know from whom we purchased them.

17 Q. Do you know if Beal Bank purchased those --  
18 that \$100 million for an average basis in the 60's, low  
19 60's?

20 A. No, sir.

21 Q. Okay. As a lawyer, you're familiar with  
22 contracts, correct?

23 A. Yes, sir.

24 Q. Okay. You're familiar with bankruptcy  
25 processes as a result of your work as a lawyer, correct?

1 A. Somewhat. Yes, sir.

2 Q. You're familiar with corporate identity and  
3 parents of subsidiaries, correct?

4 A. Yes, sir.

5 Q. You're familiar with the concept of limited  
6 liability at the corporate level?

7 A. Yes, sir.

8 Q. Okay. You're familiar with guaranty agreements  
9 and indemnity agreements and things like that?

10 A. Yes, sir.

11 Q. Okay. Now, focusing specifically on your term  
12 sheet -- and I might go back and forth. I only had the  
13 new term sheet late last night, so I kind of got my notes  
14 on the old one. So if there's a little confusion, just  
15 let me know, okay?

16 A. Yes, sir.

17 Q. The entity that's going to acquire the assets  
18 is something called Scotia Redwood Foundation, Inc.,  
19 correct?

20 A. Yes, sir. Yes, sir.

21 Q. And that entity -- what is the business of  
22 Scotia Redwood Foundation?

23 A. It's a special purpose vehicle.

24 Q. Have -- what generally is the offer designed to  
25 do, the Exhibit 110 and, I guess, the new one is 207?

1 A. I don't have 207 in front of me, Mr. Hale.

2 Q. I'm sorry.

3 MR. HALE: Toby, do you have another copy?

4 Q. (By Mr. Hale) That's the amended offer?

5 A. I'm sorry. I just didn't know what you were  
6 talking about.

7 MR. GERBER: May I approach, Your Honor?

8 THE COURT: You may.

9 MR. HALE: Well, how about I approach?

10 THE COURT: Okay. Why don't you approach.

11 THE WITNESS: Thank you.

12 Q. (By Mr. Hale) 207, for the record, is the  
13 amended term sheet, correct?

14 A. Yes, sir.

15 Q. And when did you send that to Mr. Gerber?

16 A. I physically handed it to him last night.

17 Q. Okay. Did you negotiate that with him  
18 beforehand?

19 A. After your deposition of me on Wednesday, we  
20 made changes to accommodate the concerns you raised in my  
21 deposition.

22 Q. Did you discuss those changes with Mr. Gerber  
23 beforehand, or did you take what I said and go back and  
24 change it and then hand him a new one?

25 A. I believe I discussed to make sure I had all

1 the changes that you raised as well as the changes raised  
2 by counsel for Bank of America and one of the other  
3 attorneys at the table, Mr. Alan. I don't remember.

4 Q. Now, you remember I think at the deposition on  
5 Wednesday -- it might have been Tuesday. I think it's  
6 Wednesday. I'm losing track of days, too. I asked you  
7 to describe what the purpose of the offer was; do you  
8 remember?

9 A. No, sir, I don't. I'll be glad to tell you the  
10 purpose of the offer is to buy the timberlands.

11 Q. Okay. Do you remember telling me that the --  
12 it was then Exhibit 110, which was a term sheet then --  
13 that it was an offer to buy the tree farm for \$603  
14 million?

15 A. Yes, sir.

16 Q. Does that sound generally consistent of what  
17 your intent is by purposes of this document?

18 A. Yes, sir.

19 Q. Okay. You, in fact, want to not sell -- turn  
20 around and flip and sell the property, but to operate the  
21 tree farm; isn't that what you told us?

22 A. Yes, sir.

23 Q. Okay. What exactly is a tree farm when you use  
24 that term?

25 A. Operating timberlands for tree harvesting.

1 Q. And is that the way you contemplate operating  
2 the Scotia Pacific timberlands if your offer is  
3 ultimately accepted?

4 A. Yes.

5 Q. Okay. If you take a look at -- I guess we can  
6 focus on 207, which is your amended one.

7 A. Yes, sir.

8 Q. Can you briefly describe -- obviously the  
9 document speaks for itself, but can you briefly describe  
10 what you're purchasing for your \$603 million?

11 A. The assets to be sold on page 1.

12 Q. Okay. And the first asset is all owned  
13 timberlands. Do you see that?

14 A. Yes, sir.

15 Q. And the second one is the related timber  
16 cutting rights. Do you see that? And then it goes on a  
17 little bit.

18 A. Yes, sir.

19 Q. Okay. What is your understanding of the Scotia  
20 Pacific cutting rights as used in this section?

21 A. The rights that Scotia, the debtor in  
22 possession has to cut the trees.

23 Q. What's your understanding of what Scotia  
24 Pacific right to cut trees is?

25 A. There are cutting contracts that Scotia Pacific

1 has.

2 Q. What are those -- I'm sorry, I didn't mean to  
3 interrupt you.

4 A. No, that's fine. They have timber harvest  
5 plans in place to cut the trees.

6 Q. Any other cutting rights you can think of?

7 A. No, sir.

8 Q. Okay. Now, Scotia Redwood Foundation is owned  
9 ultimately by Beal Financial, and it's in the Beal Bank  
10 family of companies; is that fair?

11 A. Fair.

12 Q. And speaking out about Beal Bank as a whole,  
13 has Beal Bank ever owned and -- owned timberlands before?

14 A. Yes, sir.

15 Q. And where were those timberlands?

16 A. Estonia.

17 Q. And Estonia is in western Europe or eastern  
18 Europe; it's the country over there?

19 A. Correct.

20 Q. As opposed to Estonia, California, I guess.  
21 And in the United States has Beal Bank ever owned any  
22 timberlands in the United States?

23 A. No, sir.

24 Q. Has it ever owned any timberlands that  
25 constitute a redwood forest?

1 A. No, sir.

2 Q. Does Beal Bank employ any certified or  
3 registered foresters?

4 A. Not as employees, no, sir.

5 Q. Okay. And Scotia Redwood Foundation doesn't  
6 have any financial statements, does it?

7 A. No, sir.

8 Q. Okay. Does it have any employees? I think you  
9 said you were an employee of Scotia Redwood Foundation,  
10 right?

11 A. Yes, sir.

12 Q. Okay. Are there any other employees of Scotia  
13 Redwood?

14 A. Andy Beal is.

15 Q. Now, in connection with its proposed offer and  
16 its interest in the Scotia assets, has Beal Bank retained  
17 any timber experts to advise it?

18 A. We've had timber experts retained since 2001.

19 Q. When we spoke at your deposition the first  
20 time -- I saw you last week in Dallas too, didn't I?

21 A. Yes, sir.

22 Q. The day of your daughter's birthday, if that  
23 helps you place the time.

24 A. Yes, sir.

25 Q. And in formulating the offer for -- that's

1 contained in this document, has Beal Bank been working  
2 with the timber harvesting expert or anyone like that?

3 A. To formulate this specific offer --

4 Q. Correct.

5 A. -- no, sir.

6 Q. No. Scotia Redwood Foundation, Inc. is not any  
7 kind of a tax efficient vehicle to hold timberlands, is  
8 it?

9 A. As you and I discussed at my deposition, tax  
10 efficient you use in terms of TMO's and things like that?

11 Q. It's not a TMO, is it?

12 A. No, sir.

13 Q. And a TMO is a timber management organization?

14 A. I told you then I still don't know what it is,  
15 but after listening yesterday, I have a better idea. It  
16 is a sub chapter -- part of a sub chapter S family.

17 THE COURT: TMO is part of a subchapter --

18 THE WITNESS: No, sir, Scotia Redwood  
19 Foundation --

20 THE COURT: Scotia Redwood acquired the  
21 sub -- okay.

22 Q. (By Mr. Hale) And in a tax structure, is a sub  
23 chapter S a pass-through entity?

24 A. There's no tax at the corporate level.

25 Q. Okay. It's not an MLP, though, right, Scotia



1 Redwood Foundation?

2 A. If it's a master limited partnership?

3 Q. Correct.

4 A. No, sir.

5 Q. And it's not a real estate investment trust, is  
6 it?

7 A. No, sir.

8 Q. At the Scotia Redwood Foundation level, no Beal  
9 Bank entity has guaranteed any of the liabilities of  
10 Scotia Redwood Foundation, Inc.; isn't that correct?

11 A. Yes, sir. That is correct.

12 Q. And in the event of a breach of any agreement  
13 or bid or offer or anything like that that's contained in  
14 Exhibit 207 that might ultimately be accepted, neither  
15 Mr. Beal or any other Beal Bank entity has agreed orally  
16 or in writing to guarantee the obligations of Scotia  
17 Redwood Foundation; isn't that right?

18 A. There is no guarantee in place, that is  
19 correct.

20 Q. There's no -- no one has agreed to it, so  
21 putting aside whether there's an actual guarantee draft,  
22 there's been no agreement on that subject?

23 A. No, sir.

24 Q. That's not correct or --

25 A. I'm sorry.

1 Q. That's fair enough. There has been no  
2 agreement by anyone to guarantee the obligations of  
3 Scotia Redwood; isn't that right?

4 A. Yes, sir.

5 Q. Okay. And currently the assets of Scotia  
6 Redwood hold Beal Bank's and Andy Beal's timber notes,  
7 correct?

8 A. The Beal affiliates. I've explained to you  
9 that there's some steps that have to be gone through  
10 before Andy's personal notes can go in.

11 Q. And that transfer hasn't been effectuated yet,  
12 but that's the intent?

13 A. It will be effectuated, yes, sir.

14 Q. Okay. And it's got a small amount of cash, I  
15 think you told me, maybe some accounts receivable?

16 A. It does.

17 Q. Less than a million dollars; isn't that right?

18 A. That was my recollection, yes, sir.

19 Q. I think it was less than \$100,000, I think, is  
20 what we talked about at your deposition.

21 A. Whatever it was on that day, Mr. Hale.

22 Q. Okay. And there's no agreement currently in  
23 place that those timber notes and cash and AR will stay  
24 at Scotia Redwood Foundation, say, for example, like next  
25 week; isn't that right?

1           A.    No, sir.  Actually, I told you at my deposition  
2           that I would agree for the duration.  And I believe the  
3           new term sheet provides that the notes would remain in  
4           Scotia Redwood Foundation.  And if it doesn't so state, I  
5           state now and I will agree to make whatever change to the  
6           term sheet right now that will expressly provide that.

7           Q.    I didn't mean to interrupt.

8           A.    That's a very good point.  If that change  
9           wasn't made, that was fatigue on my part that it wasn't  
10          made.  That was the intent, to make that change as well.

11          Q.    Okay.  Looking at 207, do you know if that's in  
12          there or covered in the changes that Mr. Gerber and, I  
13          guess, I pointed out earlier?

14                   MR. GERBER:  Your Honor, I'll state for  
15          the record, I don't think that change came through on the  
16          changes, but if Mr. Cherner did promise to make it at the  
17          deposition, then I'll get it.

18          Q.    (By Mr. Hale)  Now, this term sheet, I think  
19          you and I got together a week -- not even a week ago  
20          anymore.  It was Thursday, last Thursday, correct?

21          A.    April 3rd.  Yes, sir.

22          Q.    April 3rd.  And at that point in time, you  
23          didn't have a draft of this term sheet, did you?

24          A.    No, sir, I did not.

25          Q.    And you hadn't sent a draft of that term sheet

1 to the indenture trustee, had you?

2 A. No, sir, I had not.

3 Q. And you got the term sheet either the next day  
4 or slightly after our deposition ended; isn't that fair?

5 A. Yes, sir, Friday, I believe is when I got it.

6 Q. And then you turned around and sent the  
7 indenture trustee the next day or shortly thereafter;  
8 isn't that right?

9 A. Yes, sir.

10 Q. And you negotiated with Mr. Gerber and his firm  
11 over the weekend, correct?

12 A. Yes, sir.

13 Q. And you told me at your deposition you probably  
14 talked to Mr. Gerber and his firm for about two or three  
15 hours on this; is that fair?

16 A. In multiple different conversations it may  
17 aggregate that. I do not know.

18 Q. And then after two or three hours of  
19 discussions with Mr. Gerber and his firm and the  
20 indenture trustee representatives, you have an agreement;  
21 is that right?

22 A. No sir, I had several conversations with my own  
23 counsel, Hunton & Williams.

24 Q. I just meant interaction with the indenture  
25 trustee and that side of the table.

1           A.    There was also a conversation or two -- two  
2           conversations between myself and Houlihan Lokey or their  
3           people at Houlihan Lokey.

4           Q.    Now, those conversations, you didn't have any  
5           conversation with Mr. Daniel, did you?

6           A.    No, sir.

7           Q.    And, in fact, I think when we talked last week,  
8           you didn't know who Mr. Daniel was; isn't that right?

9           A.    I didn't recall the name, no, sir.

10          Q.    And you've never spoken with Mr. Daniel at  
11          Houlihan Lokey, have you?

12          A.    To the best of my knowledge, Mr. Hale, I have  
13          not.

14          Q.    Okay. Now focusing specifically on the offer,  
15          if your offer is accepted and ultimately it results in a  
16          sale, the timber noteholders aren't going to receive \$603  
17          million, are they?

18          A.    The indenture trustee will receive it. If  
19          there's monies that have to come out for the plan agent  
20          to pay administrative claims and things like that, net of  
21          that amount -- those amounts.

22          Q.    Well, that's what I want to talk about. I want  
23          to talk about two things. First, you're familiar with  
24          the indenture trustee's plan in this case, aren't you?

25          A.    Yes, sir.

1 Q. Okay. Did you review it before it was  
2 submitted when you -- in your capacity as a member of the  
3 noteholder committee?

4 A. I believe I did.

5 Q. Okay. And if we can get the disclosure  
6 statement. And specifically I want to turn to page 83 of  
7 the disclosure statement, which is a --

8 MR. HALE: Your Honor, this is Exhibit 35.

9 THE COURT: All right.

10 MR. HALE: MMX 35. Can I approach the  
11 witness?

12 THE COURT: You may. So page 83.

13 MR. HALE: 83, Your Honor.

14 Q. (By Mr. Hale) Before we walk through the  
15 waterfall, why don't we talk about timing of the offer  
16 and when it was accepted. If your offer is accepted, you  
17 would only be obligated to pay \$603 million at the  
18 earliest six months after a confirmation; isn't that --  
19 isn't that the timing contemplated? Let me break it down  
20 a little bit.

21 A. Yes, sir. Thank you.

22 Q. The way your offer works is there would be a  
23 confirmation order entered in this case, correct?

24 A. Yes, sir.

25 Q. And then Beal Bank would put down a deposit

1       shortly thereafter, right?

2           A.     The foundation.

3           Q.     And then there would be a six-month bidding  
4       procedure sale process, correct?

5           A.     Yes, sir.

6           Q.     And then after that sale process is done, the  
7       Court approves the sale in an order to your liking -- to  
8       your approval, correct?

9           A.     Yes, sir.

10          Q.     Okay.  And when does the sale close?  When does  
11       money change hands?

12          A.     As soon as possible after that.

13          Q.     After that.  Is it contemplated that it closes  
14       when the Court confirms the sale process after that six  
15       months, or is there another period of time after that for  
16       the sale to close?

17          A.     As soon as possible after that.

18          Q.     Okay.  So if confirmation is -- if a  
19       confirmation order is entered about a month from now --  
20       and I know we can't make a commitment for the Court, but  
21       just for timing -- about a month from now, then we have  
22       another six months on the back end, right?

23          A.     Yes, sir.

24          Q.     And so the best case scenario is \$603 million  
25       comes in seven months from now, right?

1                   MR. GERBER: Objection, Your Honor. The  
2 term sheet does not say that. And it says that no more  
3 than six months for closing. So to say that it's got to  
4 take six months is mischaracterizing the term sheet.  
5 It's just not fair of this witness.

6                   THE COURT: And it is a bid. Somebody  
7 could overbid, so it might not be 600. So go ahead.

8                   Q. (By Mr. Hale) If it's six months, just for  
9 timing's sake, we can talk about, at the present value  
10 that \$603 million back to the day compare apples to  
11 apples, wouldn't you, with an offer on the table today?

12                   A. Six months was the request at the indenture  
13 trustees to provide a marketing period. If the indenture  
14 trustee wants to close this in two months, we're ready to  
15 close it in two months.

16                   Q. I guess what I'm saying, though, is --

17                   MR. GERBER: Your Honor, he's interrupting  
18 the witness. He hasn't finished answering.

19                   THE COURT: I don't think he did it  
20 intentionally. It's his personality.

21                   MR. GERBER: I understand that.

22                   THE COURT: Just let him take a little  
23 more time to answer.

24                   MR. HALE: Okay, Your Honor.

25                   Q. (By Mr. Hale) Did I interrupt you?



1           A.    No.  Mr. Hale, you and I have been in  
2           depositions so many times, I think I'm anticipating your  
3           next question.  I apologize.  You didn't interrupt me.

4                    THE COURT:  And I thought that was what  
5           was happening.  So go ahead.

6           Q.    (By Mr. Hale)  Okay.  But there is a timing  
7           differential whenever the consideration is received in  
8           the closing in an offer on the table today, correct?

9           A.    There will be a time elapse, yes, sir.

10          Q.    Okay.  And so you -- in order to look at a sale  
11          that would close shortly after confirmation, you would  
12          have the present value, the consideration you received  
13          back to basically confirmation.  Maybe it's six months.  
14          Maybe it's whatever sales process takes; isn't that  
15          right?

16          A.    The noteholders need to consider the time value  
17          of money.  Is that your question, Mr. Hale?

18          Q.    No.  I guess what I'm trying to say is that the  
19          distributions -- there's a difference in when anyone  
20          receives money under your offer and the indenture trustee  
21          plan and the Mendocino Redwood plan and Marathon plan,  
22          which would close shortly after confirmation.  Is that  
23          fair?

24          A.    Yes, sir.

25          Q.    Okay.  And in order to compare apples to

1 apples, you would have to present value the offer of the  
2 timing of the consideration?

3 A. Yes, sir.

4 Q. Okay. And there's also expenses associated  
5 with the sale process, aren't there?

6 A. Sure. Yes, yes. There would be expenses.

7 Q. But we have the plan agent, correct?

8 A. Yes, sir.

9 Q. Okay. And also, you know, I read this last  
10 night, too. I think there was another change in here.  
11 Oh, no. Mr. Gerber pointed it out. That's where I saw  
12 it. That the plan agent basically will be stepping in  
13 the shoes of the indenture trustee or it references the  
14 indenture trustee or now the plan agent afterwards. The  
15 plan agent is going to be doing that marketing work and  
16 things like that; is that right?

17 A. Yes, sir. The objective here is to give the  
18 opportunity for there to be an active marketplace testing  
19 to see what the value of the tree farm is.

20 Q. Okay. And the plan agent fee in this case --  
21 or do you know who Governor Wilson is?

22 A. I've never spoken to Governor Wilson. I know  
23 him, yes, sir.

24 Q. It's contemplated he be the plan agent, right?

25 A. Yes, sir.

1 Q. And he's going to be paid at a rate of \$150,000  
2 a month; is that familiar?

3 A. Yes, sir.

4 Q. Okay. So we've got his fee on it. We also  
5 have a -- Houlihan Lokey's been retained to help sell the  
6 assets, too, correct?

7 A. Yes, sir.

8 Q. And do you contemplate Houlihan Lokey would  
9 receive some sort of transaction fee for that work in  
10 marketing and selling the assets?

11 A. Mr. Hale, I don't know. I'm almost certain  
12 that they will charge something for that.

13 Q. I think that's probably right. And then  
14 there's also related professional fees associated with  
15 closing a transaction and lawyer work and thing like --  
16 things like that, correct?

17 A. Yes, sir.

18 Q. All right. And if you take a look now at the  
19 disclosure statement, in the document. That's page 83.  
20 There's a -- there's a waterfall of distributions. Do  
21 you see that between 83 and 84?

22 A. Bottom left page is --

23 Q. I'm sorry, look at the top left corner of 83.

24 A. Under non-classified claims? Administrative  
25 claims.

1 Q. That's right.

2 A. Administrative claims, yes, sir.

3 Q. And administrative claims and then comes down  
4 to tax claims, priority non-tax claims. Do you see that?

5 A. Yes, sir.

6 Q. Okay. And do you have an understanding of  
7 which of the claims in this case on these two pages  
8 between 83 and 84 represent the noteholders' claims? And  
9 I'll tell you I think it's on page 84, class 2(b).

