IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

IN RE:	Civil Action No. 08-259
SCOTIA DEVELOPMENT LLC., *et. al.*,	Bankruptcy Case No. 07-20027-C11
Debtors.	

MOTION OF APPELLEES MENDOCINO REDWOOD COMPANY, LLC AND MARATHON STRUCTURED FINANCE FUND L.P. TO DISMISS APPEAL FOR LACK OF SUBJECT MATTER JURISDICTION OR AS EQUITABLY MOOT

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Appellees Mendocino Redwood Company, LLC ("MRC") and Marathon Structured Finance Fund L.P. ("Marathon") hereby move to dismiss the instant appeal for lack of subject matter jurisdiction or as equitably moot.[1] In support of this motion (the "Motion"), MRC and Marathon have simultaneously filed a memorandum of law detailing the bases for the relief sought and, in addition, respectfully state as follows:

Background

A. Bankruptcy Court Proceedings

1. Scotia Pacific Company LLC ("Scopac") owned and operated over 200,000 acres of timberlands (the "Timberlands") in Humboldt County, California. The Pacific Lumber Company ("Palco"), Scopac's parent, operated a nearby milling facility and cogeneration plant. It also owned the Town of Scotia – one of the last remaining company towns in the United States.

2. On January 18, 2007 (the "Petition Date"), Scopac and Palco (and its other subsidiaries) (collectively, the "Debtors") filed voluntary petitions for reorganization relief under Chapter 11 of the United States Code, 11 U.S.C. §§ 101 et. seq. (the "Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of Texas, Corpus Christi Division (Schmidt, J.) (the "Bankruptcy Court"). The bankruptcy cases were procedurally consolidated and jointly administered pursuant to Rule 1015 of the Federal Rules of Bankruptcy Procedure.

3. After almost a year of intense bankruptcy proceedings, the Bankruptcy Court terminated the Debtors' exclusive period to file and solicit acceptances of a plan of reorganization. Specifically, exclusivity was terminated with respect to Marathon (a secured creditor of Palco), The Bank of New York Trust Mellon Company, N.A., as Indenture Trustee

[1] The Appellees have conferred with the Appellants and counsel cannot agree on the disposition of this Motion.

(the "Indenture Trustee") for the Holders of Timber Notes (the "Noteholders") (a secured creditor of Scopac) and the Official Committee of Unsecured Creditors of both Palco and Scopac (the "Committee").[2]

4. Five proposed plans of reorganization were filed – one by MRC and Marathon (the "MRC/Marathon Plan") which was supported by, among others, the Committee, the State of California and Humbolt County; one by the Indenture Trustee (the "Indenture Trustee Plan"); and three alternative plans by the Debtors. The Debtors' plans ultimately were withdrawn and, thus, only the MRC/Marathon Plan and the Indenture Trustee Plan were considered for confirmation by the Bankruptcy Court.

5. The confirmation trial began on April 8, 2008. Over 25 fact and expert witnesses testified and hundreds of exhibits were admitted into evidence. On June 6, 2008, the Bankruptcy Court issued a 119-page decision containing its findings of fact and conclusions of law with respect to confirmation (the "Confirmation Findings"). [R. 306; Appellant 113].[3] The Bankruptcy Court held that (subject to a few "technical" modifications) the MRC/Marathon Plan complied with all of the requirements of the Bankruptcy Code and, therefore, was confirmable provided that the Indenture Trustee be paid at least $510 million in cash on the Effective Date of the MRC/Marathon Plan. This amount represented the value, as found by the Bankruptcy Court, of the Indenture Trustee's collateral. The Bankruptcy Court also held that the Indenture Trustee Plan was not confirmable for a multitude of reasons, including that it was not proposed in good faith and was not feasible. [*Id.*]

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[2] Appellants herein consist of the Indenture Trustee and certain Noteholders. For the Court's convenience we simply refer to the Indenture Trustee unless the context requires otherwise.

[3] Citations to the items listed in the Index to the Record prepared by the Clerk of the Bankruptcy Court are noted as "R", with the assigned record number in that Index, along with an Appellant number or Appellee number based on which party designated the document.

6. Entry of a confirmation order was delayed, however, pending resolution of the Indenture Trustee's motion for a superpriority administrative claim under section 507(b) of the Bankruptcy Code based on an alleged diminution in the value of the Indenture Trustee's collateral during the bankruptcy case (the "507(b) Motion"). A trial on the 507(b) Motion was held from June 30, 2008 through July 2, 2008. On July 7, 2008, the Bankruptcy Court issued a transcribed oral ruling denying the Indenture Trustee's motion for a superpriority administrative claim, but holding that in order for the MRC/Marathon Plan to be confirmed, the Indenture Trustee must receive a minimum of $513.6 million in cash on the Effective Date of the MRC/Marathon Plan, rather than $510 million as set forth in the Confirmation Findings. This modification ensured that the Indenture Trustee would receive cash in the value of its collateral as of the Petition Date and, thus, the Indenture Trustee was fully protected from any diminution in the value of its collateral that may have occurred during the bankruptcy case. [R. 383; Appellant 213 at 22-28] As a result, the MRC/Marathon Plan was amended to increase the minimum payment to the Indenture Trustee from $510 million to $513.6 million. [R. 354].

7. On July 8, 2008, the Bankruptcy Court entered an order confirming the MRC/Marathon Plan (the "Confirmation Order") [R. 355; Appellant 134], and also entered an order denying the Indenture Trustee's motion for a superpriority administrative claim under section 507(b) of the Bankruptcy Code (the "507(b) Order"). [R. 356; Appellant 135].

B. Appellate Proceedings

8. The Indenture Trustee appealed, sought a stay pending appeal and requested certification for a direct appeal from the Confirmation Order to the Fifth Circuit Court of Appeals. After a two-day evidentiary hearing, the Bankruptcy Court denied the request for a stay pending appeal and certified the Confirmation Order for direct appeal to the Fifth Circuit.

9. After the Bankruptcy Court denied the Indenture Trustee's motion for a stay pending appeal, the Indenture Trustee sought a stay from this Court, which denied such relief on the grounds that the relief should have been sought in the Fifth Circuit. [District Court case no. 08-mc-66, Dkt. 53]. The Indenture Trustee then sought a stay from the Fifth Circuit which denied the request, but accepted the direct appeal and imposed an expedited briefing and argument schedule. [Fifth Circuit case no. 08-27].

10. The Indenture Trustee subsequently asserted that the MRC/Marathon Plan could not go effective until all appeals were complete, even though no stay had been issued. The Bankruptcy Court rejected this argument and issued an order (the "Effective Date Order") holding that the MRC/Marathon Plan could go effective notwithstanding the pendency of the appeal from the Confirmation Order in the Fifth Circuit. [R. 382; Appellee 171].

11. The MRC/Marathon Plan went effective on July 30, 2008. All transactions contemplated under the MRC/Marathon Plan have been consummated and the Indenture Trustee has been paid $513.6 million in cash.

12. MRC and Marathon filed a motion to dismiss the appeal from the Confirmation Order with the Fifth Circuit on the ground that the appeal was equitably moot. The parties' respective papers on the motion to dismiss (without exhibits) are annexed hereto as Exhibits A, B and C. That motion, as well as the merits of the appeal from the Confirmation Order, have been fully briefed and were argued before the Fifth Circuit on October 6, 2008. No decision has been issued yet. [Fifth Circuit case no. 08-40746].

13. The Indenture Trustee also sought leave to appeal the Effective Date Order. This Court denied that motion because the appeal from the Confirmation Order was pending in the Fifth Circuit, stating "[b]ecause the Fifth Circuit Court of Appeals has accepted

appellate jurisdiction to review the Bankruptcy Court's order confirming [the MRC/Marathon Plan], this Court declines to exercise its jurisdiction over the motions for leave." [District Court case nos. 08-mc-71, Dkt. 6 at 2 and 08-mc-72, Dkt. 8 at 2].

The Instant Appeal

14. The Indenture Trustee improperly has appealed to this Court from the Bankruptcy Court's 507(b) Order denying its motion for a superpriority administrative claim. The 507(b) issue is inextricably intertwined with the confirmation process. Indeed, the Confirmation Order specifically incorporated the 507(b) decision and was expressly premised on denial of the Indenture Trustee's 507(b) Motion. Thus, the 507(b) issue was part of the direct appeal from the Confirmation Order to the Fifth Circuit and this Court lacks subject matter jurisdiction over this appeal. Further, in light of the failure of the Indenture Trustee to obtain a stay pending appeal, the substantial consummation of the MRC/Marathon Plan and deleterious impact that reversal of the 507(b) Order would have on numerous innocent third parties, the appeal of the 507(b) Order is equitably moot.

Lack of Subject Matter Jurisdiction

15. All of the parties and the Bankruptcy Court recognized that the issues of whether, and in what amount, the Indenture Trustee had a superpriority administrative claim were part and parcel of the confirmation process. If such a claim existed in the amount asserted (over $200 million), the MRC/Marathon Plan would not have been feasible and therefore could not have been confirmed. Recognizing the feasibility issue, counsel for several of the Noteholders stated: "[i]t is critically important for this administrative claim to be determined ***before*** the plan is confirmed." [R. 310; Appellant 208 at 43] (emphasis added). Indeed, counsel

for the Indenture Trustee agreed with the Bankruptcy Court's statement that "if you have a $200 million claim, there's no way that they can confirm a plan." [R. 336; Appellant 210 at 45].

16. As the Bankruptcy Court explained:

> I'm not going to sign a confirmation order if there is, in fact, a real administrative claim. I mean, it's not confirmable. We all agree with that.

[R. 310; Appellant 208 at 13].

17. In denying the Indenture Trsutee's 507(b) Motion, the Bankruptcy Court stated its ruling was a "***reconsideration of my [confirmation] findings.***" [R. 374; Appellant 214 at 18] (emphasis added).

18. Most importantly, the Confirmation Order expressly referenced, incorporated and depended upon the 507(b) ruling. In fact, the Confirmation Order specifically provides:

> The Court, based on the findings of fact and conclusions of law noted on the record in open court, denied the 507(b) Motion and finds that the Indenture Trustee does not have a 507(b) superpriority administrative claim ***as a result of the confirmation of the MRC/Marathon Plan.***

[R. 355; Appellant 134 at p. 14] (emphasis added).

19. Certain Noteholders even included as one of the issues on appeal of the Confirmation Order to the Fifth Circuit:

> whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC [sic] Plan satisfies 11 U.S.C. § 1129(a)(9) because it does not adequately provide for payment in full of the Indenture Trustee's superpriority claim asserted under 11 U.S.C. § 507(b) . . .

[Exhibit D at p. 3].[4] The fact that after designating the issue, the Indenture Trustee decided not to brief it to the Fifth Circuit means that the issue was waived. *See Gates v. Texas Dep't of Protective and Regulatory Services*, 537 F.3d 404, 438 (5th Cir. 2008).

20. It does not mean that this Court now has subject matter jurisdiction over the 507(b) issue. An appeal divests the lower court of jurisdiction over any issues encompassed by the appeal. *See in re TransTexas Gas Corp.*, 303 F.3d 571, 578-79 (5th Cir. 2007). Here, the Confirmation Order was appealed directly to the Fifth Circuit pursuant to 28 U.S.C. § 158(d)(2), thereby divesting both the Bankruptcy Court and this Court of subject matter jurisdiction over issues embodied by the Confirmation Order. Indeed, as this Court stated in denying the Indenture Trustee's motion for a stay pending appeal "[i]t is presumptive and inconsistent with the new statutory process of direct appeal and certification to the Court of Appeals for the District Court to intrude itself in the appellate decision process." [District Court case no. 08-mc-66, Dkt. 53 at 2-3]. *See Griggs v. Provident Consumer Co.*, 459 U.S. 56, 58 (1982) (party cannot simultaneously seek resolution of the same issue in two courts). Accordingly, this Court lacks subject matter jurisdiction over the instant appeal.