10 A. Yes, sir.

11 Q. Okay. So sitting on top of the noteholders'  
12 claim before the noteholders get any money, we pay the  
13 administrative claims which are estimated at 10 million,  
14 the tax claims which are half a million dollars, priority  
15 unsecured tax claims, class one, \$96,000. And then we  
16 come to class 2(a). Do you see that?

17 A. Yes, I do.

18 Q. Now, do you have any understanding of this  
19 section? And I don't want to talk about the distribution  
20 schedule, but do you understand what this is trying to  
21 capture, what claim this is?

22 A. Claims paid ahead of the noteholders.

23 Q. Okay. And they're paid out of a separate  
24 account. It's called the SAR account. And to the extent  
25 there's not enough in the SAR account, then they're paid

1 out of the waterfall?

2 A. Yes, sir.

3 Q. Okay. And do you know if there's enough money  
4 in the SAR account to fund that or if there's about a \$9  
5 million deficit?

6 A. I don't know, but I'll take your word for it  
7 that there is.

8 Q. If there's any deficit in this -- in this  
9 claims, the deck comes out of the consideration before  
10 the noteholders receive anything, right?

11 A. Yes, sir.

12 Q. So out of 603 we have to take \$10 million of  
13 administrative claims, the half a million dollars of the  
14 claims up above it, tax claims, the deficiency out of  
15 this claim, correct?

16 A. Mr. Hale, the deficiency out of this claim?

17 Q. Any deficiency in the SAR account?

18 A. Oh, yes, sir. Yes, sir.

19 Q. And then we have to pay their plan expenses,  
20 correct?

21 A. Yes, sir.

22 Q. So before we hit the amount that the -- and  
23 then we have the present value issue, correct, because  
24 the noteholders wouldn't receive any money until after  
25 the sale closes, correct?

1 A. Yes, sir.

2 Q. Okay. Do you have any estimate as to the net  
3 that the noteholders would receive in aggregate if you  
4 ultimately sell or purchase the assets for \$603 million  
5 at some point in the future?

6 A. No, sir.

7 Q. Okay. Now let's go specifically to your offer,  
8 all right, and how it would be financed. And let's go  
9 specifically to page 2. Hold on. Let me make sure I'm  
10 on the right -- 207, page 2. At the bottom,  
11 consideration and deposit. And the last paragraph here  
12 it says: "The buyer has already arranged for  
13 approximately 420 million in equity in junior debt from  
14 related entities." Do you see that?

15 A. Yes.

16 Q. Let's talk first about that. How much of that  
17 420 million is in debt?

18 A. 195 million.

19 Q. And how much of that is in equity?

20 A. The balance.

21 Q. So that is roughly \$225 million in equity, if I  
22 did my math right?

23 A. Close to that, yes, sir.

24 Q. Okay. So we have 420, and we ultimately have a  
25 603 purchase price, right?

1 A. Yes, sir.

2 Q. And so we're looking for -- that leaves a  
3 financing gap, doesn't it?

4 A. No, sir.

5 Q. Well, where is the difference between 420 and  
6 603? Where does that money come from?

7 A. Either first lien lender or dividends from  
8 subsidiaries.

9 Q. All right. Well, let's talk first about a  
10 first lien lender, and then we'll talk about dividends  
11 from subsidiaries. Have you had any conversations with  
12 the first lien lender in this case or in connection with  
13 your offer?

14 A. Perspective first lien lenders, yes, sir.

15 Q. And who is that?

16 A. Lehman Brothers.

17 Q. All right. And do you have a commitment from  
18 Lehman Brothers that you've accepted to provide that  
19 first lien financing?

20 A. No, sir.

21 Q. And, in fact, you have refused to give us  
22 documents that reflect the correspondence back and forth  
23 with Lehman; isn't that right?

24 A. Yes, sir.

25 Q. Okay. And we talked about that at your

1 deposition, correct?

2 A. Yes, sir.

3 Q. And even though you produced a couple documents  
4 last night with this offer, you didn't include the Lehman  
5 documents, did you?

6 A. No, sir.

7 Q. Other than Lehman, have you talked to any other  
8 first lien lender?

9 A. One phone call yesterday unsolicited in to me,  
10 yes.

11 Q. Okay. That's -- there's no commitment from  
12 that lender then, is it?

13 A. No, sir. I can do it again within the Beal  
14 families through dividends if we don't get a first lien  
15 lender in place.

16 Q. Okay. So we're looking at 225 million of the  
17 420 comes from Beal entities. Hold on. Let's take a  
18 step back for a second.

19 Right now in terms of financing, you have  
20 commitments for junior debt fees of \$195 million; isn't  
21 that right?

22 A. Yes, sir.

23 Q. Okay. And then of the 420 you referenced, we  
24 decided that 225 either had to come from first lien or  
25 dividends, you said, correct?



1 A. Yes, sir.

2 Q. Okay. And then we've got another \$203 million  
3 that has to come from somewhere else also, correct?

4 A. Yes, sir.

5 Q. Okay. And what is to be the source of that  
6 \$203 million?

7 A. It would either be from dividends or borrowings  
8 against the timber notes.

9 Q. Okay. So that leaves \$428 million that either  
10 come from Beal or from dividends. Do you see how I added  
11 that, 225 and 203?

12 A. No, Mr. Hale, I don't. But you're close.  
13 Close enough for our purposes, I think.

14 Q. How did I do it wrong? Can you tell me that?

15 A. The 195 -- the balance was 195.

16 Q. Right.

17 A. Then there's availability for there to be a  
18 \$200 million first lien piece, and the balance of that  
19 would come from dividends.

20 Q. Okay. Well, you don't have a first lien agreed  
21 to, right?

22 A. That's correct.

23 Q. Okay. And if you don't ever get a first lien  
24 agreed to or a commitment or one that you want to take,  
25 where is the money going to come from?

1           A.    Increase the size of the dividends.

2           Q.    Okay. I guess that's what I'm saying.

3           A.    I'm sorry. I apologize.

4           Q.    No, no. So we're looking at going potentially  
5 \$420-odd million coming from Beal, correct?

6           A.    Yes.

7           Q.    An that's in addition to the 195 million in  
8 junior debt that you've identified, correct?

9           A.    Right.

10          Q.    Okay.

11          A.    Yes, sir.

12          Q.    Let's focus first on the 195 piece, okay? Now,  
13 Scotia Redwood Foundation didn't ever fill out a loan  
14 request or fill out any documents and give them to any  
15 bank or anything seeking a loan, did they?

16          A.    No, sir.

17          Q.    Okay. And, in fact, Scotia Redwood Foundation  
18 hasn't received from any bank any written document  
19 commitment, loan agreement, anything like that agreeing  
20 to lend money into the transaction; isn't that right?

21          A.    There's no written document, but we have the  
22 authorities we need to complete the transaction.

23          Q.    And that authority is based on a -- the bank's  
24 approval, correct?

25          A.    The bank's approval for the loan and then the

1 board meetings approving the dividends, if necessary.

2 Q. When did the board approve the dividends, if  
3 necessary?

4 A. This week on Monday afternoon.

5 Q. Is there any written evidence of that?

6 A. There are minutes that have not yet been  
7 circulated and signed.

8 Q. You haven't given those to anyone outside of  
9 Beal, have you?

10 A. Mr. Hale, I don't think that they've been  
11 completed and circulated for signature.

12 Q. You're not on the board of directors of Beal  
13 Financial, are you?

14 A. No, sir.

15 Q. And is that the board that approved -- would  
16 have to approve the dividends up?

17 A. Each board, Beal Bank, Beal Bank Nevada, and  
18 Beal Financial Corporation.

19 Q. Now, I think I asked you if there was any  
20 written commitment for the Beal entities to contribute  
21 into equity of the transaction. Do you remember us  
22 having that conversation?

23 A. Yes, sir.

24 Q. And I asked you was there any written agreement  
25 between Scotia Redwood Foundation on one hand and Beal

1 Bank, Beal Bank Nevada, Beal Financial, and Mr. Beal to  
2 contribute equity to the Scotia Redwood Foundation. Do  
3 you remember that?

4 A. Yes, I do.

5 Q. And what is the answer to that question? Is  
6 there any such written agreement or commitment?

7 A. No, sir; there's no written agreement. But I'm  
8 here to tell you that I have authority necessary to close  
9 the transaction as I described to you.

10 Q. What do you base that authority on?

11 A. Be present at board of director meetings and my  
12 discussions with Andy.

13 Q. Now, we also talked about this at your  
14 deposition, whether or not you had the authority to -- I  
15 think I used the term "cut a check." Do you remember?

16 A. Yes.

17 Q. And you said that you'd have to make a phone  
18 call, correct?

19 A. Yes.

20 Q. And to whom would that phone call be?

21 A. Andy.

22 Q. Mr. Beal, right?

23 A. Mr. Beal.

24 Q. And Mr. Beal would have to sign off on, you  
25 know, authorizing any of the funding or any of the -- any

1 of the transactions you're talking about; isn't that  
2 right?

3 A. Sure.

4 Q. Okay. And Mr. Beal hasn't committed himself in  
5 writing to do any of that, has he?

6 A. There's no written instrument, no, sir.

7 Q. Okay. Let's go specifically to the loan  
8 agreements for the two junior debt pieces, the 195 is  
9 broken down into two pieces, correct?

10 A. Yes.

11 Q. And who is the -- who are the two lenders that  
12 have agreed to contribute that 195 million?

13 A. The loan is from Beal Bank and Beal Bank  
14 Nevada.

15 Q. So we have two entities, right?

16 A. Yes.

17 Q. Beal Bank and Beal Bank Nevada, right?

18 A. Yes.

19 Q. Okay.

20 MR. HALE: Toby, do you have copies of --  
21 does the witness have a copy of your new exhibits? I've  
22 got my copy, but that's all I have.

23 MR. GERBER: Let me hand them up to him.

24 MR. HALE: Does the Court have copies?

25 MR. GERBER: No.

1                   MR. HALE: Your Honor, would you like a  
2 copy of 205 and 206?

3                   THE COURT: All right. Are these on the  
4 exhibit list that were submitted at the beginning of the  
5 case?

6                   MR. GERBER: No, Your Honor. These were  
7 new exhibits circulated last night. I owe the Court an  
8 updated exhibit list.

9                   THE COURT: For my sanity's sake and to be  
10 certain that everybody gets everything admitted that they  
11 want to, at some time in this trial we'll have a complete  
12 exhibit list, and we'll go through it. Hopefully you-all  
13 will go through it and tell me which ones are objected  
14 to, so that the rest of them can be admitted, and we  
15 can -- we can rule on those that are objected to.

16                  Q. (By Mr. Hale) Can you identify --

17                   THE COURT: And because we're admitting  
18 some and sort of skipping over others, I just have a  
19 feeling in the back of my mind that we get to the end of  
20 this and ones that everybody intended to admit might not  
21 get admitted. I don't want that to happen.

22                  Q. (By Mr. Hale) Okay. If you take a look at 205  
23 and 206, what are these documents?

24                  A. Beal Bank Nevada executive loan committee  
25 profile is 205. 206 is Beal Bank executive loan

1 committee profile.

2 Q. Okay. And these are the only written  
3 documents, aren't they, that reflect any agreement to  
4 lend the \$195 million in junior debt to Scotia Redwood  
5 Foundation?

6 A. Yes, sir.

7 Q. Okay. If you take a look at -- and I'm  
8 focusing to start with 205. It's the top of my stack.  
9 Above the signature pages, the last page, which is BFC  
10 23 --

11 A. Yes.

12 Q. -- this loan agreement is subject to adequate  
13 legal documentation. Do you see that?

14 A. I can't see where you're laser pointing. Am I  
15 looking at the screen?

16 Q. You can look at the document or the screen.

17 A. I'm sorry.

18 Q. That's okay. Above the laser pointer.

19 A. Yes, I see it.

20 Q. And we talked about what is adequate legal  
21 documentation that's referenced in this agreement or in  
22 this document?

23 A. Credit agreement, note, deed of trust, UCC  
24 filings, things like that.

25 Q. Have any of those documents been drafted?

1 A. No, sir.

2 Q. Okay. And I also think we talked about that  
3 one of the conditions in the loan agreements you would  
4 expect is that the collateral would have to be insured.  
5 Do you remember that?

6 A. Yes, sir.

7 Q. Okay. Are you familiar with the ability to  
8 insure the timberlands owned by Scotia Pacific?

9 A. No, sir. I thought I said we were going to  
10 hire consultants to be able to help us out with that, and  
11 that's what we would have to do, hire a consultant.

12 Q. Okay. Is there any regulatory reason why the  
13 collateral for a loan this size would have to be insured,  
14 to the best of your knowledge?

15 A. I'm not positive about for a tree farm, what  
16 the insurance requirements are, Mr. Hale. I don't know.

17 Q. But for a -- from a regulatory perspective,  
18 might there be a regulatory reason why the bank would  
19 have to have insurance on the collateral?

20 A. Yes.

21 Q. Okay. And what's that regulatory reason?  
22 That's a bad question. I'll move on. You haven't tried  
23 to purchase any of that insurance or investigate it yet,  
24 whether you can get that insurance, have you?

25 A. Not on the tree farm.



1 Q. Okay. Now, it is also conditioned on board of  
2 director concurrence. Do you see that?

3 A. Yes, I do.

4 Q. And has that board of director -- has the board  
5 of directors concurred?

6 A. Yes, sir, that's the signature lines beneath.

7 Q. So this is -- this is the -- this is also a  
8 board meeting? Oh, I see. So there it is right there?

9 A. Yes, sir.

10 Q. So there's an approval at the top and then  
11 there's a separate way that they would concur?

12 A. A recommendation approval and concurrence, yes,  
13 sir.

14 Q. Now, moving off the 195 piece, let's go to the  
15 next piece, which would be the first lien piece. Is it  
16 your --

17 MR. GERBER: Just a second. You've  
18 questioned him about the documents. Do you want to move  
19 for admission?

20 MR. HALE: No. If you want them. I got  
21 them last night at 12:30. I don't know what they are.  
22 They're redacted. They're --

23 MR. GERBER: He's now testified as to the  
24 documents.

25 THE COURT: Any objections to the

1 admission of these two documents?

2 MR. NEIER: I don't know why Mr. Hale's  
3 examination is being interrupted by Mr. Gerber.

4 THE COURT: That's an objection? We'll  
5 move on.

6 MR. FIERO: I would also object on two  
7 pieces. One, this document is redacted, and we don't  
8 know why. And it doesn't appear to be complete. You see  
9 there's a reference to an exhibit. I don't believe the  
10 exhibit has been included.

11 MR. NEIER: DCF analysis seems --

12 THE COURT: We're not going to argue the  
13 admissibility of the document right now. Just continue  
14 with your -- we'll see where we are at the end.

15 Q. (By Mr. Hale) There's an Exhibit A that's  
16 referenced here. Do you see that, a DCF analysis?

17 A. Yes, sir.

18 Q. Have you given that to anybody outside in the  
19 context of this case? Have you produced that document?

20 A. I've only given it to my counsel.

21 Q. And if you look back in here, there's a series  
22 of redactions in this document or stuff that's blacked  
23 out, to say. What stuff is blacked out, or what  
24 material, what language is blacked out?

25 A. Material related to our valuation of the

1 collateral.

2 Q. Okay. Take a look at this line right here.  
3 Based on -- something, that's blacked out. Do you see  
4 that referencing the MMCAs. This is in the middle of --

5 A. Yes. Yes, sir. I'm here with you.

6 Q. All right. Just so everyone is on the same  
7 page, that's at BFC 22, probably the -- I guess it's the  
8 last text in the paragraph. It's talking about the  
9 MMCAs, right?

10 A. Yes, sir.

11 Q. And it says there's approximately 7,600 acres  
12 in the MMCAs. Do you know if that's right?

13 A. As I look at it right here, no, sir, I don't.

14 Q. Okay. And then you come down and say based on  
15 something that's blacked out. Do you see that?

16 A. Yes, sir.

17 Q. Is that information that's redacted because of  
18 a valuation reason?

19 A. Yes, sir.

20 Q. Okay. Keep that -- hold that place in mind  
21 because we'll come back to that place in just a second.  
22 If you go back up to the description of the collateral  
23 for this, and that's at the bottom of page 1 of the  
24 document --

25 A. Yes, sir.

1 Q. -- it says a second lien on assets and -- then  
2 it's got a pretty lengthy description of assets after  
3 that. Do you see that?

4 A. Yes, sir.

5 Q. It carries over to page 2. The offer, on the  
6 other hand, has a series of excluded assets, though,  
7 doesn't it?

8 A. Yes, sir.

9 Q. And this collateral description in the loan  
10 document is broader than the collateral actually being  
11 purchased by Scotia Redwood Foundation in your term  
12 sheet, isn't it?

13 A. It's been a while since I compared the two,  
14 Mr. Hale. I'm sorry.

15 Q. Page 2 of your offer there's a title that says  
16 Excluded Assets. Do you see that?

17 A. Yes, I do.

18 Q. And the first one is cash?

19 A. Yes.

20 Q. Then there's a reference to the Headwaters  
21 litigation which we'll get to later. Do you see that?

22 A. Yes.

23 Q. There's no reference to excluded assets in the  
24 collateral profile that was approved by the bank,  
25 correct?

1 A. Yes, sir.

2 Q. And, in fact, since the bank has made these  
3 approvals, you've changed the scope of the excluded  
4 assets, haven't you?

5 A. Yes, sir, I have.

6 Q. Okay. Has the bank signed off on any change  
7 for exclusion of assets?

8 A. Not yet.

9 Q. Okay. Now, Scotia Redwood Foundation also had  
10 to obtain board approval from its board to seek the  
11 financing, correct?

12 A. Yes.

13 Q. Okay. And there's one document that reflects  
14 that board approval, too, correct?

15 A. So far as I know.

16 Q. And you gave me that document on Tuesday or  
17 Wednesday, whenever it was when I saw you in Corpus last.

18 MR. HALE: And, Your Honor, this is a  
19 document that was given in deposition, and I didn't have  
20 it on our exhibit list or anything like that. So it's a  
21 new number. We're going to make it MMX 71.

22 THE COURT: Okay.

23 MR. HALE: Can I approach, Your Honor?

24 THE COURT: You may.

25 MR. HOLZER: Are you going to circulate

1 that?

2 MR. HALE: It was at the deposition. I  
3 mean, I don't -- I don't have a problem doing it. We'll  
4 put it up on the Elmo.

5 MR. HOLZER: Thank you.

6 Q. (By Mr. Hale) Have you seen this document  
7 before, Mr. Cherner?

8 A. Yes, sir.

9 Q. Okay. It looks familiar to you, doesn't it?

10 A. Yes, sir.

11 Q. And it looks remarkably similar to the loan  
12 approvals that are 205 and 206, doesn't it?

13 A. Yes, sir.

14 Q. Okay. This document is also pretty heavily  
15 redacted, isn't it?

16 A. Yes, it is.

17 Q. And if you take a look at page 2 of the  
18 document, which is BFC 009, do you see that page?

19 A. Yes, I do.

20 Q. And if you take a look at the paragraph that  
21 relates to the MMCAs, I guess I'm showing -- I'm tipping  
22 my hand here as this is my notes on the document. This  
23 is the same paragraph that appears in the loan approvals,  
24 doesn't it? For example, you take a look at 205, that  
25 paragraph.

1 A. Yes, sir, I do see that it is the same.

2 Q. And the last sentence of this document is the  
3 same as the last sentence of the loan approval, right?  
4 And I'm going to fold this up and I guess -- that's the  
5 loan approval there. Same paragraph, same language,  
6 isn't it?

7 A. Yes, sir.

8 Q. And because of the redaction now, I guess we  
9 can see what was redacted out of the loan approval, can't  
10 we?

11 A. Yes, sir.

12 Q. And what was redacted was "on public testimony  
13 from the timber noteholders appraiser." Do you see that?

14 A. Yes, sir.

15 Q. Okay. Is that something that's related to  
16 valuation?

17 A. Yes, sir.

18 Q. Is that why that was redacted in the loan  
19 document and not in the board minutes?

20 A. It should have been redacted in both places  
21 together with the dollar amount.

22 Q. And I guess what were your instructions then to  
23 the people who were taking information out that you  
24 didn't give to me? What did you tell people what  
25 information to redact?

1           A.    I'm sorry, Mr. Hale.  I understand the question  
2           now.  Anything related to how we valued the timberlands  
3           needed to come out.  How we arrived at our bid needed to  
4           come out and anything that would identify any other  
5           potential lender and the terms and conditions of that  
6           loan.

7           Q.    Okay.  If you take a look then at the Scotia  
8           Redwood Foundation board approval, which I think is a  
9           document that is my MMX 71 that I passed out earlier.  
10          And the contemplation for this is that there'll be a  
11          first lien term loan.  Do you see that, of \$200 million?