Equitable Mootness

21. Even if this Court concludes that it has subject matter jurisdiction, it should dismiss this appeal as equitably moot. The Fifth Circuit has established a three-factor test for determining when an appeal of a bankruptcy case is equitably moot: (1) whether the complaining party has failed to obtain a stay pending appeal; (2) whether the plan has been substantially consummated; and (3) whether the relief requested would affect the rights of parties

[4] This document was inadvertently omitted from the designation of the record on appeal. A copy of it is annexed hereto as Exhibit D for the Court's convenience. It is Bankruptcy Docket No. 3434.

not before the Court or the success of the plan. *See In re Grimland, Inc.*, 243 F.3d 228, 231 (5th Cir. 2001); *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1998).

22. Here, it is undisputed that a stay was not obtained and that the MRC/Marathon Plan has been substantially consummated. Further, if the 507(b) Order was reversed, the MRC/Marathon Plan would have to be unraveled. Confirmation of the MRC/Marathon Plan was predicated on the full payment in cash to the Indenture Trustee of the value of its collateral -- $513.6 million as determined by the Bankruptcy Court. The Bankruptcy Court was clear that it could not have confirmed the MRC/Marathon Plan, and MRC and Marathon would not have been able or willing to consummate the MRC/Marathon Plan, if the Indenture Trustee had a $200 million superpriority administrative claim. Thus, the 507(b) appeal is equitably moot. *See In re Continental Airlines*, 91 F.3d 553, 561 (3d Cir. 1996).

23. Reversal of the 507(b) Order would doom the MRC/Marathon Plan to failure, to the detriment of hundreds of employees, vendors and customers who have relied on confirmation and consummation of the MRC/Marathon Plan in doing business with the reorganized companies. It would also endanger the environment by leaving uncertain who would operate the Timberlands and would deprive MRC and Marathon of the benefit of the bargain by destroying the reorganized companies into which they have invested over half a billion dollars. Accordingly, the appeal should be dismissed as equitably moot. *See In re Crystal Oil Co.*, 854 F.2d 79, 81-82 (5th Cir. 1998).

Schedule

24. Simultaneously with filing this Motion, MRC and Marathon filed their brief on the merits of this appeal. The Indenture Trustee's reply brief on the merits is due December 5, 2008 and oral argument is scheduled for February 18, 2009, at 9:00 a.m.

25. The parties have agreed to the following schedule with respect to this Motion: the Indenture Trustee's joint response will be filed on or before December 19, 2008 and MRC and Marathon's joint reply will be filed on or before January 30, 2009. Further, if this Court determines that oral argument on the Motion is necessary, it will be held on February 18, 2009, the same day as oral argument on the merits. An agreed motion seeking an order setting this schedule was filed simultaneously with this Motion.

Conclusion

26. For all the foregoing reasons, as well as those set forth in the accompanying memorandum of law, MRC and Marathon respectfully request that this Court dismiss the instant appeal for lack of subject matter jurisdiction or as equitably moot, and grant such other and further relief as this Court deems just and proper. A proposed order is annexed hereto as Exhibit E.

November 14, 2008

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on November 14, 2008, a true and correct copy of the foregoing document was served via e-mail (i) upon the parties listed below, and (ii) upon the parties that receive electronic notice in this case pursuant to the Court's ECF filing system.

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Exhibit A

No. 08-40746

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: PACIFIC LUMBER CO.; and SCOTIA PACIFIC CO. LLC, *Debtors*

BANK OF NEW YORK TRUST CO. NA, as Indenture Trustee for the Timber Notes; ANGELO GORDON & CO. LP, AURELIUS CAPITAL MANAGEMENT LP, and DAVIDSON KEMPNER CAPITAL MANAGEMENT LLC; SCOTIA PACIFIC COMPANY LLC, CSG INVESTMENTS; and SCOTIA REDWOOD FOUNDATION, INC.,

Appellants,

v.

OFFICIAL UNSECURED CREDITORS' COMMITTEE; MARATHON STRUCTURED FINANCE FUND LP; MENDOCINO REDWOOD COMPANY LLC; THE PACIFIC LUMBER CO.; UNITED STATES JUSTICE DEPARTMENT; and CALIFORNIA STATE AGENCIES,

Appellees.

MOTION OF APPELLEES MENDOCINO REDWOOD COMPANY, LLC AND MARATHON STRUCTURED FINANCE FUND L.P. TO DISMISS APPEAL BASED ON EQUITABLE MOOTNESS AND JUDICIAL ESTOPPEL

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

(1) 08-40746; *The Bank of New York Company, NA. as Indenture Trustee for the Timber Notes et al. vs. Official Unsecured Creditors' Committee et al.*

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

Appellees	**Counsel**
Marathon Structured Finance Fund L.P. (Marathon Asset Management, LLC ("MAM") is a Delaware limited liability company that serves as the investment advisor to a family of funds. MAM is privately held and is a investment advisor registered with the SEC under the Investment Advisors Act. All of the funds that MAM advises are privately held, with limited partners in the United States and shareholders for certain funds incorporated in the Cayman Islands. MAM's affiliate Marathon Structured Finance Fund, L.P. was a creditor of Palco. Town of Scotia Company LLC now owns assets of the Debtors and has distributed its membership interests to Marathon Special Opportunity Fund, L.P. and MSOF Town of Scotia Corp.)	David Neier William Brewer Steven M. Schwartz Carey D. Schreiber Winston & Strawn, LLP New York, New York Eric E. Sagerman Winston & Strawn, LLP Los Angeles, California John D. Penn Haynes & Boone, LLP Ft. Worth, Texas Trey Monsour Alan Wright Haynes & Boone, LLP Dallas, Texas

Mendocino Redwood Company LLC (Managing members are Mendocino Redwood Company LLC are Alexander J. Dean, Jr., and John J. Fisher. The following affiliated entities participate in the Plan of Reorganization: Mendocino Forest Products Co. LLC and Humboldt Redwood Co. LLC. The equity of all of these entities is owned privately by Mr. Dean, Mr. Fisher, various family members of Mr. Fisher or trusts for which members of the Fisher family are beneficiaries, except that Marathon entities also hold equity in Humboldt Redwood Co.)	Allan S. Brilliant Brian D. Hail Craig R. Druehl Stephen M. Wolpert Goodwin Procter LLP New York, NY Frederick C. Schafrick Richard M. Wyner Goodwin Procter LLP Washington, D.C. Kenneth M. Crane Peter G. Lawrence Perkins Coie LLP Chicago, Illinois
The Official Committee of Unsecured Creditors (now dissolved) (The Committee has been dissolved, but its members were Pacific Coast Trading, Inc., Steve Wills Trucking & Logging, LLC, SHN Consulting Engineers & Geologists, Environmental Protection Information Center, Pension Benefit Guaranty Corp., and Steve Cave)	Maxim B. Litvak John D. Fiero Kenneth H. Brown Pachulski Stang Ziehl Young Jones & Weintraub San Francisco, California

Appellant The Bank of New York Mellon Trust Company, N.A., as Indenture Trustee (f/k/a the Bank of New York Trust Company, N.A.)	William Greendyke Zack A. Clement R. Andrew Black Jonathan C. Bolton Fulbright & Jaworski LLP Houston, Texas Louis R. Strubeck, Jr. O. Rey Rodriguez Toby L. Gerber Fulbright & Jaworski LLP Dallas, Texas
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United States Department of Justice for Federal Wildlife Agencies	Alan S. Tenenbaum Bradford T. McLane Andy Mergen U.S. Department of Justice Environment & Natural Resources Division
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August 20, 2008

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STATUTES:

Appellees Mendocino Redwood Company, LLC ("MRC") and Marathon Structured Finance Fund L.P. ("Marathon") hereby move to dismiss this bankruptcy appeal of an order (the "Confirmation Order") confirming a plan of reorganization on the grounds of equitable mootness and judicial estoppel.[1] The appeal is equitably moot because all three relevant factors weigh strongly in favor of finding equitable mootness. First, Appellants did not obtain a stay pending appeal. Second, the reorganization plan confirmed by the Bankruptcy Court has been substantially consummated: All of the assets of the Debtors have been transferred; the Debtors' properties are now being operated by new companies using new management; and the distribution of payments to creditors has commenced. Third, the relief sought in this appeal—reversing the Confirmation Order in its entirety and unraveling the entire reorganization plan—would adversely affect the rights of numerous third parties and the success of the Plan.

Furthermore, Appellants are judicially estopped from denying that their appeal is moot. Their motions in the Bankruptcy Court, the District Court, and finally this Court for an emergency stay of the Confirmation Order pending appeal were grounded on the explicit premise that their appeal would become moot absent a stay. For example, the largest appellant Noteholders told this Court that "the

[1] Counsel for the Appellants Indenture Trustee and Noteholders have stated that they will file an opposition to this motion. Appellant Scopac no longer exists, and its former counsel has advised that it will no longer be participating.

appeal in this case will definitely become moot if the stay is not granted." Exh. 8, p. 14. This Court denied the stay motion, and the reorganization plan was then substantially consummated. As a result, Appellants are now judicially estopped from arguing that this appeal is not equitably moot.

STATEMENT OF THE CASE

1. This is a direct appeal from the Confirmation Order entered by the Bankruptcy Court. Bankr. Dkt. No. 3302. That Order confirmed the reorganization plan ("MRC/Marathon Plan" or "Plan") for Debtors The Pacific Lumber Co. ("Palco")[2] and Scotia Pacific Co., LLC ("Scopac") proposed by Appellees MRC, Marathon and the Official Committee of Unsecured Creditors (the "Committee"); and (2) denied confirmation of a competing plan for Scopac alone proposed by Appellant Bank of New York as Indenture Trustee ("Indenture Trustee") for the Appellant Noteholders.

2. Immediately following entry of the Confirmation Order, Appellants sought a stay pending appeal from the Bankruptcy Court, the District Court, and this Court specifically on the ground that this appeal would become moot if the MRC/Marathon Plan became effective. The Bankruptcy Court, the District Court,

[2] For purposes of this motion, Palco includes Debtors Pacific Lumber Co. and its subsidiary Debtors, Britt Lumber Company, Salmon Creek LLC, Scotia Inn, Inc. and Scotia Development LLC.

and this Court, however, all denied the stay motions.[3] Accordingly, the MRC/Marathon Plan became effective on July 30, 2008. Bankr. Dkt. No. 3473.

3. Since that date, numerous transactions and changes in operations have taken place pursuant to and in reliance on the Plan and the Confirmation Order that have resulted in the substantial consummation of the Plan, as set forth in the accompanying Declaration of Alexander L. Dean, Jr. ("Dean Decl.") (Exh. 1); Declaration of Daniel Pine ("Pine Decl.") (Exh. 2); and Affidavit of Julianne Viadro ("Viadro Aff.") (Exh. 3). The precarious financial state of Palco required that the Plan be substantially consummated as rapidly as possible (Dean Decl. ¶5).

4. At the time of their bankruptcy filings, Scopac owned over 200,000 acres of timberlands in northern California; and Palco, which was Scopac's parent company, owned a lumber mill, certain other timberlands, a cogeneration plant, an Inn, and Scotia, California, one of the last company-owned towns. The assets of the Debtors Palco and Scopac have been transferred pursuant to the MRC/Marathon Plan to two new entities—Humboldt Redwood Company ("HRC") and Town of Scotia LLP ("TOS"). Dean Decl. ¶ 7. Certain of Debtors' causes of action have also been assigned to trusts responsible for litigating them for the benefit of creditors. *Id.* ¶ 8. In addition, various releases as provided in the Plan took effect, and all liens (except as provided in the Plan or Confirmation Order)

[3] *See* Exh. 4, 5, and 6 hereto (copies of stay denial orders from all three courts).

were released. *Id.* Palco has been dissolved and Scopac's certificate of formation has been cancelled. *Id.* ¶ 12; Pine Decl. ¶ 7. The Committee also has been dissolved as of the Effective Date. *Id.* ¶¶ 8-9.

5. HRC has raised $615 million in new funds, including $325 million from lenders who now have a first lien on the timberlands. Dean Decl. ¶¶ 19-22. HRC incurred over $3 million in nonrefundable fees and expenses in obtaining those loans. *Id.* ¶ 21. HRC is also seeking additional financing that will provide it with additional needed working capital. *Id.* ¶ 23.

6. To date, HRC has paid out more than $575 million to creditors of the Debtors and other third parties. Dean Decl. ¶¶ 13-18. This includes $513.6 paid to the Indenture Trustee for distribution to the Noteholders, representing what the Bankruptcy Court determined to be fair value of the Noteholders' collateral. *Id.* ¶ 14. Another $37.4 million has been paid to the Bank of America, as agent for itself and three other senior lenders to Scopac, and over $10.6 million has been placed in the PLC Litigation Trust for the benefit of hundreds of unsecured claimants, the distribution to whom will be commencing shortly. *Id.* ¶ 14; Viadro Aff. ¶¶ 9-10. That Trust has already settled claims exceeding $8 million for approximately $3.3 million, and a settlement of a $270 million claim is imminent. *Id.* ¶ 8. In addition, HRC has paid $5.6 million for administrative expenses and pre-petition priority claims, $1.2 million to settle post-petition liabilities owed to local logging

companies, and $3.4 million to Palco's former owner. Dean Decl. ¶¶ 15-18. Moreover, employees of the Debtors were paid approximately $629,000, $1.38 million, and $992,000 in payment of, respectively, accrued vacation time, earned wages, and Bankruptcy Court-approved retention bonuses and performance incentives. *Id.* ¶ 49. HRC has also assumed an obligation of $60 million under Palco's pension plan, which is underfunded by $5 to $10 million, as well as Palco's pre-existing liability for workers' compensation. *Id.* ¶¶ 54-55.

7. After detailed, intensive negotiations with federal and state regulators, HRC obtained the necessary approval to own the timberlands, which is required by covenants recorded against their title. Dean Decl. ¶¶ 24-29. The timberlands could not be transferred back to the Debtors or to some other entity without extensive investigation by and approval of the relevant government agencies. *Id.* ¶ 25. Moreover, numerous other approvals or permit transfers are required to operate on the timberlands, which approvals HRC and TOS have obtained or are in the process of obtaining. *Id.* ¶ 31-34; Pine Decl. ¶¶ 48-50.

8. HRC and TOC have either rejected or assumed hundreds of the Debtors' pre-existing contracts. Dean Decl. ¶ 35; Pine Decl. ¶¶ 26-28. New contracts for trucks and other services, such as logging, have been entered into. Dean Decl. ¶¶ 37, 60. Moreover, HRC has re-signed contracts with 15

independent contractors to perform State-required roadwork for which there is an $8 to $13 million backlog. *Id.* ¶ 63.

9. An entire new management team has been brought in by HRC and TOS has brought in a new COO/CFO. Dean Decl. ¶¶ 39-47; Pine Decl. ¶¶ 40-42. HRC's new managers have moved or are moving to Humboldt County from their prior homes located more than 100 miles away. Dean Decl. ¶ 45. The former management of the Debtors has been terminated. Dean Decl. ¶ 43; Pine Decl. ¶ 40.

10. About 40 of the employees previously employed by Palco and Scopac have not been offered positions. Dean Decl. ¶ 49. Of the 226 former employees of the Debtors who now work at HRC, 80% have had their compensation, title, or job responsibilities change. *Id.* ¶ 50. All HRC employees receive benefits under different health, incentive, workers' compensation and retirement programs from those provided by the Debtors. *Id.* ¶ 50-53.

11. HRC has changed the business strategy and performance of the sawmill and lumber finishing operations and is broadly changing the way redwood is sold. Dean Decl. ¶¶ 56-59. A new distribution center is being established, and significant new business relationships have been formed with remanufacturers and retailers. *Id.* The failing business strategies for harvesting and selling lumber that had been employed by Debtors have thus been dramatically revamped. These measures cannot be readily reversed. *Id.* ¶ 59.

12. The Debtors' Information Technology systems have been shut down and all information migrated to an existing MRC system, and 75% of the personnel in the Debtors' IT department have been terminated. Dean Decl. ¶ 61.

13. Because HRC's business strategy is built around earning the trust of regulators, environmental organizations, suppliers, customers, and the public, it has changed the Debtors' forestry practices. It has implemented programs to protect old-growth trees and eliminate traditional clear-cutting. Dean Decl. ¶ 60. It has re-negotiated 16 logging contracts and issued 18 new logging contracts (with approximately 12 logging operators) to further that policy. *Id.*

14. Since July 30, 2008, TOS has taken over active operation of the town of Scotia. Pine Decl. ¶¶ 29-39. It has paid vendors over $783,000. *Id.* ¶ 32. It has also begun making significant capital improvements to the Town and power plant, which will require it to commit several hundred thousand dollars. *Id.* ¶ 51. Moreover, it has begun the process of subdividing the Town so that residents of this company-owned town can purchase their homes. *Id.* ¶ 35.

15. In this appeal, Appellants seek to challenge the Confirmation Order in its entirety, arguing that the Bankruptcy Court instead should have confirmed their competing plan under which the assets of Scopac would be auctioned and Palco would be left in bankruptcy even though that court found their plan not to be proposed in good faith, to be laden with conflicts of interest, and to be not feasible.

Bankr. Dkt. 3088 at 118. Thus, by this appeal, Appellants seek to wipe out the entire MRC/Marathon Plan and to unravel all of the transactions that have taken place under the Plan pursuant to the authority granted by the Confirmation Order, which the Bankruptcy Court, the District Court and this Court each refused to stay.

ARGUMENT

I. THIS APPEAL SHOULD BE DISMISSED ON THE GROUND OF EQUITABLE MOOTNESS.

A. Equitable Mootness Is Designed To Protect Confirmed Reorganization Plans and Those Who Rely On Them.

"The doctrine of equitable mootness should be and often is applied to forestall bankruptcy appeals from confirmed bankruptcy plans, because the appellate courts recognize that 'there is a point beyond which they cannot order fundamental changes in reorganization cases.'" *In re Hilal*, 2008 U.S. App. LEXIS 14318, at *3 (5th Cir. July 8, 2008) (quoting *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994)). "Equitable mootness is a prudential, not a constitutional, doctrine that evolved in response to the particular necessities surrounding consummation of confirmed bankruptcy reorganization plans." *Id.* (quoting *In re Grimland, Inc.*, 243 F.3d 228, 231 (5th Cir. 2001)). "In this context, 'mootness' is not an Article III inquiry as to whether a live controversy is presented; rather, it is a recognition by the appellate courts that there is a point beyond which they cannot order fundamental changes in reorganization actions." *Manges*, 29 F.3d at 1038-39.

"The doctrine rests on the need for finality, and the need for third parties to rely on that finality, in bankruptcy proceedings." *In re Grimland, Inc.*, 243 F.3d at 231.

This doctrine is not unique to this Circuit, for other circuits as well "have recognized that a plan of reorganization, once implemented, should be disturbed only for compelling reasons." *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994).[4] Indeed, "[s]everal provisions of the Bankruptcy Code of 1978 provide that courts should keep their hands off consummated transactions." *Id.* For example, Section 1127(b) of the Bankruptcy Code limits the power to modify a reorganization plan after its "substantial consummation." 11 U.S.C. § 1127(b). "[T]he pains that attend any effort to unscramble an egg . . . are so plain and so compelling that courts fill the interstices of the Code with the same approach." *In re UNR Indus.*, 20 F.3d at 769.

B. The Requirements for Equitable Mootness Are Satisfied Here.

"An appeal is equitably moot when a plan of reorganization has been so substantially consummated that a court can order no effective relief even though there may still be a live dispute between parties . . . ." *In re Grimland, Inc.*, 243 F.3d at 231. This Court has employed "a three-factor test for when a bankruptcy case is equitably moot": (1) "whether the complaining party has failed to obtain a

---

[4] *Citing, e.g., In re Chateaugay Corp.*, 10 F.3d 944, 952-54 (2d Cir. 1993); *In re Roberts Farms, Inc.*, 652 F.2d 793, 797 (1981); *Miami Ctr. Ltd. P'ship v. Bank of New York*, 838 F.2d 1547, 1554-55 (11 Cir. 1988); *In re AOV Indus., Inc.*, 792 F.2d 1140, 1147-50 (D.C. Cir. 1986).

stay, (2) whether the plan . . . has been substantially consummated, and (3) whether the relief requested would affect the rights of parties not before the court or the success of the plan." *Id.* (citation omitted). All three of the relevant factors points strongly toward finding that this appeal is equitably moot. Indeed, as certain of the Noteholder Appellants previously acknowledged, it would be "unfair to all involved" to try to unravel the Plan at this point. Exh. 8 at 15.

1. Appellants Did Not Secure a Stay Pending Appeal.

"The first question in a mootness inquiry is whether the appellants secured a stay to prevent execution of the Plan." *In re Berryman Prods., Inc.*, 159 F.3d 941, 944 (5th Cir. 1998). In that regard, it makes no difference whether the Appellants tried to secure a stay; the only relevant issue is whether they actually obtained one. *See id.* at 944 ("Nationwide asserts that because it diligently *pursued* a stay, its failure to *obtain* the stay does not require dismissal of the proceeding as moot. We rejected this argument in *In re Manges.*" (emphasis in original; footnote omitted). This Court has also made clear that it makes no difference whether the Appellants secured a temporary stay, if the temporary stay expired and the plan was implemented. *See In re GWI PCS 1 Inc.*, 230 F.3d 788, 800 (5th Cir. 2000). Nor does it make any difference that other parties were put on notice of the Appellants' arguments as to why the Bankruptcy Court was in error, for mere notice "cannot serve as a proxy for a judicial stay of the reorganization plan." *Id.* at 800-01.

In this case, the Bankruptcy Court, the District Court, and this Court all denied Appellants' motions for a stay pending appeal. Exh. 4-6. Accordingly, the Confirmation Order was not stayed and the MRC/Marathon Plan went effective on July 30, 2008. "This [first] factor therefore militates in favor of dismissal for mootness." *In re GWI PCS 1 Inc.*, 230 F.3d at 801.

2. The Plan Has Been Substantially Consummated.

"The second question in the mootness inquiry is whether the Plan has been substantially consummated . . . ." *In re Berryman Prods., Inc.*, 159 F.3d at 945. The Bankruptcy Code defines "substantial consummation" as:

> (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
>
> (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
>
> (C) commencement of distribution under the plan.

11 U.S.C. § 1101(2). As this Court has explained, it "has borrowed the 'substantial consummation' yardstick because it informs our judgment as to when finality concerns and the reliance interests of third parties upon the plan as effectuated have become paramount to a resolution of the dispute between the parties on appeal." *In re Manges*, 29 F.3d at 1041.

This Court, moreover, has emphasized that this standard "requires only 'substantial consummation,' not absolute or complete consummation." *In re GWI*

PCS 1 Inc., 230 F.3d at 802. Furthermore, the issue of substantial consummation is to be determined based on the extent of plan consummation at the time this Court reviews the mootness issue. *See In re Manges*, 29 F.3d at 1041 ("Mootness is evaluated by the reviewing court, which may take notice of facts not available to the trial court if they go to the heart of the court's ability to review.).[5] All of the elements of the definition of "substantial consummation" are clearly satisfied here.

a. All of the Debtors' Property Has Been Transferred.

The MRC/Marathon Plan provided for the transfer of the Debtors' assets, including the timberlands, sawmill, and the town of Scotia, to HRC and TOS. These transfers have occurred, and the Debtors have been dissolved. Dean Decl. ¶¶ 7, 12. Moreover, the relevant governmental authorizations necessary to own the timberlands and operate on them have been transferred to HRC and TOS, which cannot be transferred back without governmental approval. Dean Decl. ¶¶ 24-34; Pine Decl. ¶ 49-50.

b. HRC and TOS Have Assumed the Management of the Debtors' Properties.

As recounted above, HRC and TOS have assumed complete control of the property of Palco and Scopac and have instituted dramatic changes in what had been their historic operations: *e.g.*, a new management team, rejection or

[5] In addition, this Court has rejected the argument that transactions with "insiders" or other parties to the case should not be counted in determining whether a plan has been substantially consummated. See *In re GWI PCS 1 Inc.*, 230 F.3d at 801-02.

assumption of hundreds of pre-existing contracts, significant changes in terms of employment, new logging procedures, and a new business plan. *See* pp. 5-7 above.

c. The Distribution of Payments to Creditors Under the Plan Has Commenced.