12          A.    I do.

13          Q.    And then a second term loan of -- of a second  
14          loan of 194.6.  Do you see that?

15          A.    Yes, sir.

16          Q.    Okay.  That is an aggregate of \$395 million of  
17          debt?

18          A.    Yes, sir.

19          Q.    That's okay.  You and I spent a lot of time  
20          talking to one another.  That's roughly \$395 million of  
21          debt in your offer, correct?

22          A.    Potentially.

23          Q.    That's how you would finance it potentially?

24          A.    The banks decided to get approval for a second  
25          lien debt.  You can always move it up to first lien and



1 add more equity as opposed to try to having it approved  
2 as a first lien and then try to push it down and be a  
3 second.

4 Q. But as contemplated by Scotia Redwood  
5 Foundation, you're looking at \$395 million in debt; isn't  
6 that right?

7 A. Potentially. It depends how that first lien  
8 debt is priced.

9 Q. Is that an efficient -- is that an appropriate  
10 capital structure for an entity owning the Scotia  
11 timberlands, roughly two-thirds debt, one-third equity?

12 A. It depends what the pricing of the debt is  
13 going to be.

14 Q. Okay. But it doesn't -- you don't think there  
15 has to be more equity cushion or anything like that, just  
16 so long as the debt is reasonable?

17 A. Well, it needs to cover.

18 Q. And did you calculate a series of coverage  
19 ratios?

20 A. Yes.

21 Q. And you redacted that from this document,  
22 correct? That's what you include in your valuation  
23 materials?

24 A. Yes, sir.

25 Q. So putting aside the commitments that we've

1 looked at that are the 195 junior debt -- well, let's go  
2 back to coverage ratio and interest.

3 Now, because the timberlands don't have a lot  
4 of operations, their primary method of generating cash is  
5 to harvest and sell timber, correct?

6 A. Yes, sir.

7 Q. Okay. So in order to project out what your  
8 coverage would be, you had to come up with an income  
9 number, right?

10 A. Yes, sir.

11 Q. What does the income depend on if you own the  
12 Scotia timberlands?

13 A. Harvesting trees and cost of harvesting trees,  
14 price of the lumber.

15 Q. Let's focus first on harvest rates. Did you  
16 develop a series of schedules of harvest rates for the  
17 Scotia timberlands?

18 A. Yes.

19 Q. Okay. And that was done internally at Beal  
20 Bank, right?

21 A. Well, it had been generated over a number of  
22 years, Mr. Hale, starting in '01, and then marching  
23 forward every year thereafter by outside consulting firms  
24 starting in the summer of '01, three different firms and  
25 a review firm, and then our own internal modeling

1 annually thereafter.

2 Q. When did you begin your internal model? When  
3 did sort of that become in-house at Beal Bank as opposed  
4 to what the consultants had said?

5 A. We spent probably summer of '01 to October of  
6 '03, maybe the end of '03 working with outside  
7 consultants.

8 Q. And after that, the internal modeling on  
9 harvest rate, harvest schedules, things like that has all  
10 been done in-house at Beal Bank?

11 A. Predominantly.

12 Q. And who's the individual at Beal Bank who's  
13 done most of that work?

14 A. The person today, Mr. Hale?

15 Q. Yes.

16 A. James Erwin.

17 Q. And did Mr. Erwin do the harvest rate modeling  
18 that was used in connection with your offer?

19 A. Yes, sir.

20 Q. Is Mr. Erwin a certified Forester?

21 A. No, sir.

22 Q. Has he ever been to Scotia and the Scotia  
23 property?

24 A. I don't believe so.

25 Q. Does he have any forestry or timber background?

1 A. I don't believe so.

2 Q. Do you know that if the harvest rate that  
3 you've used to project, generate cash to cover the debt,  
4 is achievable?

5 A. Yes.

6 Q. Okay. And what do you base that on?

7 A. It's well within parameters of what are  
8 currently being and have been harvested by the company  
9 prior to this time.

10 Q. What sorts of information? I mean, what did  
11 you base it on that you could achieve the harvest rate  
12 that you projected? What told you that?

13 A. We had publicly available information. I don't  
14 know who else Mr. Erwin would have spoken to, and we feel  
15 comfortable we've achieved harvesting rights today.

16 Q. I guess to be a little more -- who have you  
17 spoken to about the harvest rates imbedded in your --  
18 imbedded in your model or your forecasts?

19 A. James Erwin and Steve Harvey and Andy Beal.

20 Q. I know who Andy Beal is. I know Mr. Harvey.  
21 Who's -- I'm sorry, I know who Mr. Erwin is. Who's Steve  
22 Harvey?

23 A. He was working on this matter also.

24 Q. He's a Beal Bank employee, right?

25 A. CSG, but I'm not going to split hairs. For the

1 record, it would be CSG, but if we're saying the Beal  
2 family, I don't want to slow it down.

3 Q. He's in the Beal family?

4 A. Yes.

5 Q. That's what I meant. I appreciate that. And  
6 have you done any outside -- well, let me ask you another  
7 question. Have you seen -- have you heard the name James  
8 Fleming?

9 A. Yes.

10 Q. Okay. Have you -- before you put in your bid,  
11 you sent a letter to Houlihan Lokey back in January,  
12 didn't you?

13 A. Yes, sir.

14 Q. And Houlihan Lokey letter had the same number,  
15 \$603 million in it, right?

16 A. Yes, sir.

17 Q. And when you made the \$603 million number in  
18 your letter or your offer or whatever we want to call  
19 that January letter, had you seen Mr. Fleming's harvest  
20 schedules?

21 A. I'm not sure if I had or not, Mr. Hale.

22 Q. You didn't premise your \$603 million offer on  
23 Mr. Fleming's harvest schedules, did you?

24 A. No.

25 Q. You didn't premise that on Mr. Fleming's

1 discounted cash flow or cash flow modeling, had you?

2 A. No.

3 Q. Did you ask Houlihan Lokey or discuss with  
4 Houlihan Lokey Fleming's cash flows?

5 A. I'm sure people on my team did. I don't recall  
6 me being on the phone excessively.

7 Q. As you sit here today, do you know how your  
8 harvest projections related to Mr. Fleming's?

9 A. Not off the top of my head, no.

10 Q. Do you have a general idea?

11 A. If you tell me what his are, to remind me,  
12 refresh me, I'll be glad to give you some indication.

13 Q. Well, I'm focused a little bit more on an issue  
14 that -- you didn't develop your harvest and modeling in  
15 connection with Mr. Fleming's harvest and modeling, did  
16 you?

17 A. No, sir.

18 Q. And your cash flow schedule or timing could be  
19 completely different than Mr. Fleming's, correct?

20 A. It could be.

21 Q. Did you ever discuss that with Houlihan Lokey  
22 about the comparison of your cash flow modeling to the  
23 Fleming cash flow modeling?

24 A. No, sir.

25 Q. Now, Beal Bank itself wouldn't operate the

1 timberlands, right?

2 A. We would -- the Scotia Redwood Foundation would  
3 operate them.

4 Q. I apologize. Scotia Redwood Foundation -- I  
5 meant the Beal Bank family.

6 A. Right.

7 Q. Scotia Redwood Foundation, has it ever operated  
8 timberlands before?

9 A. No, sir, it hasn't.

10 Q. Okay. How would you go about operating the  
11 timberlands?

12 A. We'd get -- hire the consultants we need and  
13 the employees that are there, retain those employees.

14 Q. So is it contemplated Scotia Redwood Foundation  
15 is going to hire up a bunch of people and actually have  
16 an office out in Scotia and run the timberlands?

17 A. We hadn't decided whether it would be Scotia  
18 Redwood Foundation proper with an office out there  
19 running it, or whether there would be an office out there  
20 independent of the one we have in Dallas.

21 Q. Now, I thought we talked at your deposition a  
22 couple of days ago and last week, that you would hire and  
23 work with a timberland operator, experienced operator?

24 A. That's correct.

25 Q. Has that plan changed?

1 A. No, sir.

2 Q. Okay. You still contemplate joint venturing or  
3 partnering or hiring that timber operator to tell you how  
4 to work the Scotia Pacific lands?

5 A. Yes, sir.

6 Q. Have you talked to any of those operators in  
7 the last six months?

8 A. I don't think I've spoken with the operators we  
9 had in mind since the October time frame.

10 Q. You didn't talk to them in connection with your  
11 January letter to Houlihan Lokey, did you?

12 A. No.

13 Q. And you didn't talk to them in connection with  
14 your most recent term sheet, have you?

15 A. No, sir.

16 Q. So you haven't gotten the benefit of those  
17 operators inside as to whether your harvest schedules and  
18 modeling is accurate or appropriate, have you?

19 A. Sure, in the past we have.

20 Q. I'm talking about specifically for this type  
21 of -- for this offer. You didn't say, can we make it  
22 this way; is our plan reasonable? Did you call them up  
23 and ask them that?

24 A. No. We had a number of discussions with them  
25 before, and this is well within those parameters.



1 Q. So the most recent modeling you've done to  
2 support this offer is based on historic modeling you've  
3 done over a series of years, right?

4 A. Seven years.

5 Q. Okay. Has the Scotia timberlands productivity  
6 changed over the last seven years?

7 A. Sure.

8 Q. Have the regulatory environment changed in that  
9 time period?

10 A. Yes, sir.

11 Q. Okay. And you've updated your models to  
12 account for that, correct?

13 A. We've reduced harvesting rates and updated the  
14 modeling, yes, sir.

15 Q. And that was done by a Beal Bank individual,  
16 correct?

17 A. Yes, sir.

18 Q. Now, the offer in -- that's embodied in 207 is  
19 only for the Scotia Pacific assets, right? You can take  
20 a look at 207.

21 A. I'm sorry. One second, Mr. Hale.

22 Q. Assets to be sold.

23 A. Yes, sir. That's correct.

24 Q. This is a long way of saying --

25 A. I'm sorry, I'm switching between glasses and

1 not glasses.

2 Q. You're not interested in -- you don't  
3 contemplate purchasing the mill pursuant to this term  
4 sheet, do you?

5 A. No, sir.

6 Q. And you don't contemplate purchasing any of the  
7 assets that are currently at Palco, do you, in this  
8 offer?

9 A. Not in this offer.

10 Q. Okay. And do you have any idea who you're  
11 going to sell -- if you buy this -- if you purchase this  
12 Scotia timberlands, have you committed to sell the mill  
13 logs from the Scotia timberlands?

14 A. Yes, sir.

15 Q. And the indenture trustee plan says that the  
16 purchaser will commit to sell 40 percent of the logs to  
17 the Palco mill, correct?

18 A. Yes, sir.

19 Q. Is that currently your contemplation? Do you  
20 intend to sell 40 percent of your logs to Palco mill?

21 A. No, sir.

22 Q. Okay. How much do you intend to sell?

23 A. Not less than 50.

24 Q. That was in your January letter, right?

25 A. I don't know if it was in the January letter or

1 the March letter, Mr. Hale.

2 Q. It's not -- that agreement is not reflected in  
3 this term sheet, right?

4 A. Oh, is the percentage cutting?

5 Q. Right.

6 A. No, sir. I believe that's part of the plan as  
7 well as indenture trustee plan. You make a great point.  
8 I'll add that to the term sheet.

9 Q. Okay. And -- but in any event, the 50 percent  
10 is the maximum that you would be required to sell to  
11 Palco -- required to sell to the Palco mill, right?

12 A. Yes, sir.

13 Q. You would retain the freedom to sell 50 percent  
14 of your logs to another mill, right?

15 A. Yes, sir.

16 Q. And have you drafted any log supply agreement  
17 reflecting this understanding?

18 A. There was a log supply agreement in the works  
19 between the indenture trustee and the Palco Mendocino --  
20 excuse me, Marathon, someone on that side. I don't know  
21 that it's been in final form yet. And I haven't seen it  
22 in months.

23 Q. Okay. You didn't review it in connection with  
24 this offer, did you?

25 A. No, sir.

1 Q. Okay. And what price would you agree to sell  
2 logs to the Palco mill if you owned the Scopac assets?

3 A. Market price.

4 Q. And how do you define market price?

5 A. Palco and the foundation need to agree on the  
6 price for the timberlands.

7 MR. GERBER: Your Honor, may I approach  
8 the witness to give him some water?

9 THE COURT: You may.

10 THE WITNESS: Thank you.

11 Q. (By Mr. Hale) Now, I think we were talking  
12 before about how the log supply agreement would work and  
13 the market price. What would be the term of the  
14 agreement that you would agree to sell the logs to the  
15 Palco mill?

16 A. Mr. Hale, can you help me out and repeat the  
17 question, please.

18 Q. Sure.

19 A. I'm sorry.

20 Q. How would you calculate the price under the  
21 potential log supply agreement?

22 A. There was discussion about either standard  
23 board equalization pricing or market pricing. And if  
24 that couldn't be determined, we would go to some third  
25 party to set the pricing.

1 Q. And now you're talking about a log supply  
2 agreement that you haven't seen in a long time. This is  
3 the Palco/MRC/Marathon?

4 A. I saw a number of -- I saw a bullet point  
5 framework of it and a draft of it in the December time  
6 frame?

7 Q. I'm going to ask you a slightly different  
8 question. If you owned the assets, and have you thought  
9 about how you're going to price any logs you sell to the  
10 Palco mill?

11 A. I want the Palco mill to buy as many logs as  
12 possible. I want to be competitive with them.

13 Q. My question is, how would you price those logs  
14 you sell to the Palco mill?

15 A. We compare it to market indices of prices of  
16 redwood and Douglas Fir in the marketplace, see what that  
17 pricing would yield.

18 Q. Do you know what those market indices are?

19 A. In the 800 and the 220 range.

20 Q. Well, what is the name of the indices? What  
21 indices are you referring to? Let's start there.

22 A. Well, actually I'm far more familiar with our  
23 modeling, but the standard board of equalization pricing  
24 is what I was referring to. I apologize.

25 Q. That's fair. And when you say 800 to 220, what

1 were you referring to?

2 A. Redwood versus Douglas Fir.

3 Q. And so the 800 price you referenced was a  
4 current redwood price, or what was 800 when you said  
5 that?

6 A. Yes, sir. That was close to it.

7 Q. And 220 was -- was what?

8 A. The Douglas Fir number we used. What I gave  
9 you was market indications I got, not what we used in our  
10 modeling.

11 Q. Where did you get those market indications; do  
12 you remember?

13 A. James told me what the standard board of  
14 equalization pricing was that he got.

15 Q. All right. Have you discussed your proposed  
16 harvest plans? Well, let's take a step back about your  
17 harvest plan and scheduling. Have you had access to the  
18 company's GIS data?

19 A. We have not accessed company's data.

20 Q. Do you know -- have you looked at individual  
21 stands or harvesting units or anything like that?

22 A. Not to my knowledge, no, sir.

23 Q. Okay. And do you know in your modeling for  
24 your harvesting, have you considered the various  
25 regulatory constraints on harvesting in a timber -- in

1 the Scopac timberlands?

2 A. Yes, sir.

3 Q. How did you account for those?

4 A. We had --

5 MR. GERBER: Objection, Your Honor. I've  
6 kind of been patient about this, but this gentleman is a  
7 bidder. He doesn't have to go into all of his thought  
8 processes on how he calculated his bid and all that came  
9 to that amount. He's here to tell the court he's got a  
10 bid. He's going to comply with the regulations as set  
11 forth in his proffer. Now we're getting into competitive  
12 information. Mr. Hale represents a competing plan  
13 proponent, competing bidder for this property, and I  
14 don't think it's fair to make him open his kimono and  
15 show everything how he calculated his bid.

16 MR. HALE: Your Honor, I'm not looking  
17 to -- I haven't asked him what his harvest rate schedule  
18 is. I haven't asked him any of that kind of information.

19 MR. GERBER: Yes, you have.

20 MR. HALE: What I want to know is how can  
21 he represent -- exactly what Mr. Gerber said, if he will  
22 comply with all environmental and regulatory reasons  
23 based on what his model is. He can't just --

24 THE COURT: I will give him some latitude  
25 to question him about the environmental and the

1 regulations and how -- whether he can comply with the  
2 regulations. But go ahead, I agree that we're not going  
3 to get into the details of this -- of his confidential  
4 information, but to the extent that this is being used as  
5 a valuation of the property.

6 MR. GERBER: Your Honor, we're not asking  
7 as a valuation. We're just trying to show it as a bid.  
8 They can question --

9 THE COURT: I thought your expert -- I had  
10 value efforts on real estate that have used the three  
11 methods of valuation over and over to the point that I  
12 don't even allow them to testify about that anymore. I  
13 know there are three valuations, but we now have a fourth  
14 one, potential bids. So I don't know -- I mean, there is  
15 some -- there is a -- there has been some issues raised  
16 in that area. To the extent that you don't want me to  
17 consider any of those bids as evidence of value, then I  
18 agree with you that we should not go into all that other  
19 stuff.

20 MR. GERBER: What we would like to show,  
21 Your Honor -- if Mr. Neier will let me speak. What we're  
22 trying to show is that --

23 THE COURT: And I didn't try to belittle  
24 the point because as a practical matter, serious bids are  
25 relevant information. Nobody believes that serious bids



1 aren't relevant information, but they're not part -- I  
2 mean, so in any event, but it seems to me that though  
3 your expert was relying a lot on those bids.

4 MR. GERBER: Well, Your Honor, he did not  
5 rely on this particular bid. Mr. Cherner --

6 THE COURT: Wait a second. There were  
7 three bids, and this is one of them.

8 MR. GERBER: No.

9 THE COURT: Now, this one has been refined  
10 and has now become a serious --

11 MR. GERBER: I'm sorry. Your Honor is  
12 correct, except that we're offering this --

13 MR. KRUMHOLZ: Can I just make one  
14 comment? From an evidentiary perspective, Your Honor, we  
15 don't control Mr. Cherner or the related Beal entities.  
16 It is a fact that there is a bid, and our witness has  
17 taken that into consideration. That does not open --  
18 that opens up our witnesses to reliance on whatever he  
19 saw. It does not open up Beal.

20 THE COURT: Right. I agree with you. I  
21 agree with you. And that's what I said.

22 MR. KRUMHOLZ: So in that context, we  
23 can't waive Beal's confidentiality.

24 THE COURT: I can't confirm a plan -- even  
25 if it's otherwise confirmable, I don't believe that

1 you're capable of complying with the regulations of the  
2 state of California. Can you agree with that?

3 MR. GERBER: Your Honor, I agree, Your  
4 Honor, the --

5 THE COURT: So I'll allow some further --  
6 some further questioning in this area.

7 MR. NEIER: Your Honor, David Neier from  
8 Marathon. Can I get into this one?

9 THE COURT: We're going on.

10 MR. GERBER: No, Your Honor --

11 MR. NEIER: Your Honor, this is critical  
12 for us. You know, I gave you a chance to speak.

13 MR. GERBER: Your Honor, just one thing,  
14 please.

15 MR. NEIER: What is this?

16 MR. GERBER: Excuse me, Your Honor. This  
17 is a matter of ethics situation. Mr. Neier has a  
18 conflict of interest and before he --

19 MR. NEIER: What conflict do I have?

20 MR. GERBER: I'll be glad to voir dire the  
21 witness on it, Your Honor, but Mr. Neier has now come up.  
22 We didn't expect him to speak against CSG. We're  
23 surprised that he's going to speak against Beal. But if  
24 he is, then I want to voir dire the witness to prove up  
25 that Mr. Neier and CSG have a conflict.

1                   MR. NEIER: Well, I'm not aware of that  
2 conflict, so --

3                   MR. GERBER: Well, I just need to --

4                   MR. NEIER: But meanwhile, may I be heard  
5 finally and may Mr. Gerber let me be heard?

6                   THE COURT: Hold it. I know that, you  
7 know, we've been here for a while, but this is still a  
8 civilized -- this is still a civilized courtroom  
9 situation. So let's --

10                  MR. NEIER: Judge, the real question with  
11 respect to -- before the Court --

12                  THE COURT: Go ahead.

13                  MR. NEIER: The real question which, you  
14 know, frankly Marathon has separate interests. Marathon  
15 has separate interests if the noteholders' plan is  
16 confirmed obviously. It's a creditor and its collateral  
17 will be affected if the noteholder is concerned. So I do  
18 want to question the witness. But with respect to this  
19 question of valuation, there is an issue here which --  
20 and I'm willing to discuss how the competitive analysis  
21 that may have been made by Beal can be tested. But the  
22 issue for me is if Mr. -- if Mr. Beal is bidding more  
23 than he believes is the fair market value for these  
24 assets. In other words, if it is a defensive bid, that  
25 is something the Court needs to know in determining what

1 the fair market value bid is.