Finally, the distribution of payments to hundreds of creditors, including secured creditors, creditors with administrative claims, creditors with priority unsecured claims, general unsecured creditors, and other parties with contractual claims has clearly "commenced," with HRC so far paying over $560 million to creditors. Dean Decl. ¶¶ 13-18. Of that amount, $513.6 million has been paid to the Indenture Trustee and $37.4 million to Bank of America, which has distributed it to the senior lenders. Dean Decl. ¶ 14. Approximately, $5.6 million in administrative expenses have been paid. *Id.* ¶ 15. HRC has also paid over $10.6 million to the PLC Litigation Trust for the claims of hundreds of unsecured creditors, the further distribution of which will commence shortly. *Id.* ¶ 14; Viadro Aff. ¶¶ 9-10. Moreover, hundreds of employees have received Bankruptcy Court-approved retention and incentive bonuses and accrued vacation pay and wages, totaling approximately $3 million. Dean Decl. ¶ 49.

3. The Relief Requested by Appellants Would Adversely Affect Both Third Parties and the Success of the Plan.

"The final question in the mootness inquiry is whether the requested relief would affect the rights of parties not before the court or the success of the Plan."

In re Berryman Prods., Inc., 159 F.3d at 945-46. In applying this third factor, this Court has repeatedly and uniformly held that appeals that seek to invalidate an entire reorganization plan would affect both the rights of third parties and—of course—the success of the plan. *See In re Berryman Prods., Inc.*, 159 F.3d at 946 ("Unraveling the Plan at this time clearly would affect the position of trade creditors who granted concessions to the Debtor under the reorganization."); *In re Manges*, 29 F.3d at 1043 (third factor weighs heavily in favor of mootness where appeal seeks "nothing less than a wholesale annihilation of the Plan").[6]

This line of authority is directly on point here, because Appellants seek in this appeal to reverse the Confirmation Order in its entirety and to unravel the entire MRC/Marathon Plan. All one need do is to peruse, for example, the 26 issues for appeal set forth by the Indenture Trustee (Exh. 7) to recognize that Appellants want to "dismantle" and "annihilate" the Plan.

There can be no genuine dispute that reversal of the entire Confirmation Order and the unraveling of the entire MRC/Marathon Plan would dramatically affect third parties and the success of the plan. To take one example, HRC has

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[6] *In re GWI PCS 1 Inc.*, 230 F.3d at 802-03 ("it appears quite unlikely that we could place the Debtors' estates or the third parties back into the status quo as it existed . . . if we were to unravel this important and fundamental aspect of the reorganization plan at this time"); *In re U.S. Brass Corp.*, 169 F.3d 957, 962 (5th Cir. 1999) (factor weighed in favor of finding mootness where appeal "would dismantle a substantially consummated plan"); *In re Block Shim Dev. Co.*, 939 F.2d 289, 291 (5th Cir. 1991) (appeal seeking reversal of confirmation order held moot because "granting appellants the relief they seek would not only jeopardize, but eviscerate, the plan").

undertaken to fulfill the extensive environmental and habitat obligations of Palco and Scopac, obligations on which the Debtors had fallen behind. Dean Decl. ¶¶ 24-34, 63. Undoing the Plan would cast into doubt who, if anyone, would fulfill those duties, for the necessary authorizations have been transferred to HRC and TOS, and it is unlikely that any of the governmental agencies would transfer them to some other entity without requiring extensive investigation and negotiation. *Id.* ¶ 30. In that regard, it is highly significant that both the United States and the California State Agencies opposed the attempt by Appellants to secure a stay pending appeal from this Court, precisely because of the impact such a stay could have on the environment and the public interest.[7] As the Bankruptcy Court found, the Plan "ensures that an experienced and environmentally conscious timber operator will run the Palco and Scopac Timberlands in accordance with the applicable government regulations." Exh. 4, ¶ 28.

Moreover, unraveling the MRC/Marathon Plan would have drastic adverse effects on hundreds of other third parties. These include, as described above at pp. 4-7: (a) the creditors other than Appellants who have their claims paid under the Plan and would have to return the funds if that is even feasible;[8] (b) lenders to

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[7] See Brief of the United States in Opposition to Appellant's Emergency Motion for a Stay at 6-7 No. 08-27 (5th Cir.); California State Agencies Opposition to Emergency Motion for a Stay at 3, No. 08-27 (5th Cir.).

[8] If return of distributions is not feasible, that would be a further ground for finding mootness. *Manges*, 29 F.3d at 1043.

HRC; (c) the employees of HRC and TOS who will once again have the livelihood threatened by the possibility that their employers might be shut down and liquidated; (d) managers who have moved to Humboldt County in reliance on the Plan; (e) persons to whom Palco owed workers' compensation or pension benefits; (f) vendors, contractors, distributors, and retailers which have entered into new relationships with HRC or TOS; and (g) residents of the town of Scotia who rely on TOS to ensure proper operation of utilities and other facilities (Exh. 4, ¶ 28). Indeed, the Official Committee of Unsecured Creditors, which was a co-proponent of the MRC/Marathon Plan, has been dissolved and thus can no longer participate in this appeal.

Not only does this appeal expressly seek to unravel the Plan in its entirety, but both the Bankruptcy Code and the Confirmation Order preclude drastic changes to the Plan. As this Court held in rejecting an argument that, in order to avoid affecting third parties, it could simply change one provision of the plan rather than unravel the entire plan, "[t]he Bankruptcy Code provides that a plan may not be modified or amended after substantial consummation has taken place. 11 U.S.C. § 1127(b)." *In re Manges*, 29 F.3d at 1043 n.13[9] That statutory

[9] *See also In re Winn-Dixie Store, Inc.*, 2008 U.S. App. LEXIS 13986, at *10-12 (11th Cir. July 1, 2008) ("We decline ... to permit an appeal that would lead to an alteration or amendment of a substantially consummated reorganization plan.") (citing 11 U.S.C. § 1127(b)); *General Elec. Cap. Corp. v. Torres Concrete Pumping Services, Inc.*, 2004 U.S. Dist. LEXIS 7678, at *11 (W.D. Tex. Apr. 16, 2004) (rejecting effort to avoid equitable mootness by urging that plan merely be modified because "a plan may not be modified or amended after

prohibition is fully applicable here given that, as shown above, the MRC/Marathon Plan has been substantially consummated. This is particularly so given Noteholders seek to unravel the entire Plan on appeal, including its very core—the transfer of the timberlands to HRC and TOS and the payment of over $500 million to the Noteholders.[10] Moreover, the Confirmation Order expressly provides that "[t]he provisions of the MRC/Marathon Plan and this Order . . . are non-severable and mutually dependent." Bankr. Dkt. No. 3302, at 15, ¶ 6. For this further reason, no change can be made to the Plan at this point.

Instead, the only potential relief in this appeal would be the complete annihilation of the Plan. That is in large measure no longer possible and, to the limited extent that it might still be possible, would cause severe harm to numerous third parties; HRC and MRC (which have expended millions in unrecoverable expenses in reliance on the Plan and the Confirmation Order);[11] and, as shown by the intervention here of the United States and the California State Agencies, to the public interest.

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substantial completion has taken place" and "[t]hus, the plan would have to be unraveled and the parties returned to the status quo before confirmation").

[10] *See, e.g.*, Findings of Fact and Conclusions of Law pp. 2-3, 15-18, Bankr. Dkt. No. 3088 (June 6, 2008) (describing key elements of MRC/Marathon Plan).

[11] *See In re Manges*, 929 F.2d at 1043 (taking into account "significant sacrifices" of plan's proponents as an additional factor in favor of finding mootness).

II. APPELLANTS PREVIOUSLY REPRESENTED THAT THIS APPEAL WOULD BECOME EQUITABLY MOOT ABSENT A STAY PENDING APPEAL AND ARE JUDICIALLY ESTOPPED FROM TAKING A CONTRARY POSITION NOW.

The conclusion that this appeal meets the requirements for equitable mootness is buttressed by the fact that, when Appellants were seeking a stay pending appeal, they told this Court (and the lower courts) that the appeal would become equitably moot in the absence of such a stay:

Appellants CSG Investments and Scotia Redwood Foundation, which hold the largest stake of notes, represented to this Court that

> "***the appeal in this case will definitely become moot if the stay is not granted*** . . . . The MRC/Marathon Plan will almost immediately be consummated. . . . . ***[I]t will be virtually impossible (and unfair to all involved) to overturn the plan at that point.***

Exh. 8, pp. 14-15 (emphasis added). Similarly, Appellants Angelo, Gordon & Co. L.P. et al. represented to this Court: ***"Unless a stay is issued now to prevent this appeal from being rendered moot, there will be no effective appellate review of the Bankruptcy Court's erroneous rulings."*** Exh 9, p. 3 (emphasis in original). And, Appellant Indenture Trustee, in like manner, told this Court that, if it did not grant a stay, the Indenture Trustee . . . ***will lose its rights to meaningful and complete appellate review."*** Exh. 10, p. 6 (emphasis added).

By virtue of their prior arguments to this Court and the lower courts, Appellants are judicially estopped from disputing that the present appeal is now

moot. "Judicial estoppel is a common law doctrine that prevents a party from assuming inconsistent positions in litigation." *In re Superior Crewboats, Inc.*, 374 F.3d 330, 334 (5th Cir. 2004). There are two prerequisites for judicial estoppel. "First, it must be shown that the position of the party to be estopped is clearly inconsistent with its previous one; and second, that party must have convinced the court to accept that previous position." *Hall v. GE Plastic Pacific PTE Ltd.*, 327 F.3d 391, 396 (5th Cir. 2003) (internal quotes and brackets omitted).

Both of those requirements are satisfied here. First, any argument by Appellants that this appeal is not moot would be "clearly inconsistent" with their prior position in their stay motions. Second, Appellants convinced (at least) the Bankruptcy Court that their appeal would be moot absent a stay. Based on Appellants' arguments that their appeal of the Confirmation Order would become moot absent a stay pending appeal, the Bankruptcy Court stayed the finality of the Confirmation Order from July 8 to July 25 to afford Appellants time to try to obtain a stay first from it and then from this Court. Exh. 4 at 23; Bankr. Dkt. No. 3302 at 49. Under Fifth Circuit law, this is sufficient, for "[t]he previous court's acceptance of a party's argument [can] be either as a preliminary matter or as part of a final disposition." *Hall*, 327 F.3d at 398 (citation omitted). Indeed, this criterion is satisfied "whenever a party makes an argument with the explicit intent to induce the [previous] court's reliance." *Id.* at 399 (citation omitted). That test is

amply satisfied here, for there can be no question that Appellants made their argument on mootness with the explicit intent to induce courts to grant them a stay. And even the limited stay caused Palco, which was in dire straits and losing millions per month, to further weakened financially and that will cause HRC to expend more to bring operations to financial health and also cost it hundreds of thousands in additional legal and professional fees. Dean Decl. ¶¶ 66-67. Accordingly, Appellants are judicially estopped from contending that this appeal is not moot.[12]

CONCLUSION

Because the appeal is equitably moot and because Appellants are judicially estopped from arguing otherwise, this appeal should be dismissed.

Respectfully submitted,

Steven M. Schwartz

Brian D. Hail

[12] For a closely analogous case, see *In re Adelphia Communications Corp.*, 367 B.R. 84 (S.D.N.Y. 2007), where the court dismissed an appeal on ground of judicial estoppel when appellants had repeatedly asserted that their appeal would be mooted absent a stay, but then failed to post the security that the court had required as a condition for the stay.

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Exhibit B

No. 08–40746

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Bank of New York Mellon Trust Company, N.A., as Indenture Trustee for the Timber Notes; Angelo Gordon & Co. LP, Aurelius Capital Management, LP, and Davidson Kempner Capital Management LLC; Scotia Pacific Company LLC; CSG Investments, Inc.; Scotia Redwood Foundation, Inc. — Appellants,

v.

Official Unsecured Creditors' Committee; Marathon Structured Finance Fund L.P.; Mendocino Redwood Company LLC; The Pacific Lumber Company, United States of America, California State Agencies — Appellees.

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

APPELLANTS' RESPONSE TO APPELLEES' MOTION TO DISMISS APPEAL BASED ON EQUITABLE MOOTNESS AND JUDICIAL ESTOPPEL

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PRELIMINARY STATEMENT

Appellees assert in their Motion to Dismiss Appeal for Equitable Mootness and Judicial Estoppel (the "Mootness Motion") that this appeal is equitably moot because this Court cannot "*unravel[ ] the entire reorganization plan*" and that Appellants should be judicially estopped from disputing that the appeal is moot because, in their *unsuccessful* stay applications, Appellants argued that "this appeal would become moot absent a stay." Mootness Motion at pg. 1 (emphasis added).

Appellees' mootness argument overlooks a basic principle: So long as this Court can grant Appellants *some* meaningful relief, the appeal is not equitably moot. Appellees' claim, that the only relief this Court can grant is an order "unraveling the entire reorganization plan," ignores the many remedies available to this Court.[1] Specifically, this Court can render meaningful and effective relief (notwithstanding substantial consummation of the Plan[2]) that neither harms third parties who relied on the Plan, nor undermines its "success," including: re-imposing the Indenture Trustee's improperly stripped lien on the collateral forcibly acquired by Appellees' wholly-owned, newly-formed company; ordering Appellees to pay money to the Indenture Trustee for the improper diversion or

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[1] The United States acknowledges in its filing that, "equitable mootness is not a bright-line rule that forecloses any possibility of relief from a confirmed plan after substantial consummation." Stmt of Appellee U.S. at 8-9. In nevertheless supporting the Mootness Motion, both the United States and the California State Agencies (in their separate joinder) proceed from the false premise that the only possible relief on appeal is unwinding the plan.

[2] All capitalized terms not defined herein shall have the meaning ascribed to them in Appellants' Brief filed August 22, 2008.

extinguishing of its collateral; and voiding the overbroad exculpation/release clause in the MRC/Marathon Plan. *See, e.g., Hilal v. Williams (In re Hilal),* No. 07-20571, 2008 U.S. App. LEXIS 14318 (5th Cir. July 8, 2008); *Brite v. Sun Country (In re Sun Country Devl., Inc.),* 764 F.2d 406 (5th Cir. 1985). The ready availability of such relief forecloses any basis for equitable mootness.[3]

As to their claim of judicial estoppel, Appellees acknowledge that this doctrine precludes a litigant from disavowing a proposition that it has *successfully advanced* in the course of the litigation. Mootness Motion at pg. 19. But Appellants were *unsuccessful* in pursuing a stay; their stay requests were denied by three courts. Hence, this doctrine is simply inapplicable.

Having accepted this direct appeal, this Court should address, and provide circuit-level guidance regarding, the substantial legal issues that it raises.

ARGUMENT AND AUTHORITIES

I. THIS CASE IS NOT MOOT BECAUSE EFFECTIVE RELIEF CAN BE GRANTED

A. MRC/Marathon Have Not Satisfied Their Heavy Burden Of Demonstrating That This Appeal Is Equitably Moot.

Because the loss of appellate rights is the "quintessential form of

[3] To give this Court maximum flexibility to fashion an appropriate remedy, the Indenture Trustee is holding undistributed to the Noteholders the entire $513.6 million paid to it under the Plan (permitting its whole or partial return, if necessary, in connection with the re-imposition of the Indenture Trustee's lien or other Court imposed remedies).

prejudice,"[4] Appellees have a "heavy burden"[5] to establish that the appeal is equitably moot,[6] and that this Court should decline appellate jurisdiction.[7]

The fact that the Plan has been substantially consummated does not satisfy that burden: "As several courts have made clear, 'substantial consummation of a reorganization plan is a momentous event, but it does not necessarily make it impossible or inequitable for an appellate court to grant effective relief.'" *Manges v. Seattle-First Nat'l Bank (In re Manges)*, 29 F.3d 1034, 1042-43 (5th Cir. 1994). Indeed, *Hilal* makes clear that, even where no stay had been sought or obtained and the plan had been substantially consummated, an appeal would not be

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4 *ACC Bondholder Group v. Aldelphia Commc'ns Corp, (In re Adelphia Commc'ns Corp.)*, 361 B.R. 337, 348 (S.D.N.Y. 2007).

5 *See Suter v. Goedert*, 504 F.3d 982, 986 (9th Cir. 2007) (the "party asserting mootness has the heavy burden of establishing that there is no effective relief remaining for the Court to provide"); *Snowville Farms, LLC v. Barnes Banking Co. (In re Snowville Farms, LLC)*, No. UT-06-034, 2007 Bankr. LEXIS 1474, at *10 (B.A.P. 10th Cir. May 4, 2007); *F.H. Partners, L.P. v. Inv. Co. of the Sw., Inc. (In re Inv. Co. of the Sw., Inc.)*, 341 B.R. 298, 309 (B.A.P. 10th Cir. 2006) ("Debtor, the party asserting mootness, has not met its heavy burden of establishing that there is no effective relief remaining for this Court to provide.").

6 "The ability to review decisions of the lower courts is the guarantee of accountability in our judicial system. In other words, no single judge or court can violate the Constitution and laws of the United States, or the rules that govern court proceedings, with impunity, because nearly all decisions are subject to appellate review. At the end of the appellate process, all parties and the public accept the decisions of the courts because we, as a nation, are governed by the rule of law. Thus, the ability to appeal a lower court ruling is a substantial and important right." *Aldephia*, 361 B.R. at 342 (emphasis added).

7 *See* 28 U.S.C. § 158(d)(2)(A) ("the appropriate court of appeals shall have jurisdiction . . . "); *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 800, 821 (1976) ("[F]ederal courts have a 'virtually unflagging obligation . . . to exercise the jurisdiction given them'"); *England v. La. Bd. of Med. Exam'rs*, 375 U.S. 411, 415, (1964) ("When a federal court is properly appealed to in a case over which it has by law jurisdiction, it is its duty to take such jurisdiction.") (quoting *Willcox v. Consol. Gas Co.*, 212 U.S. 19, 40 (1909)); *Cohens v. Virginia*, 6 Wheat. 264, 404 (1821) (federal courts "have no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not").

equitably moot if the relief requested on appeal would not "affect the rights of parties not before the Court or the success of the plan." *In re Hilal*, 2008 U.S. App. LEXIS 14318, at *3; *see also Wooley v. Faulkner (In re SI Restructuring, Inc.)*, -- F.3d --, No. 07-50912, 2008 WL 3974311, at *2 (5th Cir. Aug. 28, 2008).

MRC/Marathon spend 17 pages trying to carry their "heavy burden" by arguing that this Court cannot unravel the entire Plan. This argument ignores three significant forms of narrower relief that this Court has previously recognized it can grant, directed only at MRC/Marathon/HRC:[8] (1) lien re-imposition; (2) cash payments; and (3) elimination of an overbroad exculpation clause.

B. This Appeal Is Not Moot Because This Court Can Order The Re-Imposition Of The Indenture Trustee's Lien On The Timberlands.

In *Sun Country*, this Court held that a secured creditor's appeal from a confirmation order stripping its lien under Bankruptcy Code section 1129(b) was not equitably moot, even though the plan had been substantially consummated, because the lien could be re-instated. The debtor's plan gave the objecting secured creditor twenty-one promissory notes secured by twenty-one lots, as the "indubitable equivalent" of that creditor's single note secured by 200 acres. This Court explained that:

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[8] Humboldt Redwood Company LLC, or "HRC", is, as disclosed in the Mootness Motion, MRC/Marathon's newly formed entity created as their vehicle for purchasing Scopac's assets. HRC is referred to in the Plan as "Newco."

> To dismiss this appeal on the basis of mootness, we must find that the plan has been so substantially consummated that effective judicial relief is no longer available to [the secured creditor] . . . . Because [the secured creditor's] first lien on up to thirty-five acres, which was canceled by the plan, could be reinstated if [the secured creditor] were to prevail in this appeal, effective judicial relief is still available and the appeal is not moot.

In re Sun Country Dev., Inc., 764 F.2d at 407 n.1. Significantly, MRC/Marathon cited no case from this Court dismissing as moot an appeal of a plan confirmation order where the secured creditor sought the re-imposition of a lien that had been improperly stripped from its collateral.[9]

Just a few months ago, the Ninth Circuit Bankruptcy Appellate Panel ("B.A.P.") similarly rejected a mootness argument because the appellant secured creditor's lien could be re-imposed. *Clear Channel Outdoor, Inc. v Knupfer (In re PW, LLC)*, No. CC-07-1176, 2008 Bankr. LEXIS 1934, at *9-*10 (B.A.P. 9th Cir. May 30, 2008). In that case, DB Burbank, LLC ("DB") held a first lien, and Clear Channel a junior lien, on assets of the Debtor, PW, LLC ("PW"). The chapter 11 trustee proposed to sell PW's assets free and clear of liens (including that of Clear

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[9] MRC/Marathon did cite *TNB Financial Inc. v. James F. Parker Interests (In re Grimland, Inc.)*, 243 F.3d 228 (5th Cir. 2001). In that case, the appeal of a section 506(c) surcharge order (that effectively deprived the secured creditor of its lien) was held not to be equitably moot because reversal of the order would only affect the principal parties to the appeal. *Id.* at 232 ("Reversing the surcharge order would simply require Parker to repay TNB [parties to the appeal]."). *In re Crystal Oil Co.*, 854 F.2d 79 (5th Cir. 1988), a case not cited by MRC/Marathon, appears to be the only case where this Court found a secured creditor's appeal from a confirmation order to be moot. There, however, the junior secured creditor did not seek re-imposition of its lien, but instead sought remedies that were unfair to the senior lienholder who had compromised its claims to permit confirmation of the plan and "would affect nonparties and other creditors." *Id.* at 81-82.

Channel) under Bankruptcy Code section 363 to DB, who agreed to credit bid the full amount of its debt and provided up to $800,000 to pay certain administrative claims against PW's estate.

The Bankruptcy Court overruled Clear Channel's objection that section 363(f) did not authorize the sale free and clear of Clear Channel's lien; granted the sale motion; and denied a stay of the order pending appeal, as did the Ninth Circuit B.A.P. The sale closed and DB paid over $1.5 million to various entities in reliance on the sale order and assumed various contracts. The chapter 11 trustee made interim payments out of the $800,000 to herself and her professionals. *In re PW, LLC*, 2008 Bankr. LEXIS 1934, at *9-*10.

The B.A.P. found that the consummation that had taken place had caused changes that were "numerous and complex" such that mootness applied to the sale itself. *Id.* at *15. However, the B.A.P. held that the lien stripping issues were not moot because effective relief could still be provided.

> As an initial matter, reattaching Clear Channel's lien to PW's former property is not theoretically or practically difficult. Both parties are before the court, and no third-party action is required to reestablish Clear Channel's position. Moreover, DB has not identified any third party who would be prejudiced because it relied on the bankruptcy court's orders . . . . As a result, . . .while the appeal related to the sale itself may be equitably moot, the panel could reverse the transfer of Clear Channel's lien to the nonexistent sale proceeds and hold that it remains attached to property transferred to DB.

Id. at *15 - *16.