2 THE COURT: We've gotten far away from the  
3 questions that were being asked, though. He was just  
4 asking about his ability to obtain regulatory --

5 MR. NEIER: And Mr. Gerber stood up and  
6 said --

7 THE COURT: I said he could ask those  
8 questions.

9 MR. NEIER: Right, I understand, but --

10 THE COURT: So are you trying to talk me  
11 out of that?

12 MR. NEIER: No, absolutely not.

13 THE COURT: Then let's move on. Let's get  
14 these -- I agree also that he has a point about getting  
15 into -- I mean, you know, there are any number of issues  
16 that could be raised as to the quality of the bid. I  
17 agree.

18 MR. NEIER: Thank you, Your Honor.

19 MR. FIERO: Your Honor, John Fiero for the  
20 committee. The committee has a special interest in  
21 making sure that whatever outcome comes out of this  
22 hearing, that it is truly and absolutely feasible. The  
23 committee does not want to see in the future any portion  
24 of this forest back in bankruptcy. So the committee  
25 believes that the valuation process, the deciding how

1 much to bid or the basis on which one decides what they  
2 think they're going to harvest is completely relevant.

3 THE COURT: Those are standard bankruptcy  
4 issues. And I agree with you, you have an interest in  
5 that. I have an interest in that. Hopefully, everyone  
6 in this room has an interest in a confirmable plan that  
7 will not be followed by reorganization, all those  
8 standards things that are in 1129.

9 MR. FIERO: Yes, Your Honor. My concern  
10 is that we've seen documents on the screen which are  
11 blacked out. The justification has been made that they  
12 somehow relate to valuation, and, therefore, it's  
13 appropriate to black them out. It may be appropriate to  
14 make them confidential in some way, but it is not  
15 possible, Your Honor, for this court to render a  
16 feasibility finding in connection with the Scopac plan if  
17 this is to be the stalking horse bid without an  
18 understanding of how much this buyer thinks they're going  
19 to take out of that forest, what price they think they're  
20 going to get for the wood, and whether or not they're  
21 going to be able to service the debt that they project  
22 imposing on the forest. And so I ask that the question  
23 of whether or not these redactions are appropriate be  
24 perhaps revisited, but certainly not ruled upon. The  
25 notion that valuation --



1       come forward with \$603 million of cash. Where he got the  
2       cash from, as long as he didn't steal it, is not the  
3       business of the competing bidders. The people who are  
4       asking this question are MRC and Marathon. They're the  
5       ones that want to compete. They're trying to chase Beal  
6       away from the process. They're trying to chase Scotia  
7       Redwood Foundation, Inc. away from the process. That's  
8       all this is.

9                       MR. NEIER: Your Honor, that's an untrue  
10       statement where a significant creditor owed \$160 million  
11       in this case. And what we want to know is, is this  
12       witness doing a round trip transaction taking money of  
13       which he's going to get 40 percent back from because he's  
14       a significant creditor in this case, and whether this is  
15       a defensive bid. This guy bid on -- he made a one-page  
16       letter on January 30th. That was the day the plans were  
17       due.

18                      And then he comes to this court with a  
19       four-page term sheet. This is a significant creditor  
20       that's been involved in this case since 2001, and you're  
21       telling me this is not a defensive bid. It obviously is.  
22       That's relevant for this court to determine whether this  
23       bid is nothing more than a round trip transaction. It  
24       does not establish fair market value and will not be good  
25       for a market test.





1 I mean, they don't have foresters on their -- and they  
2 have done the types of things that people who are in  
3 financial do financial transactions. They have taken  
4 other information from other places and put together  
5 their bid. They didn't do any specific additional things  
6 or have not hired foresters to do all of that. I think  
7 you've made that point.

8 MR. HALE: Okay.

9 Q. (By Mr. Hale) Do you know what a habitat  
10 conservation plan is?

11 A. Generally, yes, sir.

12 Q. Okay. Are the Scotia Pacific timberlands  
13 governed by an HCP?

14 A. Yes, sir.

15 Q. Okay. Have you read that HCP?

16 A. Not in several years.

17 Q. Do you know if your transaction would  
18 require -- your purchase contemplated in the term sheet  
19 would require modification of the HCP?

20 A. Not contemplating.

21 Q. Say that again.

22 A. Not contemplating we would comply with the  
23 existing ones.

24 Q. My question is slightly different.

25 A. I'm sorry.

1 Q. Do you know if the simple fact that you're  
2 buying the timberlands would require modifications of the  
3 HCP?

4 MR. GERBER: Your Honor, calls for a legal  
5 conclusion. I know he's a lawyer, but he's not this type  
6 of lawyer.

7 THE COURT: Well, I think he just asked if  
8 he knows. If he doesn't know, I don't -- because he's a  
9 lawyer, hopefully, he would have the sense to say he  
10 doesn't know and not try to --

11 Q. (By Mr. Hale) Do you know whether it would  
12 require modification of the HCP?

13 A. No, sir.

14 Q. Okay. Have you had any conversations with any  
15 state regulatory agency or anyone affiliated with the  
16 state of California to discuss your harvest schedule?

17 A. Not to discuss our harvest schedule, no, sir.

18 Q. Have you had any discussions with any  
19 regulatory agency or any California water board or  
20 anything like that to discuss whether your proposed  
21 harvest schedule would comply with the various  
22 environmental regulations and regulatory framework in  
23 California?

24 A. No, sir, but we would make sure it did.

25 Q. How would you make sure that it did?

1           A.    We'd go out and retain counsel and go visit  
2 with the regulators, show them what we were intending to  
3 do and make sure -- the same way we handled the term  
4 sheet. We would make adjustments to our plan to  
5 accommodate the California state regulatory authorities  
6 and to make sure that the constituencies perceived us  
7 environmentally compliant and in compliant with the  
8 California regulations.

9           Q.    Have you begun any of those efforts?

10          A.    No, sir.

11          Q.    Okay. Let's take a look at your term sheet,  
12 specifically the excluded assets section, if you wouldn't  
13 mind.

14                   MR. HALE: That is page 2 and I think it's  
15 207, Your Honor, the exhibit number.

16          Q.    (By Mr. Hale) 207, do you see that, page 2?

17          A.    I'm sorry. I was confused. Yes, sir. I'm  
18 there.

19          Q.    Excluded assets includes -- if I read down  
20 after the parenthetical: "Scotia Pacific companies LLC  
21 interest, if any, in the so-called Headwaters  
22 litigation." Do you see that?

23          A.    I do.

24          Q.    And then it goes on to say: "Which Headwaters  
25 litigation shall be resolved/settled in a manner

1 acceptable to buyer as further ascribed in the  
2 acquisition documents prior to closing of the Scotia  
3 acquisition." Do you see that?

4 A. Yes, sir.

5 Q. Thus, it's a condition to your offer that the  
6 Headwaters litigation be resolved or settled prior to  
7 closing, correct?

8 A. Or wait, yes.

9 Q. And you retain the ability to determine what is  
10 an acceptable resolution or settlement, correct?

11 A. Yes, sir.

12 Q. Okay. And if you're not happy with it, you  
13 don't have to close, right?

14 A. Reasonably happy, yes, sir.

15 Q. Okay. Now, Scopac only owns -- do you know who  
16 owns -- who's asserting claims in the Headwaters  
17 litigation?

18 A. Not missing many people. Scotia is; Palco is;  
19 Brick Lumber. I don't remember the entire plaintiff's  
20 list, Mr. Hale.

21 Q. Well, Scotia Pacific doesn't -- isn't asserting  
22 all the claims in the Headwaters case, right?

23 A. That's correct.

24 Q. Palco's got claims in the Headwaters case,  
25 right?

1 A. Yes, sir.

2 Q. And Palco would have to resolve, settle those  
3 claims in -- before your acquisition would close, right?

4 A. You make an excellent point, Mr. Hale. We'll  
5 adjust it so that -- to the extent it affects the assets  
6 being purchased.

7 Q. So I guess what you're saying now is that  
8 Scotia Pacific would have to settle the Scotia Pacific  
9 elements in the Headwaters litigation?

10 A. To the extent it affects the assets being  
11 purchased, that litigation would need to be settled,  
12 resolved, somehow concluded or assurances given that we  
13 would be able to harvest the timberlands.

14 Q. So there would have to be assurances given you  
15 to harvest the timberlands in accordance with your  
16 harvest schedule when you put it together; is that fair?

17 A. Yes.

18 Q. Okay. Now, earlier you talked about that -- we  
19 talked about what a potential settlement will be at your  
20 deposition; do you remember?

21 A. A potential settlement of Headwaters  
22 litigation?

23 Q. Yes.

24 A. Yes, sir.

25 Q. And you were asked, have you thought of what a

1 settlement might look like or what it might be? Do you  
2 remember being asked that question?

3 A. Mr. Hale, I don't remember being asked that  
4 question, but --

5 Q. I tell you what, I'll ask a better question.  
6 How about, sitting here today do you have any  
7 contemplation what a settlement might look like?

8 A. No, sir.

9 Q. Do you have any contemplation of how it might  
10 be resolved so that you could cut the timber on the  
11 timberlands?

12 A. If we were confirmed bidder, we'd visit with  
13 the California regulatory authorities to see what we  
14 could do to make sure that either we were satisfied that  
15 the litigation wouldn't affect the tree farm going  
16 forward or assist in the resolution of the litigation.

17 Q. But as you sit here today, you haven't made  
18 those efforts and drawn any of those conclusions, have  
19 you?

20 A. No, sir.

21 Q. Okay. Let's take a look at the section of the  
22 offer that is page 4 where it says "credit bid."

23 A. Yes, sir.

24 Q. Okay. And you're familiar with the concept of  
25 credit bidding, right?

1           A.    Yes, sir.

2           Q.    Okay.  And in this context, the indenture  
3 trustee would retain the right to credit bid in  
4 connection with the foreclosure sale, right?  That's your  
5 understanding.  That's all I'm asking for is your  
6 understanding of that.

7           A.    Yes, sir.

8           Q.    Okay.  And --

9           A.    We will agree that our notes will be voted  
10 consistent with accepting this bid and not credit bidding  
11 in excess of this bid.

12          Q.    You're about six questions ahead of me.  We'll  
13 get there.

14          A.    I'm sorry.

15          Q.    I understand.  You and I have --

16          A.    I've done this several times.  I'm sorry.

17          Q.    You and I have spoken a lot in the last week or  
18 so.  The indenture trustee retains the right -- I think  
19 what I asked was the indenture trustee retains the right  
20 to credit bid at a foreclosure sale or judicial sale of  
21 these assets; is that your understanding?

22          A.    That's my understanding.

23          Q.    And it would be entitled to credit bid in  
24 connection with the bidding procedures and the sale  
25 that's contemplated in your offer; is that right?

1           A.    I believe the bidding procedures are filed by  
2           the indenture trustee, but yes, it's consistent with our  
3           offer as well.

4           Q.    Okay.  And you have agreed that as part of the  
5           acquisition documents, you will instruct the indenture  
6           trustee not to credit bid your portion?  Well, let me ask  
7           a better question.  Do you remember how the credit bid  
8           provision in the indenture works?  Do you have an  
9           understanding of that?

10          A.    I have an understanding of it.  I can't sit  
11          here and cite it.

12          Q.    Why don't you just tell me what your  
13          understanding is.

14          A.    The indenture trustee must credit bid the  
15          current face amount or the current outstanding balance of  
16          the notes unless instructed by -- and here's what I don't  
17          recall if it was 66 and two-thirds or 66 and two-thirds  
18          plus one of the noteholders not to do so, or to accept  
19          less than the full credit bid.

20          Q.    So the indenture trustee must credit bid unless  
21          two-thirds of the notes say don't credit bid?

22          A.    That's my understanding.

23          Q.    Okay.  So in this document, you are  
24          contemplating that you will agree that your 38 percent  
25          would vote -- would instruct the trustee not to credit



1 bid, right?

2 A. Yes, sir. I'm sorry. It took me a second to  
3 walk through your question.

4 Q. It's a negative instruction, so if you get  
5 confused, just tell me. That means, though, if you are  
6 the only person who agrees not to credit bid, the  
7 indenture trustee still must credit bid, though, right?

8 A. The indenture trustee will need about another  
9 35 percent of the notes to instruct them to accept this  
10 offer.

11 Q. So outside of your 38 percent, there still is  
12 62 percent of the notes that are outstanding, or held by  
13 other people, right?

14 A. Yes, sir.

15 Q. And of that, you would need roughly another --  
16 about half of that group to agree not to credit bid; is  
17 that fair?

18 A. Yes, sir.

19 Q. Have you had any conversations with any  
20 noteholder about them credit bidding in connection with  
21 your proposed offer?

22 A. Only what I understand from counsel for the  
23 indenture trustee, Mr. Gerber.

24 Q. Well, have you had any conversations with --

25 A. No, we have not.

1 Q. Do you have any agreement with any noteholder,  
2 whether they will credit bid or not in connection with  
3 your proposal?

4 A. No, we urge them not to credit.

5 Q. But you don't have any agreement one way or the  
6 other, do you?

7 A. No, sir.

8 Q. If Mr. Gerber still says, gee, it's a great  
9 idea, everyone. Let's -- credit bid, don't obstruct the  
10 credit bid, your agreement doesn't change that, does it?

11 A. We've not entered into any such agreement with  
12 the noteholders, no.

13 Q. In terms -- if there were conversations about  
14 credit bidding that we just talked about, if Mr. Beal had  
15 those conversations or anyone in the Beal Bank family of  
16 companies, would you know about them?

17 A. Probably, Mr. Hale.

18 Q. Do you know of any such conversations by  
19 Mr. Beal or anybody else about credit bidding?

20 A. Yes. That's what led to this paragraph is to  
21 make sure we did whatever we could to make sure there  
22 wasn't a loop hole where we could make this bid and then  
23 vote our notes contrary to this and make it illusory. So  
24 that's why we put in here that we would vote our notes so  
25 that the indenture trustee would not top this bid with a

1 credit bid. That's all we could control was the notes we  
2 had. Then we presented this to the noteholders through  
3 Mr. Gerber saying here's what we propose. I dropped off  
4 the call at that point. So I don't know what the balance  
5 of that call was.

6 Q. I'm asking a more specific question.

7 A. I'm sorry.

8 Q. No, that's okay. Do you know Mr. Beal or  
9 anyone else at the Beal Bank has had conversations with  
10 noteholders about credit bids in connection with your  
11 offer?

12 A. Andy and I had conversations with our counsel  
13 at Hunton & Williams regarding this specific issue.

14 Q. When you say conversations with your lawyers,  
15 do you know if Mr. Beal has talked to any noteholder  
16 about credit bidding?

17 A. No, sir. I don't know.

18 Q. Okay. Now, we talked about the financing  
19 earlier, and we talked about the Lehman piece of the  
20 financing. Do you remember that? Or the Lehman --

21 A. Yes, sir.

22 Q. Your discussions with Lehman Brothers?

23 A. Our discussions.

24 Q. Now, Lehman Brothers is also a noteholder,  
25 right?

1 A. They are.

2 Q. Okay. They're also on the ad hoc committee,  
3 aren't they?

4 A. They're also a part of the large noteholders  
5 group.

6 Q. If we turn specifically to your offer again,  
7 and we look at the section related to the deposit. Let's  
8 take a look at page 2. Do you see that?

9 A. Page 2, yes, sir.

10 Q. And -- well, maybe it's not on page 2. It's at  
11 the bottom of page 2, top of page 3. Do you see that?

12 A. Yes, sir.

13 Q. Okay. So a deposit -- a \$10 million deposit  
14 will be funded five days after the offer is accepted,  
15 right?

16 A. Yes, sir.

17 Q. Okay. Now, in the overall -- this would happen  
18 while the acquisition documents are being drafted, right?

19 A. Yes, sir.

20 Q. Okay. The deposit has to be put into an escrow  
21 account, right?

22 A. Yes, sir.

23 Q. And that would be governed by an escrow  
24 agreement, right?

25 A. Yes, sir.

1 Q. Has that escrow agreement been drafted?

2 A. No, sir.

3 Q. Okay. Thinking about the acquisition, there  
4 would have to be an asset purchase agreement, right?

5 A. Yes, sir.

6 Q. Has that asset purchase agreement been drafted?

7 A. I believe there's a draft of it. I have not  
8 seen it. Hunton & Williams has not produced it to anyone  
9 at CSG or any of our banks. We don't have it yet, but --

10 Q. So there are some lawyers involved in the case  
11 who weren't in the courtroom today that are working on  
12 it, right?

13 A. Yes, sir.

14 Q. You certainly haven't traded it with Mr. --  
15 with Mr. Gerber and the indenture trustee, have you?

16 A. No, Mr. Hale.

17 Q. And we talked about whether there was going to  
18 be any provision in that document. Let me ask you a  
19 different question. In that document, is any Beal Bank  
20 entity going to agree to guarantee the obligations of  
21 Scotia Redwood Foundation if it defaults or fails to  
22 perform under that agreement?

23 A. That issue hadn't come up to me until our  
24 deposition -- our deposition -- my deposition earlier  
25 this week. So we haven't considered that. There

1 would -- I committed to you that the notes would stay  
2 there. You mentioned your concern about the notes being  
3 pulled out the day after the asset purchase agreement,  
4 and that it would be just a shell left. And I apologize  
5 that that did not make it into this term sheet. It will  
6 be in the next iteration of term sheets that the notes  
7 that are there will stay there, as well as the notes that  
8 are going to be contributed will stay there as long as  
9 the asset purchase agreement is outstanding.

10 Q. I understand. But my question is different,  
11 though. My question is: Is that asset purchase  
12 agreement going to contain a guarantee by Mr. Beal, Beal  
13 Financial Corporation, or any Beal entity to guarantee  
14 the performance of Scotia Redwood Foundation to fund \$603  
15 million into this transaction? Is that guarantee going  
16 to be in the document?

17 A. Hasn't been requested. I hadn't considered it,  
18 Mr. Hale.

19 Q. I talked about it in your deposition two days  
20 ago, right?

21 A. Yes, sir. There was other things we've  
22 considered between then and now.

23 Q. Okay.

24 MR. HALE: Your Honor, I have no more  
25 questions for the witness.

1 THE COURT: All right.

2 MR. HALE: A series of follow-up questions  
3 on our last point about the escrow agreement and whether  
4 there will be an agreement to put in a guarantee of  
5 performance.

6 Q. (By Mr. Hale) Is there going to be a  
7 liquidated damages clause in the asset purchase  
8 agreement?

9 MR. GERBER: I object to the question,  
10 Your Honor. He just testified that they haven't  
11 negotiated the agreement yet. They haven't --

12 THE COURT: He doesn't know. I mean, is  
13 that what you're saying? You don't know?

14 THE WITNESS: Yes, sir, that's what I'm  
15 saying.

16 THE COURT: Okay. He doesn't know.

17 MR. HALE: Thank you very much. No more  
18 questions, Your Honor.

19 THE COURT: Now we have to -- do you have  
20 additional questions?

21 MR. NEIER: I do, Your Honor.

22 THE COURT: You have some conflict of  
23 interest.

24 MR. GERBER: Yes, I need to have some  
25 questions about Mr. Neier about this --

1                   MR. NEIER: He can say whatever he wants,  
2 but it's not going to make any difference. I have an  
3 ethical obligation to an existing client. I'm being  
4 informed of this 18 months into the case. Obviously,  
5 this witness has been involved since 2001. It's a thrust  
6 on conflict. It doesn't matter what he says, I'm going  
7 forward.

8                   THE COURT: I think he has an obligation  
9 also to say what he has to say.

10                  MR. NEIER: Let him say it.

11                  THE COURT: Go ahead.

12                  MR. GERBER: Your Honor, Mr. Neier, I'm  
13 not -- I'm not instructing Mr. Neier what to do.

14                  THE COURT: I understand.

15                  MR. GERBER: Your Honor, just a brief voir  
16 dire on Mr. Cherner.

17                                VOIR DIRE EXAMINATION

18 BY MR. GERBER:

19                Q. Mr. Cherner, in the course since 2001 when  
20 you -- when CSG acquired the notes, have you attempted to  
21 keep abreast of environmental and regulatory matters with  
22 respect to the Scotia notes?

23                A. Yes, sir.

24                Q. At the time you acquired the notes and  
25 thereafter, were you concerned about the status of the



1 indenture trust and the notes issued under those trusts  
2 under California law?

3 A. Yes, sir.

4 Q. And did you retain counsel to represent CSG,  
5 Inc. specifically with respect to CSG's interest in the  
6 Scotia notes and the Beal family's interest in the Scotia  
7 notes during that time period?