As in *Sun Country* and *PW, LLC*, this appeal is not equitably moot because effective relief can be fashioned by re-imposing the Indenture Trustee's improperly stripped lien on its collateral on a junior basis, to secure the unpaid balance under the Notes (approximately $226 million after crediting the $513.6 million previously distributed to the Indenture Trustee).[10] This remedy would not require undoing complex transactions or interfering with the rights of third parties who are not parties to the appeal (including HRC's third-party financier, American Ag Credit, who would retain its lien),[11] and would leave the "success" of the Plan

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[10] MRC/Marathon's argument that, once a Plan has been substantially consummated, an appellate court cannot grant any relief short of unraveling the entire plan, *see* Mootness Motion at pp. 16-17, flatly conflicts with both *Sun Country* and *Hilal*, which MRC/Marathon do not discuss or distinguish. MRC/Marathon's cases on this point do not undercut *Sun Country* or *Hilal* because the partial relief sought in the cases they cite would have adversely affected the rights of third parties not parties to the appeal rather than, as here, affecting only Plan Proponents who are parties to this appeal. *See Manges*, 29 F.3d at 1043 (change to liquidating trust would have adversely affected distribution to creditors not before the court); *In re Winn-Dixie Stores, Inc.*, No. 07-15326, 2008 U.S. App. LEXIS, 13986, at *14-*15 (11th Cir. July 1, 2008) (reallocation of stock would have adversely affected holders of disputed claims not parties to the appeal); *General Elec. Capital Corp. v Torres Concrete Pumping Servs., Inc.*, No. SA-04-CA-56, 2004 U.S. Dist. LEXIS 7678, at *10 (W.D. Tex. Apr. 16, 2004) (requested relief would have impaired other payments to creditors).

[11] A re-imposed lien can be ordered to be junior to American Ag Credit's $325 million exit financing, thereby preserving its priority. If American Ag Credit is unwilling to tolerate this junior lien without declaring a default, this Court could direct that $325 million of the $513.6 million distributed to (and still held by) the Indenture Trustee, be used to pay off the American Ag credit loan. The debt secured by the re-imposed lien would then be $551 million ($226 million plus $325 million). Indeed, with the $513.6 cash still available, the Court could order any number of remedies which need not be cataloged here, including complete unwinding. For present purposes, what is relevant is that there are multiple forms of meaningful relief available that this Court has previously found sufficient to defeat mootness.

undisturbed.[12] The re-imposition of the Indenture Trustee's lien would affect only MRC and Marathon, who "should have known all along that [the lien stripping proposed in their Plan] might not work." *See In re PW, LLC*, 2008 Bankr. LEXIS 1934, at *22–*23. They could still keep and operate the property they acquired under the impermissible terms of the Plan, but they should not keep it free and clear of the Indenture Trustee's improperly-stripped lien. Plan, Dkt-3302, Ex. 2 at § 10.6 (12:2416).[13]

C. Certain Of The Errors Of The Plan Can Be Remedied By Ordering Cash Payments And Eliminating The Overbroad Exculpation Clauses.

In addition, this Court can, without unraveling the entire Plan, grant relief to address certain errors in the Plan by ordering MRC/Marathon or HRC to pay the Indenture Trustee at least $40 million in cash and directing the elimination of the Plan's improper third-party release/exculpation clause. The availability of this kind of relief was sufficient to prevent dismissal on mootness grounds in *Hilal*.

(1) This Court Can Direct MRC/Marathon/HRC To Reimburse Noteholders For Collateral Proceeds That Were Improperly Diverted To Pay Junior, Unsecured Claims.

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[12] This junior lien would not affect the distributions to other creditors under the Plan and can be imposed with commercially reasonable covenants and payment terms that will not jeopardize the success of the Plan by causing an immediate default. Moreover, reimposition of a junior lien would not affect the environmental and regulatory obligations of HRC thereby allaying the litany of concerns raised by the United States and the California State Agencies.

[13] References to material on the docket, including transcripts, are denoted as "Dkt-# (Record Volume: Page number assigned by district clerk, if available)." References to exhibits in the record are denoted as: "Appellant-##" for items designated by the Appellants, and "Appellee-##" for items designated by the Appellees.

The Plan crafted by MRC/Marathon improperly diverted at least $28 million of the consideration paid by HRC for the acquisition of Scopac's encumbered assets to pay junior, unsecured creditors of Scopac and Palco (an entirely separate and non-consolidated bankruptcy estate), including professionals who had no right to be paid out of the Noteholders' collateral.[14] Appellants' Brief at pp. 35-38. MRC/Marathon/HRC should be ordered to pay to the Indenture Trustee the collateral proceeds they diverted improperly to pay junior, unsecured creditors. *Cf. In re SI Restructuring, Inc.*, 2008 WL 3974311, at *3 (appeal seeking recovery of funds paid to appellee's counsel in derogation of rights of appellant secured creditor not moot); *In re EDC Holdings Co.*, 676 F.2d 945, 948 (7th Cir. 1982) (lender is not entitled to protection for knowingly entering into transaction that diverts payments to entities holding no claims against the debtor's estate).

(2) This Court Can Direct Payment Of Scopac's Unpaid Administrative Claims Against Palco As Required By 11 U.S.C. § 1129(a)(9).

The Indenture Trustee had a senior lien on Scopac's administrative claim against Palco of approximately $12 million for goods sold to Palco. Rather than paying this administrative claim in full on the Effective Date as required by section

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[14] *See In re Flagstaff Foodservice Corp.*, 739 F.2d 73, 75 (2d Cir. 1984) (secured creditor's claim has priority over payment to estate professionals such that a bankruptcy court may not order interim payments to professionals); *In re Flagstaff Foodservice Corp.*, 762 F.2d 10, 12 (2d Cir. 1985); *Salomon v. Logan (In re Int'l Envtl. Dynamics, Inc.)*, 718 F.2d 322, 326 (9th Cir. 1983). This Court could also direct the recovery from Palco's counsel (who now represents HRC) of the Indenture Trustee's collateral proceeds that were diverted to pay such counsel's unsecured professional fees. *See SI Restructuring, Inc.*, 2008 WL 3974311, at *3.

1129(a)(9) of the Bankruptcy Code, the Plan cancelled all intercompany claims (a hallmark of a *de facto* substantive consolidation which was employed improperly under the Plan). Appellants' Brief at pp. 45-46; Plan, Dkt-3302, Ex. 2 at § 4.10 (12:2398). The Court can order that MRC/Marathon/HRC comply with section 1129(a)(9) by paying the Indenture Trustee this additional amount.[15] *See Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944, 953 (2d Cir. 1993) (the court could fashion effective relief by remanding with instructions to the bankruptcy court to order the return of any funds that were erroneously disbursed).

(3) This Court Can Direct The Elimination Of The Illegal And Overbroad Exculpation Clauses Contained In The Plan.

Finally, the Indenture Trustee's challenge to the Plan's release of non-debtor third parties in its overbroad exculpation clause is not moot. Plan, Dkt-3302, Ex. 2 at §§ 10.2, 10.3 (12:2413-15). This Court held in *Hilal* that an appeal challenging the plan's exculpatory clause and the trustee's receipt of payment was not equitably moot, despite substantial consummation of the plan. *Hilal*, 2008 U.S. App. LEXIS 14318, at *1. The Court noted that Hilal challenged solely the release of the appellee-trustee (not his bankruptcy professionals or other third parties), *id.* at *4, and emphasized that:

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[15] Additionally, the Indenture Trustee is entitled to $8 million, representing Scopac's encumbered cash on hand and log inventory that the Plan transferred to HRC free and clear of the Indenture Trustee's lien, for no consideration.

> Allowing equitable mootness to insulate critically important aspects of professional conduct and compensation from appellate scrutiny, especially where the issues, as raised here, are peripheral to the plan's consummation, would disserve bankruptcy administration.

Id. at *4–*5.[16] Here, it is appropriate that the Plan's overbroad exculpation clause that releases non-debtor third parties, be invalidated so that Appellants are not deprived of their right to hold the Plan Proponents and other parties accountable for their conduct in connection with the Plan and the bankruptcy case.

II. DISMISSAL OF THIS APPEAL WOULD BE ANYTHING BUT EQUITABLE

A. MRC/Marathon Have Acted Inequitably.

MRC/Marathon manufactured their substantial consummation/mootness argument. Knowing (1) that this Court had accepted a direct appeal and expedited it, with oral argument to occur in early October, (2) that § 11.3 of their Plan already contemplated a 60-day delay (ending September 8, 2008), and (3) that the Indenture Trustee had put them on notice that their Plan did not permit an Effective Date to occur until this appeal is completed,[17] MRC and Marathon nevertheless

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[16] This Court, in *Hilal*, cites several other circuit opinions for support, including, *In re PWS Holding Corp.*, 228 F.3d 224, 236-37 (3d Cir. 2000) (even though plan had been substantially consummated, appeal was not equitably moot because "the plan could go forward even if the releases were struck"); *see also Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203 (3d Cir. 2000) (appeal of plan confirmation order challenging plan's release of debtor's officers and directors was not equitably moot).

[17] *See* Dkt-3452 and Dkt-3473, Case No. 07-20027, in the United States Bankruptcy Court for the Southern District of Texas, Corpus Christi Division, of which this Court may take judicial notice. MRC/Marathon proceeded apparently in reliance on dicta in the referenced Bankruptcy Court order supportive of their view that they could close, even though the plain language in their Plan did not permit an Effective Date until this appeal is resolved.

rushed to consummate this Plan. This haste was not necessary to preserve the going concern value of Scopac or Palco or the *status quo,* because the Indenture Trustee had already proposed financial arrangements that would, *at the Noteholders' expense,* maintain the status quo and ensure that Scopac and Palco had ample liquidity through year-end. Dkt-3366 (7:427). This is not "equitable mootness;" it is manufactured mootness used by the architects of an illegal plan to shield it from appellate review.

MRC/Marathon devised their Plan with improper motives, based on a fundamentally abusive view of the chapter 11 process. These were reflected when MRC's CEO wrote (1) of Marathon's desire to "tap into the value" of the Timberlands (in which Marathon, a creditor only of Palco, had no interest); (2) of the "valuation argument" being "muddied" by multiple conflicting appraisals; and (3) (with respect to Marathon) of a "bogus appraisal." Appellants' Brief at pg. 38.

The Plan permitted Marathon (and MRC, a self-styled "hostile acquirer") to "tap into the value" of the Timberlands and exploit the "muddied" "valuation argument" by taking Scopac's Timberlands in a coerced sale to Newco (HRC), in which *only* MRC/Marathon could bid, for the amount they were willing to pay, based on a non-market tested price set by a Bankruptcy Court valuation, arrived at on the basis of confusingly disparate appraisal testimony that had a $1 billion "spread." *Compare* Appellee 196, *with* Appellant 568. In fact, the price

MRC/Marathon was ultimately willing to pay for the Timberlands was more *than $100 million higher* than the value to which their appraiser (who, of course, offered the lowest valuation) had sworn. *See* Appellants' Brief at pp. 36-37. If not "bogus," this appraisal was disingenuous.

MRC/Marathon's Plan also denied the Indenture Trustee the fundamental right to credit bid in this forced sale of its collateral, in violation of its credit bid rights under section 1129(b)(2)(A)(ii). No one other than Marathon – a creditor of Scopac's equity holder – and Marathon's partner, MRC, was permitted to bid, violating the absolute priority rule of section 1129(b)(2)(B) as construed by the Supreme Court in *Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999). There, the Supreme Court expressed strong distaste for reorganization plans that deprive an undersecured creditor of its lien through a theoretical valuation, while an equity owner reaps the benefit of the undersecured creditors' loss. Rather, the Supreme Court held that such sales should be exposed to a market test.

The MRC/Marathon Plan provided for a result wholly at odds with *LaSalle.* The Plan took away any possibility that the undersecured Noteholders could purchase *their* collateral – the Timberlands – (whether by credit bid or through an auction) to prevent its sale, at a price they considered too low, to Marathon, the *de facto* "old equity" representative who, in league with MRC, a "hostile acquirer,"

took the property at an artificially determined, non-market tested price, without ever having to face any risk of being out-bid.[18]

Further, MRC/Marathon devised a Plan that violated the absolute priority rule and a secured creditor's basic right to priority in the proceeds of its collateral by diverting millions of dollars in proceeds of the sale of the Scopac Noteholders' collateral to HRC to pay junior, *unsecured* creditors of Scopac and of its equity holder, Palco, to buy those junior creditors' votes. Appellants' Brief at pp. 23-28; s*ee generally EDC Holdings Co.*, 676 F.2d at 948 (lender does not act in good faith under 11 U.S.C. § 364(e), if the loan agreement "has an intended effect that is improper under the Bankruptcy Code").