8 A. Yes, sir.

9 Q. And did that counsel provide you with legal  
10 advice with respect to the Scotia notes, the status of  
11 the notes, the enforceability of the notes?

12 A. Yes, sir.

13 Q. Okay. And did you pay fees? Were you charged  
14 fees by that law firm?

15 A. Yes, sir.

16 Q. And did you pay those fees?

17 A. Yes, sir.

18 Q. And what was the name of that law firm?

19 A. There was three of them. Gardier Wynn, Jenkins  
20 Gilchrist, Winston Strawn.

21 Q. Winston & Strawn?

22 A. Yes.

23 Q. Okay. Is that the -- do you now know that  
24 that's the firm that Mr. Neier belongs to?

25 A. Yes, sir.

1 MR. GERBER: Pass the witness, Your Honor.

2 CROSS-EXAMINATION

3 BY MR. NEIER:

4 Q. For how long have you known that Winston &  
5 Strawn was involved in this matter?

6 A. I called my accounting department yesterday  
7 while I was at DFW airport, and I had seen some  
8 pleadings. And I knew I recognized the name, but I just  
9 couldn't place it.

10 Q. Well, you and I sat through a mediation in  
11 Dallas --

12 THE COURT: You need to speak a little  
13 louder, a little closer to the microphone.

14 MR. GERBER: Your Honor, I took him on  
15 voir dire just simply to establish the conflict. I'm  
16 not --

17 THE COURT: I'm not ruling that you can't  
18 ask him questions.

19 MR. NEIER: What I want to establish is  
20 this is trial by ambush. That's what I want to  
21 establish. And I'm entitled to do that. He's a lawyer.  
22 He just committed an ethical violation. I want to bring  
23 that out.

24 THE COURT: Well, I don't know that he's  
25 just committed an ethical violation.

1                   MR. NEIER: Well, bringing up a conflict  
2 to enhance his interest or causing a conflict because  
3 he's been involved in this thing since 2001. I've been  
4 involved in this thing 18 months. They bring it up  
5 today. That is causing a conflict.

6                   MR. GERBER: Your Honor, Your Honor, my  
7 only purpose is to put Mr. Neier and Winston & Strawn on  
8 notice. We just learned about this, and I'm trying to  
9 prevent -- I didn't expect Mr. Neier to be  
10 cross-examining this witness. Just in terms of trying to  
11 protect Mr. Neier from doing something to consider what  
12 he was doing. If he wants to proceed, I've got --  
13 there's nothing I can do to stop him. I'm not trying to  
14 proceed. I just want to make sure he understands the  
15 facts.

16                   THE COURT: Okay.

17                   Q. (By Mr. Neier) For how long have you known  
18 that Winston & Strawn has been involved in this matter?

19                   A. Since honestly, mediation, Mr. Neier, I don't  
20 know if I knew the name of your law firm. I had seen the  
21 name of the law firm in connection with the Palco estate,  
22 so --

23                   Q. Have you been -- you've been involved in this  
24 matter since 2001, sir, haven't you?

25                   A. Yes.

1 Q. Do you review pleadings in this matter?

2 A. Yes, sir.

3 Q. Did you review the DIP loan agreement in this  
4 matter?

5 A. I don't recall if I reviewed the DIP loan. I  
6 reviewed edits from the DIP loan.

7 Q. You reviewed a lot of pleadings in this matter.  
8 Did you review the joint disclosure in this matter, which  
9 on the front page of it says Winston & Strawn?

10 A. Yes. As I said, I didn't think about it until  
11 yesterday.

12 Q. Well, because today it serves your advantage to  
13 think about it, right?

14 A. No, sir. I made a mistake. I didn't think  
15 about it.

16 Q. Well, you have your position. I have my  
17 position.

18 A. Yes, sir.

19 Q. Now, Mr. Cherner, the Beal Bank family of  
20 companies is certainly an experienced investor in  
21 distressed assets, correct?

22 A. Yes, sir.

23 Q. And it sounds like you've put a lot of work --  
24 and when I say you, I mean the Beal family has put a lot  
25 of work into this investment. You've been involved since

1 2001, correct?

2 A. To be clear, the Beal family is. I didn't  
3 start until 2002.

4 Q. Okay. But it sounds like you've done a lot of  
5 work on this investment personally?

6 A. Yes.

7 Q. And it sounds like CSG has put a lot of work  
8 into this?

9 A. Yes, sir.

10 Q. And it sounds like other entities in the Beal  
11 family have done a lot of work into this?

12 A. Yes.

13 Q. And you've hired what I think I heard is three  
14 consultants?

15 A. Yes, sir.

16 Q. And I think I just heard that you hired also  
17 three law firms just on environmental affairs?

18 A. Not just on environmental affairs.

19 Q. Okay. But you've had three law firms and three  
20 consultants?

21 A. Yes, sir.

22 Q. Three separate companies of consultants is what  
23 I gather you mean?

24 A. Yes, sir.

25 Q. I'm going to show you what's been previously

1 marked.

2 MR. NEIER: May I approach the witness,  
3 Your Honor?

4 THE COURT: Yes.

5 Q. (By Mr. Neier) I'm going to show you what's  
6 been previously marked as MMX 47. It's in these books,  
7 but it will take you a while to find it.

8 MR. NEIER: Your Honor, do you want a copy  
9 as well?

10 THE COURT: All right.

11 Q. (By Mr. Neier) Have you looked at this  
12 document?

13 A. Yes, sir.

14 Q. Do you recognize it?

15 A. Yes, sir.

16 Q. And what is it?

17 A. An expression of interest letter.

18 Q. And this is an expression of interest by the  
19 Beal Financial Corporation to Christopher DiMauro at  
20 Houlihan Lokey, correct?

21 A. Yes, sir.

22 Q. And this document is signed by Mr. Beal, but  
23 you're familiar with it, correct?

24 A. Yes, sir.

25 Q. And it's dated January 30th, 2008; is that

1 right?

2 A. Yes, sir.

3 Q. And do you know if that was the day that the  
4 plan by the noteholders was due to be filed in this  
5 court? It's on the docket, Mr. Cherner. Just do you  
6 know that?

7 A. No, sir, I didn't.

8 Q. Okay. Well, I'll represent to you that this  
9 Court required all plans be filed on January 30th, 2008  
10 after it terminated exclusivity, okay?

11 A. Yes, sir.

12 Q. It's a one-page letter for a \$603 million  
13 purchase; is that right?

14 A. Yes, sir.

15 Q. Is that typical of what Beal Financial Corps  
16 would do, write a one-page letter saying it expresses  
17 interest in the amount of \$603 million? Is that typical?

18 A. It's not atypical.

19 Q. Okay. Now, following the preparation of this  
20 letter, did you immediately engage in negotiations to  
21 draft an asset purchase agreement?

22 A. No, sir.

23 Q. Along the lines of this letter?

24 A. No, sir.

25 Q. How about a letter of intent?

1 A. No, sir.

2 Q. How about a term sheet?

3 A. No, sir.

4 Q. When was the next thing that happened by the  
5 Beal family with respect to making a purchase in this  
6 case?

7 A. I received a phone call March 26th or March  
8 27th, one of those two days, from Christopher DiMauro. I  
9 returned the call the following day. And he asked me if  
10 we would be interested in becoming a stalking horse  
11 bidder.

12 Q. Okay. So let me get this straight. You write  
13 a little on January 30th, 2008, expressing your interest  
14 in making a \$630 million purchase in the Scotia assets.  
15 And then -- and it's subject to due diligence, right?

16 A. Yes.

17 Q. It's non-binding, right?

18 A. Yes.

19 Q. Do you start doing due diligence?

20 A. No, sir.

21 Q. You don't look at the assets; you don't do --  
22 you don't go back to all your consultants and all your  
23 lawyers and start working on this -- on this purchase  
24 right then and there?

25 A. No. We had lived with the asset for a long



1 period of time where there was a built-up institutional  
2 knowledge about the asset.

3 Q. Okay.

4 A. We didn't feel the need to go out and start  
5 spending a ton of money until we knew we had something  
6 worth spending money on. It was too conditional at this  
7 point to go spend corporate assets to look and spend  
8 anymore money or time until we knew was this the high  
9 expression of interest, were we going to be placing any  
10 firm bid? We couldn't spend anymore time on it.

11 Q. Okay. So you didn't want to spend anymore time  
12 on it. You didn't want to have your consultants spend  
13 time on it. You didn't want to have your lawyers spend  
14 time on it. Two months go by. February and March go by,  
15 and you get this call from Mr. DiMauro on March 26, March  
16 27; is that right?

17 A. Yes, sir.

18 Q. And what de he say to you; what did you say to  
19 him?

20 A. Would you be interested in becoming the  
21 stalking horse bidder for the plan? And I said yes. And  
22 that's when we started to move forward to become the  
23 stalking horse bidder.

24 Q. Then you prepared this term sheet or somebody  
25 prepared this term sheet? This is what's now the revised

1 term sheet, IT 207?

2 A. Yes. Well, a prior version of this.

3 Q. What is now IT's 207?

4 A. Yes, sir.

5 Q. Did you exchange drafts of this with anyone?

6 A. Yes, sir.

7 Q. Who did you exchange the drafts with?

8 A. Counsel at Hunton & Williams, counsel for the  
9 indenture trustee.

10 Q. Did you have conversations about it with  
11 Houlihan Lokey?

12 A. Yes, I had conversations with Houlihan Lokey.  
13 I didn't exchange -- don't believe we exchanged drafts  
14 back and forth.

15 Q. Okay. And you had conversations with Fulbright  
16 & Jaworski, counsel to indenture trustee?

17 A. Yes.

18 Q. And Houlihan Lokey is the financial advisor to  
19 the indenture trustee?

20 A. Yes.

21 Q. And then you put together what is now IT 207,  
22 which is a four-page term sheet called a binding term  
23 sheet, correct?

24 A. Yes, sir.

25 Q. And do you think that a four-page term sheet is

1 typical for a \$603 million purchase, a binding term  
2 sheet? Do you think that's typical? You're in the  
3 distress business. Is that typical?

4 A. At this point subject to documentation, I mean,  
5 it's acceptable.

6 Q. Oh, I'm sorry. This is subject to  
7 documentation; it's not binding?

8 A. Well, no, it's a binding term sheet. We have  
9 to work together to get the asset purchase sheet put  
10 together. We have to change the date now.

11 Q. If there's no definitive documentation, then  
12 this is not binding is what they're saying.

13 A. Well, no, we have to work -- we're committed to  
14 working in good faith to get documents done.

15 Q. So if you don't work in good faith to get the  
16 documents done, this is not a binding term sheet?

17 A. Can you rephrase that question? I'm sorry.

18 Q. You know, so you don't work together in good  
19 faith to draft all the definitive documentation, then  
20 this is not a binding term sheet; is that correct, sir?

21 A. Well, the term sheet is binding. We need to  
22 get the documents.

23 Q. Why do you need the documents? It's a binding  
24 term sheet.

25 MR. NEERMAN: Your Honor --

1                   THE COURT: Let's not argue with the  
2 witness. He can give his characterization, and you can  
3 give yours.

4                   MR. NEIER: Thank you, Your Honor.

5                   THE COURT: But not in the questions.

6           A. You were commenting about the length of the  
7 term sheet, and we don't have an asset purchase agreement  
8 completed at this time or even a draft of it yet. And I  
9 believe it provides for a time frame between what -- when  
10 we originally set the term sheet up, I didn't realize  
11 that the court hearings weren't going to be concluded  
12 this week, and we set between now and April 20th to  
13 complete the documents with the indenture trustee.

14           Q. You wanted this to come out during the trial,  
15 correct?

16           A. I -- what do you mean I wanted it to come out?

17           Q. Well, you didn't want it coming out in February  
18 or March; you wanted it to come out right now in court,  
19 shock and awe?

20           A. No, I wanted to be appointed the stalking horse  
21 bidder as soon as possible.

22           Q. Let's go back to this. Is this a binding term  
23 sheet, or is it subject to the condition that there be  
24 definitive documentation? That's my question.

25           A. I think we're obligated under the term sheet,

1 but obviously there's additional documents that need to  
2 be done.

3 Q. Well, those additional documents are never  
4 done. Is this a binding term sheet where you're  
5 committed to paying \$603 million. That's my question.

6 A. Yes.

7 Q. So you don't really need an asset purchase  
8 agreement?

9 MR. GERBER: Objection, Your Honor. Calls  
10 for a legal conclusion.

11 MR. NEIER: He's a lawyer.

12 THE COURT: Sustained.

13 Q. (By Mr. Neier) Were you present in court where  
14 Mr. Dean mentioned that he had done a 25-page term sheet  
15 for a \$20 million investment in Palco?

16 A. No, sir.

17 Q. I believe you stated that the Beal family is an  
18 experienced investor in the distressed world?

19 THE COURT: He did.

20 MR. NEIER: Thank you, Your Honor.

21 Q. (By Mr. Neier) If you were interested in these  
22 assets, wouldn't you want to make sure that there is as  
23 short a marketing process as possible? Isn't that to  
24 your advantage?

25 A. Sure.

1 Q. Because you'd want to get the assets before  
2 anybody else could get the assets?

3 A. Absolutely.

4 Q. And you'd want to make sure that -- I mean, you  
5 could make an argument to the court that there's been a  
6 lengthy marketing process by UBS in 2004 and 2005, right?

7 A. Yes, sir.

8 Q. And you're familiar with that process because  
9 you've been in this since 2001?

10 A. I am.

11 Q. And that was an extensive marketing process  
12 conducted by UBS?

13 A. I understand it was.

14 Q. And UBS is an experienced investment bank that  
15 engages in all sorts of MNA transactions, correct?

16 A. I understand they do.

17 Q. But yet it's your position that the marketing  
18 process could be up to six months; is that right?

19 A. That is correct, at the request of the  
20 indenture trustee, if you bid a shorter marketing period,  
21 we're amicable to that.

22 Q. If you wanted to be the stalking horse bidder  
23 as soon as possible, that is, as soon as Mr. DiMauro made  
24 the offer for you to be the stalking horse bidder, why  
25 did you wait until the week before the trial or really

1 the day before the trial to send in this term sheet?

2 A. I didn't realize until our call on March 27 or  
3 28 that our expression of interest letter was apparently  
4 the top expression of interest letter. I wasn't going to  
5 work on a term sheet if we were out of market, if there  
6 were bids above us.

7 Q. So it's all just a happy coincidence that it  
8 arrived a few short hours before we came to court in  
9 about midnight the day before the trial started?

10 MR. GERBER: Objection; arguing with the  
11 client -- with the witness.

12 MR. NEIER: He's your client. Do you have  
13 a conflict of interest that we should bring out in this  
14 court?

15 MR. GERBER: I misspoke. But if he's  
16 anybody's client, Mr. Neier, he'd be yours.

17 MR. NEIER: The Beal company is your  
18 client, isn't it?

19 THE COURT: We're not going to go back and  
20 forth with each other. You can all direct your comments  
21 to me.

22 MR. GERBER: Your Honor, I'm objecting.  
23 He's just arguing.

24 THE COURT: I think he gets to -- you  
25 know, these are the questions that if we had a jury, that

1 the lawyer would love to ask. And I already know the  
2 answer to the question before you ask it. But I think he  
3 can ask some of these questions, but I agree with you  
4 they're sort of -- so you can ask that one question.  
5 What was it, a happy coincidence? Was it a happy  
6 coincidence?

7 THE WITNESS: No, sir.

8 THE COURT: Okay.

9 Q. (By Mr. Neier) Now, I think you stated that  
10 the Beal family has about a 37, 38 percent interest in  
11 the timber notes, correct?

12 A. Yes, sir.

13 Q. And you've done your own internal valuations to  
14 make your determination -- that is, the Beal family --

15 A. Yes, sir.

16 Q. -- has made its own internal valuations to  
17 determine whether the assets -- what the assets are  
18 worth, correct?

19 A. I interrupted you before. Yes, sir. That is  
20 all correct. I apologize.

21 Q. And the Beal family doesn't overpay for assets,  
22 does it?

23 A. No, sir.

24 Q. So can you represent to me that your valuation  
25 of the timberlands is less -- the fair market value, in



1 your opinion, of the timberlands is less OR more than  
2 your offer of \$603 million?

3 A. I'm not going to represent anything to you  
4 about the value of the timberlands. This is our bid. We  
5 think it's a good bid. And we're interested in closing  
6 on this bid.

7 Q. Well, if you pay a premium for these assets, a  
8 substantial amount of that premium will be going back  
9 into your pocket, correct?

10 MR. GERBER: Objection, Your Honor. I  
11 don't know what Mr. Neier means, but it sounds like some  
12 sort of legal conclusion.

13 THE COURT: No, I think it's a fair  
14 question. I don't think it's a legal issue. I think  
15 it's a financial issue. So I don't know what the answer  
16 is, but I think he can ask the question.

17 A. As a noteholder, we get the benefit of some of  
18 the proceeds of the sale. Yes, sir, we do.

19 Q. Up to 40 percent of whatever the noteholders  
20 get -- I'm sorry, up to 38 percent of whatever the  
21 noteholders get will be going back to the Beal family,  
22 correct?

23 A. Yes, sir.

24 Q. Okay. So my question to you is, can you  
25 represent whether or not you are paying a premium over

1 what you have valued the assets at?

2 A. Absolutely not. Paying a premium over what we  
3 have valued the assets for.

4 Q. So you're paying less, less than what you think  
5 the fair market value of the assets are, correct?

6 THE COURT: That's not a fair question.  
7 Less or equal to, you mean. You have to be paying more  
8 to get a premium.

9 MR. NEIER: No, I'm asking the opposite.

10 THE COURT: Right. But you left out equal  
11 to.

12 Q. (By Mr. Neier) Equal to or less?

13 A. We believe it's equal to.

14 Q. Has the -- I think Mr. Hale asked you about an  
15 instruction letter to the indenture trustee. Has the  
16 indenture trustee received an instruction letter by  
17 two-thirds to accept this offer?

18 A. I do not know.

19 Q. Well, presumably you would know because Beal  
20 would be one of the people who would have to be part of  
21 that, right?

22 A. We haven't been sent one, but we've already  
23 committed as to how we would vote our notes.

24 Q. Right, but you -- have more than a third,  
25 right?

1 A. Yes, sir.

2 Q. So there can't be any instruction to the  
3 indenture trustee that you're not part of --

4 A. We would eventually get it. Yes, sir.

5 Q. I mean, to get the two-thirds, the indenture  
6 trustee has to have your vote?

7 A. Must have, yes.

8 Q. You have what's called a blocking position in  
9 this business?

10 A. In this business, that is a common term used,  
11 yes.

12 Q. And unless -- unless the indenture trustee  
13 receives an instruction of two-thirds in dollar amount of  
14 the existing timber notes, it must ask for the full  
15 amount that the -- that is owed to the timber  
16 noteholders, and it must credit bid at any judicial sale;  
17 is that correct, sir?

18 A. That's my understanding.

19 Q. So unless the indenture trustee receives an  
20 instruction, it could never reach an agreement with  
21 Mendocino or Marathon on a plan, and it could never  
22 accept your bid? Unless it receives that instruction, it  
23 can't even negotiate anything less than the full payment  
24 due on the timber notes, correct?

25 MR. GERBER: Objection. Calls for a legal

1 conclusion.

2 THE COURT: Now you're starting to get to  
3 a legal conclusion.

4 MR. NEIER: Well, he said it was his  
5 understanding, Your Honor.

6 THE COURT: Was this your understanding of  
7 the deal?

8 THE WITNESS: Your Honor, I don't remember  
9 the questions.

10 Q. (By Mr. Neier) Under the indenture, do you  
11 understand that two-thirds in dollar amount is required  
12 to instruct the indenture trustee to accept less than 100  
13 percent owed to the timber noteholders, correct?

14 A. Right. Now I get it. What I was confused  
15 about was we had settlement discussions where we had  
16 authorized less than that, so the indenture trustee had  
17 had that type of instructions in the past that would not  
18 have been in connection with the judicial foreclosure  
19 sale, but would have been in connection with a compromise  
20 of a controversy. And we had those discussions and made  
21 those offers to try to compromise the matter.

22 Q. But it does not have such an instruction now,  
23 does it? Whatever instruction it had before has lapsed?

24 A. It's my understanding it has, yes.

25 Q. So right now there can't be any negotiations;

1 there can't be any acceptances of anything less?

2 THE COURT: I think we've gone over this  
3 ground. Let's move on.

4 MR. GERBER: Thank you.

5 Q. (By Mr. Neier) So I think Mr. Hale asked you  
6 about the timeline that would be required here, right?  
7 There will be -- your plan would be confirmed. There  
8 would have to be a final order. I think a final order is  
9 non-appealable. Then there would have to be a marketing  
10 process. There would have to be bid procedures approved.  
11 There would have to be a sales hearing. A sale order  
12 would have to be approved. Do you need regulatory  
13 approval as well?

14 A. That will be concurrent with whatever  
15 regulatory approvals we need.

16 Q. You know, I'm just asking you. You've been  
17 involved in a lot of these things. Do you think  
18 regulators talk to bidders, or they only talk to the guy  
19 who's winning, a guy who's got a court order that says  
20 plan confirmed, sale confirmed?

21 A. I have not -- we have not contacted the  
22 California regulatory authority on this matter. I don't  
23 know the answer to your question.

24 Q. How about federal regulators?

25 A. I don't know the answer to your question.

1 Q. Will you need HSR approval?

2 A. I know counsel is looking at making sure that  
3 we do not, but I don't have an answer for that.

4 Q. So maybe yes, maybe no?

5 A. I don't have -- yes, sir. I'm sorry. I didn't  
6 mean to be arguing with you. Yes, sir. Maybe yes, maybe  
7 no. Yes, sir.

8 Q. You go for the period. You get the sale order  
9 confirmed, and then whoever buys it is going to need  
10 regulatory approval from the California state agency and  
11 possibly other approvals as well?

12 A. Yes, sir. I'm sorry, I didn't realize that was  
13 a question.

14 Q. I apologize. Who supports the estate during  
15 that period?

16 A. I understand that the tree farm will probably  
17 cash flow itself; but if not, we'll find a way to support  
18 the estate.

19 Q. Well, it's not -- it's cash flow negative right  
20 now, isn't that right?

21 A. Well, there will be a lot less expenses  
22 associated with post confirmation.

23 Q. Well, you're assuming there are no appeals and  
24 that all these gaggle of people aren't still working  
25 away; isn't that right?

1           A.    That is correct.  I could be wrong, in which  
2           case we would have to find a way to fund operations  
3           during the interim.  So, that might mitigate toward a  
4           shorter sales process, which is fine with us.

5           Q.    Is it in your interest for the Palco estate to  
6           also survive or not?

7           A.    Sure, that mill should survive.

8           Q.    So are you going to support the Palco estate  
9           during the five to eight months that we're talking about?

10          A.    By selling the timber.

11          Q.    Okay.  And -- but you didn't -- you haven't got  
12          it yet, so somebody has got to sell the timber, right?

13          A.    The plan agent under the indenture trustee  
14          would sell timber to Palco.

15          Q.    Okay.  And then Palco has got to have the  
16          ability to pay for it, which it currently doesn't have,  
17          correct?

18          A.    Honestly, I've heard that, yes, sir.  I don't  
19          know that, but I have heard that.  Yes, sir.

20          Q.    So are you willing as part of your bid to keep  
21          Palco estate alive?

22                   MR. GERBER:  Objection, Your Honor.  We're  
23          not negotiating the bid here.

24                   MR. NEIER:  I'm just trying to understand  
25          it.

1                   THE COURT: Well, we sort of have  
2 negotiated the bid as we've kind of gone along. I'm not  
3 sure, I mean, he may agree to do that. I'm willing to  
4 ask him if he's willing to put together a Palco plan.

5                   MR. NEIER: Mr. Hale got some things.

6                   MR. GERBER: Mr. Neier represents  
7 Marathon. Marathon is the lender at Palco. Maybe  
8 Mr. Cherner should ask Mr. Neier if they'll support --

9                   MR. NEIER: I'll take the stand next.

10                  THE COURT: I mean, I think that there are  
11 certainly -- there are certainly practical reasons why  
12 whatever is done ought to do something on behalf of both  
13 companies. Whether there are legal reasons that prohibit  
14 that from happening is something we'll argue about, but  
15 there's no question that the practical issues come into  
16 play on what ought to be done, especially if there are  
17 two confirmable plans. So I think he can ask the  
18 question. I don't think the witness has to renegotiate  
19 his deal by any means.

20                  MR. NEIER: I didn't ask him to  
21 renegotiate. I said was he willing to fund the Palco  
22 estate.

23                  THE COURT: I think that it would be very  
24 difficult to say that -- the term sheet is a term sheet,  
25 and you obviously are expecting him to say no, he's not



1 going to write a check. Well, he doesn't have it in  
2 here. There's not a blank check for Palco in here. I'm  
3 not going to assume from this that they're going to do  
4 anything for Palco other than sell him trees, Palco  
5 exists.

6 MR. NEIER: If he gives that answer, I'll  
7 go on.

8 THE COURT: We don't need to go down that  
9 road. I mean, if they had brought it up that they were  
10 going to support Palco, then I suspect you could get into  
11 that and find out what they're really going to do. But  
12 there isn't any help for Palco other than they believe  
13 they can let the tree farm survive.

14 MR. NEIER: Can I ask him that question?  
15 I'll ask him that question.

16 Q. (By Mr. Neier) Is what you're willing to do  
17 for Palco is to sell them trees, nothing else?

18 A. Yes, sir.

19 Q. Okay. And would it be 100 percent of the trees  
20 or less than 100 percent of the trees during this sort of  
21 this gap between confirmation of the plan, ultimate  
22 effective date?

23 A. I need to meet with Palco and see what makes  
24 sense.

25 Q. Who would run Scopac during this interim

1 period, that is, between the confirmation order and the  
2 effective date? This is after the marketing, the  
3 confirmation, the sale, things like that?

4 A. Governor Pete Wilson and a Board of Directors.

5 Q. Who appoints the Board of Directors?

6 A. I believe that the noteholders will be  
7 appointing the Board of Directors.

8 Q. And you're the largest noteholder?

9 A. Yes, we are.

10 Q. Isn't that sort of like letting the fox in the  
11 hen house a little too soon?

12 MR. GERBER: Objection, Your Honor.

13 THE COURT: Those questions are a little  
14 more worrisome if we had a jury, but they're not -- you  
15 know, they sort of make the event somewhat lively.

16 MR. GERBER: It's pejorative.

17 THE COURT: It is somewhat pejorative.

18 Q. (By Mr. Neier) It's fair to say that the  
19 noteholders will be running Scopac at the time that  
20 Scopac is being marketed, correct?

21 MR. GERBER: Objection. That's not what  
22 the witness testified to. Asked and answered.

23 THE COURT: Well, he --

24 MR. NEIER: If he asked and answered --

25 THE COURT: Stop. The question is, is it

1 fair to say that that's what would happen. Is that fair  
2 to say or not?

3 A. Governor Wilson and the board would run it,  
4 sir, and --

5 Q. And the board will be noteholders?

6 A. Yes, sir. And we don't intend to be on the  
7 board.

8 Q. Thank you for that clarification.

9 A. Yes, sir.

10 Q. Now, if --

11 A. If we're the stalking horse bidder, we don't  
12 intend to be.

13 Q. Okay. So what you're saying is if somebody --  
14 some other noteholder comes up, you're not the -- you're  
15 not in the game anymore, for whatever reason; then you  
16 could serve on the board?

17 A. Could. Haven't made that decision. I'm going  
18 on the presumption that, you know, we would not both be  
19 on the board and the appointed stalking horse bidder.

20 Q. Okay. But other noteholders would be on the  
21 board?

22 A. That's my understanding.

23 Q. Now, we've covered that if this term sheet, IT  
24 207, is to be accepted, it's got to be accepted by  
25 two-thirds in dollar amount of the noteholders, correct?

1                   MR. GERBER:  Objection, Your Honor.  
2                   That's not been established, and that's not the facts.  
3                   This term sheet --  
4                   MR. NEIER:  That's why I'm asking the  
5                   witness, so I can get the facts.  Are you testifying or  
6                   is he testifying?  
7                   THE COURT:  Why are you guys doing this?  
8                   MR. NEIER:  I think the witness can handle  
9                   himself.  
10                  THE COURT:  You can say that to me.  
11                  MR. NEIER:  Okay.  I think the witness can  
12                  handle himself.  
13                  THE COURT:  I think he can, too.  I  
14                  think -- I don't know if that's a fact.  Is that what you  
15                  think it is?  
16                  THE WITNESS:  No, sir.  I believe that  
17                  50.1 percent can accept the term sheet, but more of  
18                  Mr. Neier's true point --  
19                  MR. NEIER:  Yes.  He's anticipating.  
20                  That's okay.  Go ahead.  
21                  THE WITNESS:  I'm just trying to  
22                  expedite --  
23                  THE COURT:  Go ahead.  
24                  THE WITNESS:  -- some of the argument.  66  
25                  and two-thirds have to agree to accept less than a full

1 credit bid and instruct the indenture trustee to accept  
2 less than a full credit bid is my understanding of how  
3 the indenture works. My understanding. So we own 30 --

4 THE COURT: Since I'm the one that has to  
5 understand, the only 50 percent have to vote to accept  
6 this bid or is this bid done now? It's been accepted by  
7 50 percent.

8 MR. GERBER: Your Honor, the indenture  
9 trustee has not accepted the bid. The indenture trustee  
10 can't accept a bid.

11 THE COURT: I'm not asking about the  
12 indenture trustee. I didn't realize that there was some  
13 requirement that 50 percent do anything. I did think  
14 that once the bid process started, the indenture trustee  
15 has to bid whatever the face amount of the notes is,  
16 which means they'll overbid this bid --

17 MR. GERBER: Right.

18 THE COURT: -- unless two-thirds say we  
19 can bid something less; is that correct?

20 THE WITNESS: Yes, sir.

21 THE COURT: Is there also some requirement  
22 that 50 percent accept this bid?

23 MR. GERBER: No, Your Honor.

24 THE WITNESS: I was mistaken, Your Honor.

25 MR. NEIER: We'll put Mr. Berger on next.

1                   THE COURT: Whatever it is, it is. Let's  
2 move on. That's what it is.

3           Q.    (By Mr. Neier) So if I understand this  
4 correctly, somebody has to accept the term sheet?

5           A.    Correct.

6           Q.    But the credit bid -- the waiving of the credit  
7 bid requirement has to be by 66 and two-thirds percent?

8           A.    Yes, sir, as to both questions. Someone has to  
9 accept it, and 66 and two-thirds have to agree to  
10 instruct the indenture trustee to accept less than a full  
11 credit bid, yes, sir.

12          Q.    So we have a situation where the term sheet is  
13 accepted, and then it takes 66 and two-thirds to not  
14 credit bid?

15          A.    Yes, sir.

16          Q.    Okay. And if 66 and two-thirds is not  
17 obtained, okay, in other words, a third declines to  
18 instruct the indenture trustee to not credit bid; you  
19 would still earn a break up fee; that's right?

20          A.    That's correct.

21          Q.    And the break-up fee would be \$21 million?

22          A.    That's correct.

23          Q.    So the term sheet gets accepted. And unless  
24 two-thirds, 66 and two-thirds percent say otherwise,  
25 there will be a credit bid, but you will have earned a

1       \$21 million break-up fee, correct?

2           A.    I would hope that the indenture trustee would  
3       already have taken the vote on that point about the  
4       credit bid before it accepts this term sheet.  That's not  
5       what we're looking to achieve.  If there were a way for  
6       us to -- if we had owned 68 percent of this, it wouldn't  
7       be an issue.

8           Q.    I think you've now -- you've gotten there for  
9       me.

10          A.    I'm doing the best I can.

11          Q.    The point is you're not going to agree to not  
12       instruct the indenture trustee yourself to not credit bid  
13       unless this term sheet is already accepted, correct?

14          A.    That -- it was the intent for us to actually  
15       have done what you just asked under the credit bid  
16       section, page 4 of 4.  The intent of this text was to  
17       address the point you just raised.  If we failed to do  
18       it, good for you.  Tell me what we failed to do, and  
19       we'll change it.  We agree that we would instruct the  
20       indenture trustee to agree not to credit bid an amount in  
21       excess of this bid.

22          Q.    But only if this term sheet is accepted by the  
23       indenture trustee?

24          A.    Yes.

25          Q.    So there's this thing where you could -- you

1       could -- you don't earn the break-up fee until this has  
2       been accepted, correct?

3           A.     Correct.

4           Q.     Okay.  So once --

5           A.     And approved by the court.

6           Q.     It has to be approved by the court?

7           A.     Yes, sir.

8           Q.     Okay.  So if the court doesn't approve it --

9           A.     I don't think it ever goes into effect if the  
10       Court doesn't approve it.

11          Q.     When does the Court approve this?

12          A.     As soon as possible.

13          Q.     Okay.  Well, the point is that there could be a  
14       period where you earn a break-up fee, but the -- and you  
15       earn the break-up fee because the indenture trustee never  
16       lets this term to credit bid, and that's my point.  It  
17       gets accepted by 50.1 percent, which doesn't have to  
18       include you?

19          A.     No.  Actually Mr. Gerber corrected me.  It's  
20       not a 50.1 percent.

21          Q.     Okay.  What requirement is there?

22          A.     I would hope that the noteholders that would be  
23       two-thirds an amount would vote before we did this.  I  
24       don't want the outcome that you've just outlined.

25          Q.     Okay.



1           A.    If we go through this, and we're out-of-pocket  
2           and we're spending money and time and management  
3           resources, we're not doing that so the indenture trustee  
4           can credit bid the asset.

5           Q.    How about competing bids?

6           A.    That's fine.

7           Q.    Okay.  So the indenture trustee -- under your  
8           scenario, the indenture trustee would have to waive the  
9           right to credit bid against any bid, not just you?

10          A.    Well, our instruction was to stop at 603, so  
11          presumably you're talking about bids over 603.  So the  
12          instruction would stand.

13          Q.    Do you think there's anything wrong with -- I  
14          mean, do courts normally approve break-up fees when the  
15          largest single creditor is the bidder?  Is that something  
16          you think is reasonable?

17                   MR. GERBER:  Objection.  Which question  
18          would -- there's two questions there.

19                   THE COURT:  Right.  So --

20          Q.    (By Mr. Neier)  Is it reasonable in your view?

21                   THE COURT:  Counsel, I don't think that's  
22          relevant.  Let's move on.

23                   MR. NEIER:  All right.

24          Q.    (By Mr. Neier)  Did I hear you right?  Did you  
25          want to purchase the mill at some point?

1                   MR. GERBER: Objection. He did not answer  
2 any question. There was nothing mentioned remotely to  
3 that.

4                   MR. NEIER: He said not at this point.

5           Q.    (By Mr. Neier) I'm trying to figure out, at  
6 some point do you want to purchase the mill? Is that the  
7 idea?

8           A.    Not particularly. We have not looked at  
9 purchasing the mill. We have not looked at it.

10          Q.    And I believe what -- a little different from  
11 the term sheet. What you said is you'll sell the mill  
12 not less than 50 percent of the logs that -- if this all  
13 gets approved five to eight months from now and so forth  
14 and so on, you will sell the mill not less than 50  
15 percent of the logs to mill, correct?

16          A.    Yes.

17          Q.    Can the mill survive on not less than 50  
18 percent of the logs, in your view?

19          A.    As to it's operated, I don't know.

20          Q.    The mill is not surviving on 100 percent of the  
21 logs coming from Scopac today, is it? It's an insolvent  
22 company?

23          A.    I understand. I want the mill to survive.

24          Q.    Do you believe your bid is in a defensive  
25 nature to stop another plan from being confirmed in this

1 process?

2 A. No. We're ready to close.

3 Q. Does Mr. -- does Mr. Gerber represent the Beal  
4 family or some parts of the Beal family?

5 A. Not presently to my knowledge.

6 Q. Has he represented Beal interests in the past?

7 A. Yes, sir.

8 MR. NEIER: I have no further questions,  
9 Your Honor.

10 THE COURT: Anyone else?

11 MR. JONES: Yes, Your Honor.

12 THE COURT: We have lots of different  
13 people. Who gets to go next? This is the creditor's  
14 committee.

15 MR. GERBER: Your Honor, may I just  
16 inquire of the witness whether he needs a break.

17 THE COURT: Do you need a break now?

18 THE WITNESS: No, sir. Let's go.

19 THE COURT: Okay.

20 CROSS-EXAMINATION

21 BY MR. BROWN:

22 Q. Good afternoon, Mr. Cherner. My name is Ken  
23 Brown. I represent the creditor's committee.

24 THE COURT: We're going for another hour.

25 THE WITNESS: Yes, sir.

1 THE COURT: So you can make it?

2 THE WITNESS: Yes, sir.

3 Q. (By Mr. Brown) Mr. Cherner, have you or anyone  
4 else on behalf of any of the entities within the Beal  
5 umbrella done any analysis of the Palco mill's ability to  
6 stay open if only 50 percent of the logs from the  
7 timberlands are sold to the mill?

8 A. Not to my knowledge, no, sir. And that's not  
9 the intent. The intent is that we are committed to sell  
10 50 percent. A desire -- if it's the closest mill, it  
11 should be the prevailing bidder for that balance.

12 Q. I'm just referring to, I believe what I --

13 MR. GERBER: Objection, Your Honor. He's  
14 interrupting the witness.

15 Q. (By Mr. Brown) I'm sorry.

16 A. No, Mr. Brown. Go ahead. If I was not  
17 answering your question, please.

18 Q. Inquiring with respect to what I understood  
19 your earlier testimony to be, that although it was not  
20 currently set forth in the revised bid -- I don't have  
21 the exhibit number, but I believe you know what I'm  
22 referring to --

23 A. Yes, sir.

24 Q. -- that you would add a provision in there that  
25 upon -- if you were the successful bidder and ultimately

1       acquired the assets, that you would commit to sell 50  
2       percent of the logs to Palco; is that accurate?

3                   THE COURT: I'm going to take a ten-minute  
4       break anyway even though he's got a steel constitution.

5                   MR. BROWN: That's the first one you've  
6       requested all week, Your Honor.

7                   (A recess was taken.)

8                   THE COURT: Okay. I think we've got a  
9       fair representation of everybody. Go ahead.

10                  Q.     (By Mr. Brown) Mr. Cherner, just before we  
11       took the break, I believe you had testified that neither  
12       you nor anyone else employed by the Beal umbrella  
13       companies or on behalf of them has performed any analysis  
14       on Palco mill's ability to stay open if only 50 percent  
15       of the logs from the Scopac forest are sold to them,  
16       correct?

17                  A.     Yes, sir.

18                  Q.     And would it be true to say that neither you  
19       nor anyone else at the Beal umbrella companies or on  
20       their behalf has undertaken a market analysis to  
21       determine how log prices will be affected if the Palco  
22       mill closes?

23                  A.     No, sir. That's not the way we looked at it,  
24       no, sir.

25                  Q.     You have not undertaken any analysis?

1           A.    We've looked at the incremental costs to  
2    harvesting the trees to take them to alternative sites,  
3    but we haven't looked at costs relative to Palco, no.

4           Q.    So the answer to my question is no?

5           A.    I'm sorry, Mr. Brown, I'm doing --

6           Q.    Is it a true statement that neither nor anyone  
7    employed by any of the Beal entities or on their behalf  
8    have undertaken any market analysis to determine how log  
9    prices will be affected if the Palco mill closes?

10          A.    No, sir, that is -- yes, sir, that is correct.  
11    You made a correct statement.

12          Q.    You referred earlier to some modeling that you  
13    had done internally in connection with coming up with the  
14    pricing on the bid for the Scopac assets, correct?

15          A.    Yes, sir.

16          Q.    And can you tell me how that modeling was done?  
17    Did you use specialized harvest schedules in connection  
18    with that modeling, or just something akin to an Excel  
19    spreadsheet?

20                   MR. GERBER:  Objection, Your Honor.  This,  
21    again, goes into details about how they calculated their  
22    bid, and it's information that's not appropriate at this  
23    time.

24                   MR. BROWN:  We're not asking for  
25    confidential information.  It's a very generalized

1 question. It just asks whether there were any  
2 specialized schedules used or whether it was just a  
3 spreadsheet analysis.

4 MR. GERBER: Your Honor, what possible  
5 relevancy can that have?

6 THE COURT: I can't possibly -- I mean, I  
7 think if everyone -- I tend to agree. We're getting  
8 pretty far-field here now, so let's move on.

9 MR. BROWN: But I'm going to ask some  
10 other questions. I understand they may be subject to the  
11 same objections.

12 THE COURT: Okay. Well, let's see where  
13 they are.

14 Q. (By Mr. Brown) Can you tell me how many  
15 billions of board feet per year were imbedded in your  
16 analysis --

17 MR. GERBER: Objection, Your Honor.

18 Q. -- what the harvest levels were in your  
19 analysis?

20 MR. GERBER: I'm sorry. Objection.

21 THE COURT: I think let's move on to  
22 another area.

23 MR. BROWN: We think it goes to  
24 feasibility, Your Honor, and whether or not this has any  
25 chance of ever, you know, being a real bid that's going

1 to be able to be supported.