To overcome the predictable "no" vote on the Plan by Noteholders holding approximately $740 million (roughly *95% in amount*) of the claims against Scopac, MRC/Marathon misused the 5% minority to confirm its Plan by (i) gerrymandering a separate "trade" class of less than $250,000 in voted unsecured claims, which excluded, and received far better treatment than, the

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[18] The Bankruptcy Court's limited termination of exclusivity [Dkt-2004] (31:8859) (allowing only the Creditors' Committee, Indenture Trustee and Marathon to propose plans) did not create a market test for the value of the Noteholders' collateral, given (a) the short window of time to propose a plan, (b) the unique nature of the assets, (c) the Debtors' complete failure to assist in marketing the collateral, and (d) the fact that none of the parties allowed to present a plan had any experience in owning and operating timberlands. The Indenture Trustee proposed a plan for a meaningful and competitive sale process for the Timberlands, open to the full range of bidders knowledgeable on timberland operation, but the Bankruptcy Court criticized it as "half a plan" and did not confirm it. The limited modification of the Debtor's exclusive right to file a plan undid the deadbolt, but kept the safety chain in place; MRC/Marathon slipped through the opening and confirmed an illegal plan.

Noteholders' $200 million unsecured deficiency claim of the *same* rank and priority; and (ii) artificially "impairing" the only non-Noteholder Scopac secured creditor class by "deferring" a *de minimis* amount of alleged default interest.[19] *See* Appellants' Brief at pp. 46-55. Thus, the vote of *less than 5%* in amount of the claims against Scopac effectively marginalized the "no" vote of the *95%* held by Noteholders.

Thus, MRC/Marathon perpetrated the very "abuse of creditors" which now-Justice Alito warned can result from a gerrymandered classification scheme "designed to secure approval by an arbitrarily designed class of impaired claims even though the overwhelming sentiment of the impaired creditors was that the proposed reorganization of the debtor would not service any legitimate purpose." *John Hancock Mut. Life Ins. v. Route 37 Bus. Park*, 987 F.2d 154, 158 (3d. Cir. 1993). Such an "abuse" undermines the integrity of the plan confirmation process and should not go unreviewed. *See generally, In re Boston Post Rd. Ltd. P'ship*, 21 F.3d 477, 483 (1st Cir. 1994) ("Approving a plan that aims to disenfranchise the overwhelming largest creditor through artificial classification is simply inconsistent with the principles underlying the Bankruptcy Code").

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[19] The Plan paid this class $37.4 million in principal, interest and other charges in cash, but deferred the payment of approximately $1 million in default interest – *less than 3% of this amount* – over a one-year period. Appellant-59, pg. 2; Appellant-331, p. 6.

B. Equitable Mootness Does Not Protect Parties Who Act Inequitably.

Courts take into account this kind of inequitable conduct by the parties against whom relief is sought when addressing assertions of equitable mootness.[20] In *Hilal,* this Court recognized that "equity strongly supports appellate review of [] issues" challenging the "integrity" of the conduct of the Chapter 11 case, especially when the appellees "who are no strangers to the plan . . . have been on notice of this contingent exposure since early in the confirmation process." *Hilal,* 2008 U.S. App. Lexis 14318, at *3.

The Ninth Circuit B.A.P. expressed a similar view when the appellee asserted that, because the sale could not be unwound, no appellate relief could be given concerning the related illegal lien stripping.

> DB knew or should have known all along that lien stripping might not work. So its assertion that the sale was inseparable from the lien-stripping rings hollow, as does its argument that a stay was required to avoid mootness . . . a sophisticated lender such as DB knew of the risks inherent in relying solely on Section 365(f)(5) to strip Clear Channel's lien.

In re PW, LLC, 2008 Bankr. LEXIS 1934, at *23. The court further expressed its

[20] Courts have held that equitable mootness should apply to plans involving sales, only if the purchaser can show it had proceeded in good faith. "The policy behind mootness is 'to protect the interest of a good faith purchaser . . . of the property.'" *Suter*, 504 F.3d at 986 (quoting *Onouli-Kona Land Co. v. Estate of Richards (In re Onouli-Kona Land Co.)*, 846 F.2d 1170, 1172 (9th Cir. 1988) (emphasis added)); *see also S. Pac. Transp. Co. v. Voluntary Purchasing Groups*, 246 B.R. 532 (E.D. Tex. 2000).(concluding that the appeal was not moot because none of the parties who would be affected by unwinding the plan "could be properly deemed innocent third parties who are not before the court"). Indeed, where the Bankruptcy Code expressly provides for mootness concerning orders for sales (section 363(m)) and loans (section 364(e)), it does so only if the non-debtor party acted in good faith.

reluctance to give the appellees a "review free stripping of . . . [appellant's] non-bankruptcy property rights." *Id.*

MRC/Marathon "should have known all along" that a Plan that violated the Indenture Trustee's credit bid right and the absolute priority rule, and whose confirmation depended on gerrymandering one creditor class and artificially impairing another, "might not work." The proposed remedies of re-imposing an improperly-stripped lien and ordering payment by Appellees for improperly diverting collateral proceeds and extinguishing valid claims flow precisely from the wrongs that MRC/Marathon should have known they were committing under the Plan. These remedies will simply require MRC/Marathon/HRC to pay for what they took from Noteholders illegally under the Plan.[21]

III. JUDICIAL ESTOPPEL DOES NOT APPLY

MRC/Marathon claim that Appellants are estopped from seeking any relief from this Court because, while seeking unsuccessfully to obtain a stay pending appeal from three different courts, the Appellants cautioned that MRC/Marathon would seek to substantially consummate the Plan and thereafter assert equitable mootness. Their premise is wrong and Appellees' reliance on *Hall v. GE Plastic Pacific PTE Ltd.*, 327 F.3d 391 (5th Cir. 2003) is misplaced. There, Hall's

[21] MRC/Marathon cannot complain that they would not have proceeded had they known that they or HRC would have to make these payments, or face the reimposition of a lien on the Timberlands they purchased. Having made it difficult to unwind the entire transaction by rushing to consummate their Plan when they did not have to do so, MRC/Marathon have made the lien re-imposition and payment remedies necessary and appropriate forms of relief.

statements about the past facts of his injury were irreconcilably inconsistent with his future pleadings, and convinced the court to rule in his favor on two critical motions that quickly forced a $15 million settlement. *Id.* at 396-98. Here, Appellants merely anticipated the Appellees' arguments,[22] a "position" not inconsistent with their present request for limited, partial relief, and, ultimately, were unsuccessful in their efforts to obtain a stay. *See, e.g., In re Coastal Plains, Inc.*, 179 F.3d 197, 206 (5th Cir. 1999).

In contrast to *Hall*, Appellants' only "success" was that the Bankruptcy Court gave them a few more days to seek relief than required by the automatic 10-day stay provided in Bankruptcy Rule 3020(e), before then denying any stay at all. *See Wooley v. Faulkner (In re SI Restructuring, Inc.)* 2008 WL 3974311 (no stay had been obtained for mootness purposes when a bankruptcy court had merely

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[22] Appellants argued, for instance, that "if allowed to consummate the sale, there's no doubt that [MRC/Marathon] will argue that the issues have become moot, the lands will be transferred, the regulatory hurdles will have been jumped through . . .." Tr. of July 10, 2008 Hr'g at 18:4-9; Appellants' Motion To Stay Pending Appeal, Appellant 339 at p. 75-76 ("[U]nless a stay pending appeal is granted, Marathon and MRC will quickly move to consummate the sale of Scopac's assets, and then argue that the Indenture Trustee's appeal has become moot, thereby potentially depriving the Trustee of the ability to seek complete and meaningful appellate review and eviscerating its statutory right of full appeal."); Indenture Trustee's Emergency Motion for Reconsideration of Stay and Injunction in Light of Materially Changed Circumstances, filed with this Court on July 28, 2008, at p. 15 ("Stay relief should be granted to foreclose what will surely become the Appellees' mantra to avoid complete appellate review in this case – that implementing the Plan and transferring the unique redwood timberlands at issue in this case renders the appeal equitably moot. This will arguably make any appeal equitably moot."); Reply of the Indenture Trustee to Oppositions Filed in Response to the Emergency Motion for Stay and Injunction, filed with this Court on July 22 2008, at p. 9 (stating that "where the denial of a stay pending appeal risks mooting any appeal of significant claims of error, the irreparable harm requirement is satisfied")(all above emphasis added).

ordered this 10-day automatic stay, then later denied an actual stay request).

Finally, appellate review would not result in any unfair advantage to Appellants or unfair detriment to Appellees. *See Hall*, 327 F. 3d at 399; *see also Maiz v. Virani*, 311 F.3d 334, 339 (5th Cir. 2002) (stating that this Court exercises its "discretion to apply [judicial estoppel] only when it is necessary to protect the integrity of the judicial process" and that "the equities weigh[ed] in favor of hearing [the] appeal."). Here, both the law and the "equities" support denial of the Mootness Motion.

IV. NEITHER EQUITABLE MOOTNESS NOR JUDICIAL ESTOPPEL SHOULD PRECLUDE APPELLATE REVIEW

Two years ago, Congress enacted a statute permitting direct appeals from bankruptcy courts to circuit courts. *See* 28 U.S.C. § 158(d)(2)(A); *Ad Hoc Group of Timber Noteholders v. Pac. Lumber Co. (In re Scotia Pacific Co., LLC)*, 508 F.3d 214, 219 n.4 (5th Cir. 2007). The purpose of this new jurisdictional grant was to promote greater circuit-level guidance and uniformity on important questions of bankruptcy law, a purpose contemplated by the United States Constitution. U.S. CONST. art. I, § 8, cl. 4.[23] That purpose would be frustrated were this Court, having

[23] *See Weber v. United States Tr.*, 484 F.3d 154, 158 (2d Cir. 2007) ("Congress intended [the direct appeal procedure] to facilitate our provision of guidance on pure questions of law. Among the reasons for the direct appeal amendment was widespread unhappiness at the paucity of settled bankruptcy-law precedent." (footnote omitted)); H.R. Rep. No. 109-31, at 148 (2005). Consistent with Congressional intent, *In re Scotia Pacific* has already generated substantive bankruptcy law precedent that has been relied upon by a bankruptcy court in a neighboring circuit. *See In re Webb MTN, LLC*, No. 07-32016, 2008 WL 656271 (Bankr.

found the issues presented important enough to warrant a direct appeal on an expedited briefing schedule, to dismiss it under the federal common law of equitable mootness or judicial estoppel. It will not protect the integrity of the judicial process to use judicial estoppel (or equitable mootness) to shield MRC/Marathon's Plan from appellate review. No court of appeals has dismissed a direct appeal accepted under this statute on such grounds.

The judge-made doctrine of equitable mootness[24] shields plan confirmation orders, the most important order in any chapter 11 case, from appellate review. Bankruptcy judges can effectively insulate their orders from appellate review by denying discretionary stays and permitting plan proponents to claim substantial consummation and mootness, defeating Congress's clearly expressed intent to foster the development of circuit-level bankruptcy precedent in this most important area of bankruptcy law. Just such an effort is presented in this case.

CONCLUSION

For all of the above reasons and because meaningful relief can be granted to Appellants when they prevail on the merits, the Appellees have failed to prove any basis for the application of either equitable mootness or judicial estoppel. The Court should deny the Appellees' Mootness Motion.

E.D. Tenn. Mar. 6, 2008).

[24] Sections 363(m) and 363(c) of the Bankruptcy Code provide for mootness in connection with sales and loans. There is no similar provision in section 1129 concerning plans.

Dated: September 4, 2008
Houston, Texas

Respectfully submitted,

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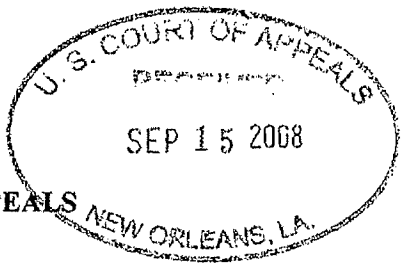
Exhibit C



No. 08-40746

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: PACIFIC LUMBER CO.; and SCOTIA PACIFIC CO. LLC, *Debtors*

BANK OF NEW YORK TRUST CO. NA, as Indenture Trustee for the Timber Notes; ANGELO GORDON & CO. LP, AURELIUS CAPITAL MANAGEMENT LP, and DAVIDSON KEMPNER CAPITAL MANAGEMENT LLC; SCOTIA PACIFIC COMPANY LLC, CSG INVESTMENTS; and SCOTIA REDWOOD FOUNDATION, INC.,
Appellants,

v.