2 THE COURT: I think the problem is that  
3 he's already testified he doesn't have forestry. He just  
4 used other people stuff and they made up the best offer  
5 they could. I don't think that his estimation of how  
6 many billion board feet can be cut in the forest for the  
7 next five years or ten or 50 years really has a lot of  
8 relevance.

9 MR. BROWN: I'll move on.

10 Q. (By Mr. Brown) I just want to ask the question  
11 indirectly related to that, though, is: Do you expect  
12 that the state is going to require you to disclose the  
13 basis of your analysis? For example, how many millions  
14 of board feet you intend to harvest before it agrees to  
15 allow Beal to be the transferee of the Scopac assets?

16 A. I expect that they would, yes.

17 Q. So you do intend to disclose that information  
18 at some time?

19 A. If required to the state regulatory  
20 authorities, yes.

21 Q. But you won't disclose it here?

22 A. No, sir.

23 MR. GERBER: Objection, Your Honor. It's  
24 not that he's refusing to disclose it; it's an improper  
25 question. We're not refusing to disclose it. We're



1 saying it's not appropriate here. And it's fair for  
2 Mr. Brown to characterize it that way.

3 MR. FIERO: Your Honor, we're going to  
4 file a motion next week seeking an appropriate protective  
5 order with regard to all of this information because we  
6 think it is absolutely relevant. We understand why  
7 Mr. Cherner might not want to testify to it here in open  
8 court today, but we think that this question, which goes  
9 to the core of the feasibility of the indenture trustee's  
10 plan, has to be addressed.

11 THE COURT: I guess the problem I have,  
12 though, is that he doesn't have to convince me that he  
13 can get state regulation. He may end up buying a forest  
14 without the ability to harvest any trees whatsoever, and  
15 that will be bad on B of A, but I don't know that this is  
16 contingent upon any of that stuff.

17 And I agree that some -- the ability for  
18 them to operate the forest has profound impacts in  
19 northern California if this deal is accepted and we move  
20 forward and all that. But whether their bid to buy all  
21 of this really goes more to whether they have the  
22 financial wherewithal to pay for it, don't you think?

23 MR. GERBER: Thank you, Your Honor.  
24 That's exactly our position.

25 MR. FIERO: I think that is exactly the

1 justification I articulated and precisely why you find  
2 all that information about MRC in its disclosure  
3 statement, that the creditors of these estates have a  
4 right to know what it is that's going to happen in the  
5 future. They all voted against the indenture trustee  
6 plan because of its uncertainty. Some of that  
7 uncertainty, in order for judge -- this court to rule on  
8 feasibility, has to be removed.

9 THE COURT: Right. But they're the ones  
10 that have to prove up their plan, not you. You don't  
11 have to prove it is -- so what I'm saying is I think I  
12 have already heard plenty about what they have done thus  
13 far and how much more they've got to go with respect to  
14 forestry operations and stuff like that. They don't have  
15 a forestry department yet other than in Astonia.

16 MR. FIERO: Your Honor, my concern is we  
17 have been presented with documents which were redacted.

18 THE COURT: You may request the other  
19 information and we'll deal with that at a later time, but  
20 right now let's move on.

21 MR. BROWN: Thank you, Your Honor.

22 Q. (By Mr. Brown) Do you know in -- this 50  
23 percent of the harvest that you've indicated you're  
24 willing to sell to the Palco mill, do you know how much  
25 that in board feet?

1                   MR. GERBER: Your Honor, objection.  
2           Again, that's just another way of finding out how much  
3           board feet they intend to cut.

4                   THE COURT: So what are you trying to  
5           show? What are you trying to show me, that he doesn't  
6           know how much it is? Or that he doesn't and it's X  
7           amount and that Palco won't survive on that? What are  
8           you trying to show me?

9                   MR. BROWN: It was one of the things that  
10          he said in the bid. It was one of the additions that  
11          he's added as part to the bid today as part of the  
12          negotiation that were entered into as part of the  
13          examination. He said 50 percent of the Scotia cut would  
14          be sold to Palco. What does that mean to him? I mean,  
15          it's part of the bid. I think we all have a right to  
16          know.

17                   MR. GERBER: Your Honor, there couldn't be  
18          a better example of somebody trying to chill bidding than  
19          the way these attorneys have tried to run off Beal. Beal  
20          has come in here with a bid of \$603 million. The only  
21          reason they don't -- that they're pounding on Mr. Cherner  
22          is because under their plan, they don't have any  
23          competition for their bid. What we're trying to do is to  
24          establish that there's someone out there who's a  
25          financially responsible and environment -- promises to be

1 environmentally responsible, and they're trying to run  
2 them off.

3 MR. BROWN: Your Honor, we're going to  
4 move on. I know there's other people that want to ask  
5 questions, and I don't want to get stuck in this mire,  
6 not in the way of agreeing with what Mr. Gerber said.

7 THE COURT: I understand.

8 Q. (By Mr. Brown) There was testimony earlier by  
9 you with respect to the binding nature of the bid,  
10 Mr. Cherner. And I just want to follow-up on that. If  
11 you work in good faith to achieve an asset purchase  
12 agreement and other acceptable documentation to follow-up  
13 on this bid, but you can't get there, you don't achieve  
14 an asset purchase agreement that is acceptable to Scotia  
15 Redwood Foundation and the Beal entities, you're not  
16 bound, are you?

17 A. It is subject to acceptable.

18 Q. It's a yes or no question. The question is  
19 simply: If you work -- if everybody works in good faith  
20 to achieve an asset purchase agreement, an escrow  
21 agreement and other related documents that I think are  
22 imbedded in this bid, but you can't get there, Scotia  
23 Redwood Foundation is not bound to pay the \$603 million,  
24 is it?

25 A. Yes, sir, that is a correct statement. We have

1 to have acceptable documentation and transfer ownership  
2 to Scotia.

3 Q. If you do --

4 MR. NEERMAN: Objection, Your Honor. He's  
5 not finished answering his question.

6 Q. (By Mr. Brown) Sorry. I apologize. Please  
7 finish your answer.

8 A. I think any bid would be subject to  
9 documentation to transfer ownership of the tree farm to  
10 the bidder.

11 Q. If you work in good faith and you achieve an  
12 acceptable asset purchase agreement and everybody signs  
13 off on it and that agreement contains conditions to  
14 closing that aren't met, you don't have to go forward and  
15 put in your \$603 million, do you?

16 A. The conditions to closing can be waived, so I  
17 don't know what those conditions are. I haven't seen it  
18 yet. But if we get ownership of the tree farm, even if  
19 we don't have all the other matters lined up, we'll close  
20 based on ownership of the tree farm.

21 Q. That's not my question, Mr. Cherner.

22 A. I'm sorry.

23 Q. My question is: If the asset purchase  
24 agreement contains conditions to closing which are not  
25 met, you are not bound to go forward and pay \$603 to

1 acquire the assets, are you?

2 MR. GERBER: Objection, asked and  
3 answered, Your Honor. He said they can waive the  
4 conditions.

5 MR. BROWN: No, it's not -- that's not the  
6 question I asked before. He can waive the conditions,  
7 which means he's not bound. Let him answer that  
8 question.

9 THE COURT: You-all quit arguing with each  
10 other. I mean, I think he said he wasn't bound to the  
11 documents if he can't get the right documents.

12 MR. GERBER: That's correct.

13 THE COURT: Okay. So let's move on.

14 Q. (By Mr. Brown) There's a section at page 4 of  
15 the bid, and I assume you have it in front of you. And I  
16 have to apologize, I'm working off the old one that's  
17 attached to your proffer, but I don't think the  
18 pagination in this section has changed.

19 A. Yes, sir.

20 Q. And it's titled credit bid.

21 A. Yes, sir.

22 Q. And it's the last sentence of the paragraph.  
23 It says, "In the acquisition agreement, buyer, as holder  
24 of the trustee notes, will agree to instruct the  
25 indenture trustee not to credit bid an amount in excess

1 of the cash consideration, so long as the acquisition  
2 agreement remains in effect."

3 A. Yes, sir.

4 Q. According to that language, prior to entering  
5 into an asset purchase agreement, Scotia Redwood  
6 Foundation is not obligated to instruct the indenture  
7 trustee not to credit bid, is it?

8 MR. GERBER: Objection, calls for a legal  
9 conclusion.

10 MR. BROWN: Just asking for his  
11 understanding, Your Honor. He purports to be, you know,  
12 the main author on behalf of --

13 THE COURT: Is that right?

14 A. If you think that this means that we're not  
15 bound as to how to vote our notes to instruct the  
16 indenture trustee, we would make the adjustment, if I  
17 understand your comment.

18 Q. I'm just reading what the document says, what  
19 the language says, and I want to know if that's your  
20 understanding, too, because it only says that the asset  
21 purchase agreement is the operative document that  
22 requires you to instruct the indenture trustee not to  
23 credit bit. It doesn't say this document, this bid does  
24 that.

25 A. That's correct, it does not say that.

1           Q.    Thank you.  If there is credit bid which  
2           exceeds Scotia Redwood Foundation's bid and somebody else  
3           ends up getting the assets, who's going to pay the \$21  
4           million break-up fee under your understanding of the bid?

5           A.    It would be placed into the waterfall for  
6           payment by the plan agent.

7           Q.    I'm sorry.  I either misspoke or you  
8           misunderstood.  It's not how is the \$21 million going to  
9           get distributed.

10          A.    Yes, sir.

11          Q.    But where is the \$21 million going to come  
12          from?

13          A.    The purchaser that tops this bid will be  
14          topping it with a bid presumably.

15          Q.    But what if it's a credit bid so there's no  
16          cash?

17          A.    Then it would be a claim against the estate.  
18          It's our expectation that that wouldn't happen and we  
19          hope that the noteholders vote not to do that.  I can't  
20          eliminate that outcome.

21          Q.    Does this agreement -- does this bid  
22          contemplate what the -- whether that would be a priority  
23          administrative claim if the bid does -- the language does  
24          speak to the priority of that claim for the break-up fee.

25                    You testified earlier that you had spoken to



1 operators in connection with the management of the  
2 forest. Can you tell me who those operators are?

3 MR. GERBER: Objection, Your Honor,  
4 confidential commercial information. We recommend that  
5 the Court not require him to answer that question.

6 THE COURT: What was the question again?

7 MR. BROWN: It had to do with the  
8 operators that Beal has spoken to in connection with the  
9 management of the forest if they are the successful  
10 bidder.

11 THE COURT: And so you don't want him to  
12 answer questions as to who his operator might be?

13 MR. GERBER: Yes, Your Honor. For one  
14 thing, he's in negotiations and it's going to affect the  
15 negotiations. Secondly, we're very concerned about the  
16 activities of the other plan proponents with respect to  
17 the Beal bid.

18 MR. BROWN: I believe the testimony was  
19 that he hasn't spoken to the operator for six months, so  
20 I don't know how that constitutes being in negotiation.

21 MR. GERBER: He said --

22 THE COURT: I don't think I'll allow him  
23 to answer the question, so let's move on, whatever impact  
24 that has.

25 MR. BROWN: No further questions, Your

1 Honor.

2 THE COURT: All right.

3 CROSS-EXAMINATION

4 BY MR. JONES:

5 Q. Good afternoon, Mr. Cherner. Evan Jones. You  
6 may recall from your deposition I represent Bank of  
7 America. And I'm in a wonderful position. Everyone in  
8 this room says they want to pay me and the U.S. Trustee,  
9 so I sit up with him.

10 Mr. Cherner, I've got a couple of questions  
11 towards that goal of seeing a deal for someone here close  
12 and pay me. At your deposition, I had asked you whether  
13 the -- whether you would envision that the definitive  
14 documents would provide that you were willing to close  
15 with appropriate findings of good faith, notwithstanding  
16 any appeal that might be pending.

17 And I think at the deposition you indicated you  
18 would. I don't think a change has been made in your term  
19 sheet, so I would just ask you if you would confirm on  
20 the record that if appropriate findings of goods faith  
21 and value are made, you're prepared to close over  
22 appeals?

23 A. Yes, sir.

24 Q. Thank you, sir. The only other question I had  
25 actually came up in part of the colloquy about what was

1 fair game for questions, and I'm curious. This term  
2 sheet does envision definitive documents. Would you  
3 envision that those would condition your obligation to  
4 close on having regulatory approval from the state of  
5 California?

6 A. No, sir.

7 Q. Would you envision that there would be reps and  
8 warranties that Governor Wilson as the plan agent would  
9 be giving you? Or would it be essentially an as-is  
10 where-is deal?

11 A. As-is where-is.

12 MR. JONES: Sir, I have no more questions.  
13 Thank you very much.

14 THE COURT: All right. California.

15 MR. PASCUZZI: Thank you, Your Honor.

16 CROSS-EXAMINATION

17 BY MR. PASCUZZI:

18 Q. I'm Paul Pascuzzi for the California State  
19 Agencies. Good afternoon, Mr. Cherner. Your proffer at  
20 paragraph 3(c) says that it's Scotia Redwood Foundation's  
21 sincere -- is sincere in its intentions to operate within  
22 and comply with all applicable environmental regulations  
23 and obligations; is that correct?

24 A. Yes, sir.

25 Q. But it doesn't say that in your term sheet; is

1 that right?

2 A. If it doesn't, it will.

3 Q. Okay. But there's nothing in there requiring  
4 Scotia Redwood Foundation to comply with the  
5 environmental laws and obligations?

6 A. I don't specifically recall that text being in  
7 the term sheet, but it will be amended to be -- have 3(c)  
8 put into the term sheet.

9 Q. Thank you. And I think we've already covered  
10 that you don't know specifically what Scotia Redwood  
11 Foundation has to do to comply with the environmental  
12 laws and obligations; you're going to hire people to get  
13 that done, right?

14 A. Yes, sir.

15 Q. Okay. And at this point in time, no one is  
16 hired?

17 A. Yes, sir, that's correct. Yes, sir, no one is  
18 hired.

19 Q. And I think Mr. Jones just mentioned the topic  
20 of the state and federal regulators needing to approve  
21 the sale. And I believe that both the state regulators  
22 and the federal regulators have taken the position in  
23 this matter that prior approval is required before title  
24 can be transferred of the Scotia timberlands. Are you  
25 aware of that?

1           A.    I believe I had heard that, yes, sir.

2           Q.    Okay.  And correct me if I'm wrong, but I might  
3 have just heard you say that you would not have that as a  
4 condition of closing, but isn't it true that you couldn't  
5 close --

6           A.    Well, I thought that related to the logging  
7 operations would have to be approved.  I didn't recognize  
8 that it was a title transfer issue.  You've pointed out  
9 an error on my part.  It's a condition precedent to the  
10 transfer of the title of ownership.

11          Q.    And you have no problem making that clear in  
12 your binding term sheet?

13          A.    No, sir, none.

14          Q.    Turning quickly to the resolution of the  
15 so-called Headwaters litigation or I call it the Fresno  
16 litigation in the term sheet.

17          A.    Yes, sir.

18          Q.    I believe your testimony earlier was that it  
19 would be resolved or settled so that it would not have an  
20 effect on harvesting going forward?

21          A.    Yes, sir.

22          Q.    And is the fact that that litigation is pending  
23 right now have some effect on Scotia or Scopac's  
24 harvesting right now?

25          A.    I believe it does.

1 Q. And how does it -- how? I'm just trying to  
2 understand.

3 A. I believe that the litigation is all about the  
4 cutting rights and the capacity to cut and a number of  
5 other allegations among the parties, many of which I have  
6 long since forgotten. And we want any issues in that  
7 litigation that affect that real estate to be resolved,  
8 settled, compromised or otherwise carved out so that we  
9 can operate the tree farm.

10 Q. Have you reviewed the complaint in that matter?

11 A. I did review the complaint in that matter. It  
12 has been a long time since I have reviewed the complaint  
13 in that matter.

14 Q. Have you ever reviewed the answer filed by the  
15 state defendants?

16 A. I did review -- read the answer. It's been  
17 months.

18 Q. Okay. And are you aware there's about 33  
19 affirmative defenses in that answer?

20 A. No, sir, but I suspect you're absolutely right.

21 Q. Okay. Part of the relief requested in that  
22 complaint, I believe, is some sort of injunctive relief  
23 to prevent the water board from regulating the way it's  
24 regulating today. Is that what you're referring to as  
25 far as not affecting the harvesting going forward?

1 A. No, sir.

2 Q. And are you aware that the state defendants  
3 think there's absolutely no merit to that lawsuit?

4 A. I have heard that.

5 Q. Moving on to a different topic. Do you know if  
6 there are conditions, covenants and restrictions reported  
7 against the Scotia timberlands?

8 A. Yes, sir.

9 Q. It's mentioned in the disclosure statement, I  
10 believe?

11 A. Yes, sir.

12 Q. And would you be requesting that the  
13 timberlands be transferred to Scotia Redwood Foundation  
14 free and clear of those conditions, covenants and  
15 restrictions?

16 A. No, sir.

17 Q. And so those wouldn't be considered liens,  
18 claims and incumbrances as you mentioned them in the term  
19 sheet?

20 A. Yes, sir.

21 Q. And would you be willing to clarify that in any  
22 revised term sheet?

23 A. Yes, sir.

24 Q. And then finally, I was on the phone for your  
25 deposition, but I have also read the transcript and I

1 heard you today. Both in your deposition and today you  
2 referred to the Scotia timberland as a tree farm; is that  
3 correct?

4 A. Yes, sir.

5 Q. And have you seen the letters from Governor  
6 Schwarzenegger that have been filed in this case by my  
7 office?

8 A. Yes, sir.

9 Q. And are you aware that the state of California  
10 views these timberlands as one of the state's most  
11 precious natural resources?

12 A. Yes, sir.

13 Q. And that's not exactly a tree farm; would you  
14 agree with me on that?

15 A. I'll look for a better word to refer to it.

16 MR. PASCUZZI: Thank you. I'll pass the  
17 witness, Your Honor.

18 THE COURT: All right.

19 CROSS-EXAMINATION

20 BY MR. DOREN:

21 Q. Sir, I promise to be brief. First of all --  
22 and I only had one line of questioning, but now I just  
23 have one other question.

24 Based on Mr. Pascuzzi's questions to you, I was  
25 not quite clear on what it is you are looking for that



1       you would deem sufficient in a settlement of the  
2       Headwaters litigation.  Could you describe for us what it  
3       is you will require to find that sufficient?

4           A.    The litigation, as it impairs the ability to  
5       harvest the timberlands, and I don't want our operation  
6       to be involved in any litigation associated with the  
7       bodies that are going to be governing our operation.  I  
8       want to be totally removed from that.  I want to have  
9       nothing to do with being in a lawsuit with my primary  
10      regulators.  I just want to have nothing to do with that.

11          Q.    And how does the litigation impair the ability  
12      to harvest the property currently?

13          A.    There is just a cloud over the entire  
14      operation, I believe, right now, to the lowest employee  
15      all the way up to the top about, you know, what's going  
16      to happen to the critical forestry operations.

17                  THE COURT:  Let me understand.  So since  
18      you-all know all of this litigation, perhaps you know it  
19      as well as they know it.  That litigation is the debtor  
20      against the state of California asking for relief.  There  
21      is no counterclaim from the state of California against  
22      the debtor asking them to change their operations,  
23      correct?

24                  MR. PASCUZZI:  That's correct, Your Honor.

25                  THE COURT:  So is that your understanding

1 of the lawsuit?

2 THE WITNESS: There's a little bit more  
3 than that, but I think if that's all that there is, we  
4 may be able to get beyond to term.

5 THE COURT: Go ahead.

6 MR. DOREN: Thank you, Your Honor.

7 Q. (By Mr. Doren) So to the extent these are  
8 affirmative claims by the debtors against the state, you  
9 would be willing to carve them out or carve the  
10 settlement of those claims out as a condition of your  
11 term sheet?

12 A. I would be willing to look into doing that. I  
13 don't have authority because I need to go pull the  
14 complaint again.

15 Q. Have you given any consideration to what a  
16 requirement that those claims be settled, released or  
17 waived within six months would have on the settlement  
18 value of those claims?

19 A. No, sir.

20 Q. It hasn't entered your analysis?

21 A. I understand that parties to that litigation  
22 believe it's very valuable. We just have a different  
23 view on the value of that litigation.

24 Q. And you haven't analyzed what a settlement in  
25 six months requirement would do to the valuation?

1 A. No, sir.

2 Q. I'd like to, if I could, take you back to what  
3 I think was introduced today at least is MMX 71. It's  
4 the April 7, 2008 memo. And if we can switch over to the  
5 Elmo, please. Do you have that document in front of you?

6 A. Which number is it, sir?

7 Q. It's the MMX 71, but I don't think it has a  
8 sticker on it.

9 THE COURT: It's the bid request.

10 A. Yes, sir, I have it in front of me.

11 Q. This one went by kind of quick, so I just want  
12 to make sure I understand what this is.

13 A. Yes, sir.

14 Q. This is a memo from a James Erwin to the board  
15 of directors of the Scotia Redwood Foundation; is that  
16 correct?

17 A. Yes, sir.

18 Q. And can you remind us who Mr. Erwin is?

19 A. Mr. Erwin works for me in handling this matter.

20 Q. And is he a member of the Beal family?

21 A. He is.

22 Q. And what was Mr. Erwin's responsibility in  
23 putting together this bid request?

24 A. Mr. Erwin has been on point with respect to  
25 this asset for a period of time, and he was best

1 positioned to put together this recommendation.

2 Q. Now, did Mr. Erwin work alone in putting  
3 together this request and recommendation? Or was it a  
4 combined effort of the two of you?

5 A. The two of us.

6 Q. So everything in here contains your opinions as  
7 well as those of Mr. Erwin?

8 A. Yes, sir. Yes, sir.

9 Q. And then at the bottom of page 2 where you have  
10 the signatures of Mr. Erwin, yourself, and Mr. Beal,  
11 could you just describe for me kind of the purpose of  
12 each of those signatures, how they play into the approval  
13 process?

14 A. Concurrence and agreement with the proposal by  
15 James and Jacob.

16 Q. Okay. So you, Mr. Cherner, and Mr. Erwin  
17 approved and submitted this request, and then Mr. Beal  
18 approved and signed off on the request giving you the  
19 authority to make a \$603 million bid?

20 A. Yes, sir.

21 Q. And is it your understanding, based on the  
22 practices at the Scotia Redwood Foundation, that he would  
23 have done that in reliance of this document and the  
24 information set out in here?

25 A. Well, again, we've been involved in this for

1 seven years, so this is clearly the tip of the iceberg,  
2 as it were, as far as his exposure to the asset. This  
3 was sufficient for the bid purposes, but there's a lot  
4 more behind this than just what you have in front of me.

5 Q. Understood. This document really sets out your  
6 conclusions, correct?

7 A. Yes, sir.

8 Q. And if I could direct your attention to the  
9 fourth paragraph of the document on the first page. The  
10 document that begins with the BONY plan?

11 A. Yes, sir.

12 Q. And specifically if we can go down, please, to  
13 that last sentence after the redaction. Do you see where  
14 it says "Scotia Foundation believes that the Scotia  
15 assets (described below) proposed to be purchased are  
16 worth substantially in excess of \$603 million"?

17 A. Yes, sir.

18 Q. And that was your opinion as of four days ago  
19 on April 7, 2008?

20 A. Yes, sir.

21 Q. And the Scotia assets that you're talking about  
22 are essentially the timberlands of Scotia Pacific,  
23 correct?

24 A. Yes, sir.

25 Q. And, in fact, as part of this, you've assigned

1       only \$15 million in value to the MMCAs?

2           A.     That's what one data point is. We are aware  
3       internally of many other data points we have on the MMCA.  
4       We put that in because it was in testimony we heard, yes,  
5       sir.

6           Q.     So after all your analysis and your years of  
7       data points and keeping track of testimony you've just  
8       heard, it's the opinion -- it's your opinion that the  
9       Scotia assets are worth substantially in excess of \$603  
10      million?

11          A.     Yes, sir.

12                  MR. DOREN: Thank you. I have no further  
13      questions.

14                  THE COURT: Anyone else? All right. Hold  
15      it just one second, there might be one more.

16                  MR. DOREN: Your Honor, can I move into  
17      evidence MMX 71?

18                  THE COURT: Any objection to MMX 71?

19                  MR. NEIER: Yes, Your Honor. It's a  
20      redacted document and we haven't had time to --

21                  THE COURT: I'll withhold ruling on it.

22                  MR. DOREN: Your Honor, I would just say  
23      that I'm not taking a position on whether the redaction  
24      should be removed, perhaps it well should, but for this  
25      limited purpose we would think it admissible.

1                   MR. NEIER: I still think we have a chance  
2 to study the document.

3                   THE COURT: Let's move on. We'll deal  
4 with the evidence in question.

5                   MR. GERBER: Redirect, Your Honor.

6                   THE COURT: You may.

7                   MR. GERBER: Toby Gerber for the indenture  
8 trustee.

9                                   REDIRECT EXAMINATION

10 BY MR. GERBER:

11           Q. Mr. Cherner, I got the impression that in  
12 cross-examining you, counsel was trying to establish that  
13 the Scotia Redwood Foundation, Inc. didn't have the  
14 financial ability to close the deal. Do you believe that  
15 Scotia Redwood Foundation, Inc. has the ability to close  
16 the deal?

17           A. I'm positive they do.

18           Q. What is its current financial condition? They  
19 only asked you if you had financial statements, and they  
20 knew you didn't have them. So would you describe to the  
21 Court the current financial condition of Scotia Redwood  
22 Foundation?

23                   MR. JONES: Your Honor, I'm going to  
24 object to that one if he wants to testify about what  
25 people knew they did or didn't have. This is silly.

1                   MR. GERBER: Well, they asked him the same  
2 question two days ago when they asked him to come down  
3 to --

4                   THE COURT: I'm not sure where -- I'm not  
5 sure I understand your objection.

6                   MR. JONES: Your Honor, in the middle of  
7 his introduction he says "they knew you didn't have these  
8 things." If he wants to testify, put him on the stand.

9                   THE COURT: I don't think you're entitled,  
10 but I don't listen to those things either, statements  
11 made by counsel like that. Just like questions are not  
12 evidence unless they're answered.

13                   MR. JONES: Your Honor, I'm sorry, I'll  
14 try to sit on my hands.

15                   THE COURT: Okay.

16                   Q. (By Mr. Gerber) Could you -- Mr. Cherner,  
17 could you describe the financial condition, assets and  
18 liabilities of Scotia Redwood Foundation, Inc. for the  
19 Court.

20                   A. It has no liabilities. It has a receivable and  
21 some cash receivable in the amount of \$50,000. Cash is  
22 -- Mr. Hale corrected me, it was about \$100,000. It has  
23 250 -- 250 \$1 million timberland notes and a commitment  
24 by Andy to move over another \$31 million just as soon as  
25 I can take the steps that I need to with parties in this



1 case to move that over.

2 Q. So it's got roughly \$280 million of timberland  
3 notes?

4 A. Yes, sir.

5 Q. What are those notes trading at currently?

6 A. The last time I looked, which was Monday of  
7 this week, it was about 73.

8 Q. So at market, that's about \$175 million of fair  
9 market asset?

10 A. Yes, sir.

11 Q. And no liabilities?

12 A. Yes, sir.

13 Q. If this offer -- if the plan -- if we can't get  
14 a plan confirmed and Scotia Pacific Company has to  
15 convert to a Chapter 7, would you be willing to  
16 participate in the 363 sale by a Chapter 7 trustee and  
17 bid exactly the same way?

18 A. Yes.

19 Q. With respect to the Mr. Brown's comment, which  
20 I think -- with respect to the requirement to include the  
21 bid restrictions or the bid instructions in the credit  
22 bid, that's at page 4 of 5, I think he was trying to say  
23 that you're not currently bound by the term sheet to  
24 currently instruct the indenture trustee not to credit  
25 bid. If you need to change that here to make Mr. Brown

1 comfortable or make anyone else comfortable that you will  
2 honor that obligation to instruct the indenture trustee,  
3 will you do so?

4 A. Yes, sir.

5 Q. In fact, with respect to any of these kind of  
6 hair-splitting arguments they made to kind of  
7 establish -- which I think they were intending to  
8 establish that you're really not sincere about your  
9 efforts, is it -- is it true?

10 THE COURT: Okay. I didn't hear it,  
11 though, so go ahead.

12 A. Mr. Gerber, the comments made by Mr. Hale,  
13 Mr. Brown, Mr. Neier at my deposition on Wednesday  
14 morning down here, I intended to make all those changes  
15 into the revised term sheet. It seems like I missed one  
16 or two. The ones that I have told you I would make  
17 today, as well as the one or two that I did not make from  
18 Wednesday, will be made, and this will be resubmitted  
19 just as soon as possible.

20 Q. Is this offer conditioned on you obtaining  
21 any -- Scotia Redwood Foundation obtaining any financing?

22 A. Not that -- not that is not within its control.

23 Q. In other words, you believe you've got the  
24 financing -- you know you've got the financing in place,  
25 true?

1 A. I'm positive.

2 Q. If you needed to or -- and everybody was  
3 agreeable to shorten the timing so this time value of  
4 money issue was not a problem, would you be willing to  
5 shorten the timing?

6 A. Yes, sir.

7 Q. Has Beal previously written a letter to the  
8 state agencies to indicate its willingness to work with  
9 them and to comply with all the applicable environmental  
10 regulations?

11 A. Yes, sir.

12 Q. In your testimony you said that you wished to  
13 settle -- the quote is "quickly and amicably resolve  
14 Scotia Pacific's interest in the so-called Headwaters  
15 litigation." Is that your intention?

16 A. Yes, sir.

17 Q. If it was important to the owners of the mill  
18 or the secured creditors of the mill that the Scotia  
19 Redwood Foundation, Inc. agreed to sell 100 percent of  
20 the logs, would you be willing to seriously consider  
21 that, if not do it?

22 MR. NEIER: Your Honor, I asked that  
23 question, and Mr. Gerber objected to my asking that  
24 question. How does he get --

25 THE COURT: So you don't object now to him

1 asking?

2 MR. NEIER: No, but I should be able to  
3 ask that question as well.

4 THE COURT: Well --

5 MR. GERBER: Do you want to go ahead and  
6 ask the question then?

7 MR. NEIER: Go ahead, Mr. Gerber.

8 THE COURT: Are you willing to up to 100  
9 percent?

10 THE WITNESS: I probably would not up it  
11 to 100 percent; 70 percent, 80 percent. I'm willing to  
12 negotiate on the percentage in connection with the log  
13 supply agreement.

14 Q. If they were willing to offer you a fair market  
15 value for the logs?

16 A. Well, yes, but I think that that's the sticky  
17 point.

18 Q. Okay. But if they would, you would sell them  
19 all the way up as many as you could produce?

20 A. Yes, sir.

21 Q. Do you have a -- are you planning to flip this  
22 property if you're the successful bidder?

23 A. No.

24 Q. Do you have a holding period in mind?

25 A. No, sir.

1 Q. Have you committed to anyone to resell the  
2 property at any time in the future?

3 A. No, sir.

4 Q. It's not your intention to be an absentee  
5 landlord?

6 A. No, sir.

7 Q. Are you willing to reach out to the community  
8 to be a good corporate citizen in the area?

9 A. Yes, sir.

10 Q. Do you sense that that has not been the case in  
11 the past, that for the current ownership?

12 MR. DOREN: Objection, Your Honor. Do you  
13 sense?

14 MR. GERBER: I'll withdraw the question.  
15 That's all, Your Honor.

16 THE COURT: All right. Let me just ask  
17 this question. Have you offered the same equity deal for  
18 the other bond holders that are on the committee?

19 THE WITNESS: Have I offered for them  
20 to --

21 THE COURT: For them to participate in  
22 this on the same percentage as their bonds?

23 THE WITNESS: No, sir.

24 THE COURT: Okay. You can step down.

25 THE WITNESS: Actually, I think I did last

1 week and none of them took me up on it. I withdraw that.  
2 I'm sorry.

3 MR. NEIER: I'm sorry, we didn't hear  
4 that, Your Honor.

5 THE COURT: He said he thinks he did last  
6 week, but none of them took him up on it. You can step  
7 down.

8 THE WITNESS: Thank you.

9 THE COURT: Is this our last witness  
10 today? We're getting really close.

11 MR. GREENDYKE: Yes, Your Honor.

12 THE COURT: Okay. Well, then let me just  
13 make these comments before we leave. First of all,  
14 Mr. Jordan.

15 MR. JORDAN: Since I'm not sure what  
16 comments you're going to make, may I make a comment  
17 before we leave?

18 THE COURT: About what?

19 MR. JORDAN: I just want to make the Court  
20 and the parties aware of where we are. I guess Mr. Doren  
21 made a specific comment about the exit financing for the  
22 debtors. I alluded to that. I promise no more country  
23 song references. But regarding the progress we made to  
24 obtain the exit financing for the \$150 million needed to  
25 confirm the Scopac plan and needed to finance to the

1 point that we may be able to confirm the Palco plan, we  
2 have the -- we don't have yet a signed commitment letter,  
3 we have now a signed term sheet.

4 Most important, I want to point out to the  
5 Court that we understand that this report is simply a  
6 report until we have a signed commitment letter or a  
7 signed definitive term sheet that we can disclose full  
8 terms. We want to avoid what went on today, and that is  
9 a bunch of redactions and a bunch of discussions without  
10 the commitments of time. Our aim, Your Honor, is to be  
11 certain that we accomplish the details of this exit  
12 financing well before the 29th so we can circulate, and  
13 we will immediately to all the constituents, and make  
14 available whatever discovery requests they want. But I  
15 wanted to assure the Court that we -- well, maybe more  
16 importantly, Palco has sat back very quietly during this  
17 entire week because we committed to do that.

18 We expect that when we show up on the  
19 28th, we will have a much more active role in  
20 establishing what we think is a tri-party pursuit of  
21 confirming a plan and not simply arguing between two of  
22 the constituents.

23 THE COURT: Okay. All right. First let  
24 me announce that Judge Houser is tied up in both cases  
25 and other things and is not available to meet with the

1 parties or any two parties or anyone during the break in  
2 this proceeding. And I thought I should just comment on  
3 a few things. I'm not ruling on anything. And I am  
4 obviously not in a position to rule on anything. But  
5 there are some things that are pretty obvious from the  
6 testimony. And there are some things that maybe -- I'm  
7 sure you-all have thought about. But first of all, we  
8 had -- back when we had other lawyers involved, we had an  
9 argument about 2019 and whether or not 2019 required that  
10 the committee to disclose all of the information about  
11 the members on the committee and what they bought and all  
12 that sort of stuff.

13           And there has been a ruling in New York in  
14 one way and I ruled the other way. Of course, I thought  
15 I was right, and perhaps I was. However, I did say at  
16 the time that things could happen to change the issues of  
17 conflicts of interest among the committee, etcetera. I  
18 don't know if those things have happened. We do now have  
19 one part of the committee that is proposing a plan as a  
20 plan proponent. And whether or not, you know -- I mean,  
21 if they're doing so -- I believe the witness was  
22 certainly candid and seems to be a good-spirited guy and  
23 seems honest on the stand and all that. I'm not  
24 suggesting that there's any real conflict going on here,  
25 but there's the potential perhaps. That's something that



1 I just wanted everyone to think about. I don't want to  
2 go down that road if we don't have to, but that could  
3 have a profound impact on the value of the existing bonds  
4 and all sorts of other stuff if somehow that ruling were  
5 changed. I don't know. I'm just saying that right off.

6 Number two -- I'm not inviting a motion on  
7 that, I'm just asking you-all to think about that issue  
8 and the committee to think about that issue, the bond  
9 holders committee to think about that issue. Number two,  
10 it seems to me that a plan that's based upon selling  
11 redwood acres to wealthy people in Humboldt County from  
12 somewhere doesn't sound to me like that's very feasible.  
13 I understand that that sounds like -- I mean, that may  
14 well be something that might work some day in the future,  
15 it might be that you can get the regulatory stuff, it  
16 might be all that sort of stuff. But using that to cram  
17 down something or as a feasible plan sounds to me like  
18 that kind of a plan is dead in the water.

19 Number two, it sounds like the value of  
20 these assets is probably somewhere between \$5 00 million  
21 and \$200 million, the Scopac assets, between \$500 and  
22 \$600 million, depending on who you talk to, which  
23 experts. There are substantial problems. I mean, if I  
24 want to find problems in the valuation experts that have  
25 testified, there are plenty avenues for me to find

1 problems with the testimony on both sides. All I've  
2 heard now are the noteholders and the trustee's  
3 testimony, but after listening to those, I can sit here  
4 and I can tell you that all of you know there are  
5 potential weaknesses in all of the testimony concerning  
6 valuation.

7           There are legal problems with the Marathon  
8 plan that we've already discussed. We have discussed in  
9 great detail. Some of those legal problems are not  
10 insurmountable. Standing is obviously not insurmountable  
11 because the same plan might be dilatory, but the same  
12 plan with a different plan proponent obviously wouldn't  
13 have standing problems. The same plan with a trustee  
14 obviously wouldn't have standing problems. So that may  
15 be a dilatory legal problem, if it's a legal problem.  
16 But it's still perhaps a problem. The credit bid issue,  
17 the issue of whether or not the -- this is an improper  
18 consolidation of these two cases and those issues that  
19 were brought up, those are also problems that there might  
20 well be with the Marathon plan.

21           Obviously I must find, in order to confirm  
22 that plan, that the -- that the bond holders are getting  
23 the indubitable equivalent for their bonds. And there  
24 have been a number of issues that have come up with  
25 respect to what they're getting, all of which are things

1 that could be negotiated. Obviously the price is one of  
2 them. The value of the notes is an issue that's just  
3 really -- nobody is arguing that the notes have less  
4 security than the old notes. It's really just an  
5 evaluation of the interest on the notes is all we've  
6 really been talking about. I mean, so obviously the  
7 notes could be made more attractive by difference. The  
8 price could be changed. There are a number of -- a  
9 number of ways that this could be adjusted.

10 But I'm not going to -- I'm not going to  
11 write a plan. In other words, I guess the other thing I  
12 can say is there are -- in addition to that, there are  
13 practical problems with the noteholders' plan. It  
14 doesn't really do anything with Palco. Now, maybe that's  
15 a concern that I shouldn't worry about. Maybe I should  
16 just confirm one side and not the other, let that one  
17 fall apart. There's no question that from the standpoint  
18 of equity and support from the various participants in  
19 the case that there's strong support for the Marathon  
20 plan.

21 But I can tell you that it sounds to me  
22 like the Marathon plan perhaps has the prices too low.  
23 It sounds to me like we need to -- you know, I will not  
24 tell you what the plan is that I would confirm on behalf  
25 of Marathon. And if both of them are confirmable, I

1 don't think it's very hard to figure out which one will  
2 get confirmed. So all of these are, again, areas that I  
3 think that somehow these two tables can get together on.  
4 I don't know whether or not there's room for Marathon and  
5 the noteholders to be equitable. I don't know whether  
6 that's some way to sweeten -- right now they're  
7 separately classified for their unsecured claim. I don't  
8 know whether there could be some equity provisions,  
9 something that gives them something other than just  
10 writing down the notes to \$500,000 -- \$500 million which  
11 they think is even less than that because the value of  
12 the bonds is more.

13               So what I'm saying is I don't think it  
14 will be appropriate for me to make a ruling that I like  
15 this plan, but you have to be at this amount in order for  
16 me to approve it. I just don't -- you know, if there  
17 ever were a case where I'd like to get you all in and do  
18 the old get them in one room and make them -- you can't  
19 come out of the hotel room until you've made a deal,  
20 maybe this would be the one. This is an important piece  
21 of land. Obviously the state of California will tell you  
22 how important it is to California. There are lots of  
23 issues.

24               If we -- if I rule one way or the other --  
25 I mean, I could confirm this plan, they're going the

1 appeal it. Now what's the question? If they appeal it,  
2 their appeal may become moot by virtue of not getting a  
3 state pending appeal. However, if you grant a state  
4 pending appeal, it may moot the plan because you're not  
5 going to be willing to finance it while they appeal the  
6 thing all the way up. There's a lot of problems in this  
7 case that need deciding something one way or the other  
8 isn't going to be a resolution of it. It just moves it  
9 to another level. And it may kill the case either way.

10 So in any event, I hope that rather than  
11 arguing over what information we're going to get from  
12 Beal Bank for the next three weeks, we arguing over how  
13 close we can get to settling these two people over here.  
14 Now, right off the bat I haven't said much to help you  
15 guys over here. I know you're raising your hand and  
16 thinking, what do you think about us? I haven't heard  
17 your side. I'm not ruling.

18 Good luck to you. Thank you.

19  
20  
21  
22  
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  
23 Ak/Ret Reporting, Records & Video  
555 North Carancahua, Suite 880  
24 Corpus Christi, Texas 78478  
(361) 882-9037

25