OFFICIAL UNSECURED CREDITORS' COMMITTEE; MARATHON STRUCTURED FINANCE FUND LP; MENDOCINO REDWOOD COMPANY LLC; THE PACIFIC LUMBER CO.; UNITED STATES JUSTICE DEPARTMENT; and CALIFORNIA STATE AGENCIES,
Appellees.

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

REPLY IN SUPPORT OF MOTION OF APPELLEES MENDOCINO REDWOOD COMPANY, LLC AND MARATHON STRUCTURED FINANCE FUND L.P. TO DISMISS APPEAL BASED ON EQUITABLE MOOTNESS AND JUDICIAL ESTOPPEL

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Appellees Mendocino Redwood Company, LLC ("MRC") and Marathon Structured Finance Fund L.P. ("Marathon") respectfully submit this reply in further support of their motion to dismiss this appeal (the "Motion"). The Noteholders[1] concede that they can no longer seek complete reversal of the Confirmation Order (Excerpt-H)[2] because the three criteria for finding this appeal equitably moot are satisfied: (1) the Noteholders did not obtain a stay pending appeal; (2) the Plan has been substantially consummated; and (3) reversing the Confirmation Order would adversely affect the rights of third parties and the success of the Plan. See *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994).

Instead, in a last-ditch effort to avoid dismissal of this appeal, the Noteholders argue, for the very first time, that rather than reverse confirmation of the Plan, this Court should materially re-write the Plan to (1) impose a new $226 million lien on the Timberlands, (2) pay the Noteholders an additional $40 million in cash, and (3) excise the release provision from the Plan.

This attempt to fundamentally change the terms of the Plan fails for three different reasons. First, the Noteholders did not request such relief below. Second, this Court, like many others, has held that it will not entertain requests for material modifications to a substantially consummated reorganization plan. Third, because

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[1] "Noteholders" refers to all Appellants, including the Bank of New York as Indenture Trustee.

[2] The Record Excerpts accompanying the briefs are cited as Excerpt-#. Citations to items in the record are to R.[volume number]:[page number assigned by clerk], while citations to trial exhibits are cited by the designating party, *e.g.*, "Appellant-#."

the proposed modifications would destroy the success of the Plan and thereby injure numerous third parties — just as much as if the Confirmation Order were reversed — the appeal seeking those modifications should be dismissed as equitably moot.

A. The Court Should Not Consider the Noteholders' Requests for Plan Revisions That Were Not Sought Below.

In the Bankruptcy Court, the Noteholders did not argue that the Plan could be confirmed if modified as they now suggest. Rather they only sought denial of its confirmation. See Excerpt-G; R.17:4210-4305. The Noteholders therefore are barred from seeking such relief in this Court. See *Harris v. City of Houston*, 151 F.3d 186, 191 (5th Cir. 1998) (holding appeal moot when relief sought in complaint no longer available even though plaintiffs urged Court to "read into" complaint additional requests for relief). For this threshold reason, the Noteholders' new prayer for relief cannot save this appeal from dismissal.

B. Because the Plan Has Been Substantially Consummated, It Cannot Be Materially Modified as the Noteholders Request.

Caselaw in this Circuit makes clear that once a reorganization plan has been substantially consummated it cannot be materially modified. As this Court has said, 11 U.S.C. §1127(b) "operates to prohibit modification once 'substantial consummation' has occurred." *In re U.S. Brass Corp.*, 301 F.3d 296, 307 (5th Cir. 2002) (citation omitted). As a result, appeals that seek to materially alter the terms

of a substantially consummated plan of reorganization have consistently been dismissed as moot. For example, in dismissing the appeal as equitably moot in *In re Manges*, this Court rejected the argument that it could change one provision of the plan, stating that "[t]he Bankruptcy Code provides that a plan may not be modified or amended after substantial consummation has taken place. 11 U.S.C. §1127(b)." 29 F.3d at 1043 n.13. That ruling is controlling here.

Other decisions of this Court are in accord with *Manges*. In *In re U.S. Brass Corp.*, 169 F.3d 957, 962 (5th Cir. 1999), this Court declined to consider the appellant's "proposed day surgery" to a plan because that "would excise parts to which other vitals of the plan are attached." Similarly, in *In re Trans Marketing Houston, Inc.* 1995 WL 450204, *3 (5th Cir. July 5, 1995), this Court rejected an argument that it "could 'modify' the plan to suit [appellants'] needs" and instead found the case to be equitably moot.[3] And, in *In re Crystal Oil Co.*, 854 F.2d 79, 81 (5th Cir. 1988), this Court refused to increase the interest rate being paid to a secured creditor under a substantially consummated plan because an additional $400,000 in interest per year "is not de minimis." This Court also held that it would be unfair "to deprive Bankers Trust of the benefits it bargained for without

[3] This Court in *Trans Marketing* also noted (in footnote 4) that the creditor who was appealing lacked standing to request a modification of the plan because §1127(b) limits such power to the plan proponent or the reorganized debtor. Here, too, the Noteholders lack standing to seek modification of the Plan. See also, *e.g.*, *In re Logan Place Properties, Ltd.*, 327 B.R. 811, 813-14 (Bankr. S.D. Tex. 2005) (party who was not the plan proponent or reorganized debtor could not seek modification of a substantially consummated plan of reorganization).

giving Bankers Trust a chance to reevaluate the concessions it made to get them" and that it could not "give Bankers Trust this right without jeopardizing the entire plan." *Id.* Hence, the appeal was moot. *Id.* at 82.

Consistent with these decisions, many other courts have held that once a plan has been substantially consummated, a court simply will not entertain an appeal that seeks material modifications to it.[4]

The Noteholders point to no case, and we have found none, where a court has ordered material changes to a plan after it has been substantially consummated. The cases relied on by the Noteholders involve issues that were "[w]ithin a penumbra of the reorganization plan," where a court can grant relief without engaging in "piecemeal dismantling" of the entire Plan. *Miami Cent. Ltd. P'shp v.*

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[4] See, *e.g.*, *In re Winn-Dixie Store, Inc.*, 2008 U.S. App. LEXIS 13986, *12 (11th Cir. July 1, 2008) ("We decline ... to permit an appeal that would lead to an alteration or amendment of a substantially consummated reorganization plan.") (citing 11 U.S.C. § 1127(b)); *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 145 (2d Cir. 2005) ("Even if we could carve out appellants' claims from the nondebtor releases, we would not do so. If appellants' claims are substantial (as they urge), it is as likely as not that the bargain struck by the debtor and the released parties might have been different without the releases."); *In re Longardner & Assocs., Inc.*, 855 F.2d 455, 462 n.8 (7th Cir. 1988) ("The creditor apparently argues ... that the reorganization plan should be modified. Only the proponent, however, of a Chapter 11 reorganization plan can seek to have it modified. 11 U.S.C. §1127(b)."); *Miami Cent. Ltd. P'shp v. Bank of N.Y.*, 838 F.2d 1547, 1555 (11th Cir. 1988) ("The court will not ... allow a 'piecemeal dismantling' of a reorganization plan."); *General Elec. Cap. Corp. v. Torres Concrete Pumping Servs., Inc.*, 2004 U.S. Dist. LEXIS 7678, *11 (W.D. Tex. Apr. 16, 2004) (rejecting appellant's effort to avoid equitable mootness by urging that the plan merely be modified because "a plan may not be modified or amended after substantial completion has taken place"); *In re Best Prods. Co.*, 177 B.R. 791, 802 (S.D.N.Y. 1995) ("The relief requested by the RTC would, if granted, be tantamount to confirmation of a plan that is different than the one that was proposed by the Debtors and approved by 97% of the creditors. The court cannot adopt any modification that materially alters the plan and adversely affects a claimant's treatment.").

Bank of N.Y., 838 F.2d at 1554-55. Both *In re Hilal*, 534 F.3d 498 (5th Cir. 2008), and *In re SI Restructuring, Inc.*, 2008 U.S. App. LEXIS 18527 (5th Cir. Aug. 28, 2008), dealt with claims challenging the release or fees of professionals that were not material to the plan and did not affect the benefit of the bargain of any party in interest. Likewise, in *In re Sun Country Dev., Inc.*, 764 F.2d 406, 407 n.1 (5th Cir. 1985), the appeal merely sought to change the specific property in which the creditor had a security interest and thus did not affect a material term of the plan.

The Noteholders wholly ignore 11 U.S.C. §1127 and do not dispute that their proposed modifications to the Plan are material and would change the benefit of the bargain to MRC, Marathon, and many others. Under the authority cited above, therefore, the Noteholders' request for those material modifications is barred by §1127(b) and, hence, this appeal should be dismissed as equitably moot.

C. The Modifications Requested by the Noteholders Would Adversely Affect the Success of the Plan and the Rights of Numerous Third Parties.

Even if the Noteholders were not precluded from seeking relief that they did not request below and from seeking material modifications to a substantially consummated plan, the Noteholders' new prayer for relief would not save their appeal from equitable mootness. This is because the proposed modifications would doom the Plan to failure, just like, as the Noteholders implicitly concede, reversal of the Confirmation Order would. That would in turn directly affect the

hundreds of employees, vendors, and customers who have relied on the Plan. It would also, as demonstrated in the mootness submissions of the United States and the California State Agencies, endanger the environment. And it would deprive both MRC (a third party that was neither a creditor nor shareholder) and Marathon of the "benefits [they] bargained for" by destroying the reorganized companies into which they have just invested over half a billion dollars of new money. *In re Crystal Oil Co., supra.*

The New $226 Million Lien. The Noteholders ask this Court to impose an obligation on Humboldt Redwood Company ("HRC") ("Newco" in the Plan) to pay the Noteholders an additional $226 million and to place a lien on the Timberlands to secure payment.[5] To begin with, that would require this Court to rewrite the Plan's terms from thin air. As the Noteholders recognize (at 7 n.11), this Court would have to manufacture the terms of repayment (such as interest rate and maturity) and deal with the existing lien held by American Ag Credit securing $325 million in post-reorganization debt — a loan that would be in default if a new lien were imposed. Moreover, the added debt would cause the reorganized company to fail. The Debtors entered bankruptcy precisely because they were so

[5] Strikingly, the Noteholders are asking for a lien of $226 million even though they have already been paid $513.6 million as the fair market value of their collateral. That is, they ask to have all of their old debt secured even though their own evidence showed that they were undersecured by almost $200 million. The Noteholders' brazenness in asking this Court to grant them relief far beyond their own evidence is astonishing.

over-leveraged that they could not service their debt. R.25:6617, 6666. A central feature of the Plan is that it reduces debt to a level that is serviceable from HRC's cash flow. Appellant-638 ¶¶23, 98-99. Saddling HRC with $226 million of additional secured debt would lead to failure of the Plan and thereby adversely affect hundreds of third parties, including employees, vendors, and the public.

The Noteholders cite no case in which a court has so rewritten a plan that has been substantially consummated. Instead, the Noteholders cite *In re Sun Country Dev., Inc.*, *supra*, and *In re PW, LLC*, 391 B.R. 25 (B.A.P. 9th Cir. May 30, 2008). As shown above, *Sun Country* only held that a lien could be moved from one property to another — which would not affect the new company's finances or injure third parties — if the appeal had been successful (which it was not). By contrast, here the Noteholders seek to impose a massive new debt and lien that will swamp the reorganized company and harm many third parties.[6] Nor is *In re PW* on point. It involved a sale under 11 U.S.C. §363(f) "outside a plan of reorganization." 391 B.R. at 29. As such, the prohibition on modification of substantially consummated reorganization plans imposed by §1127 was not at issue. Further, *PW* expressly turned on the fact that re-imposing the lien would not have adversely affected any third party, since no third parties invested new money

[6] Moreover, as noted above, the Court in *Sun Country* would not have had to manufacture additional terms, because repayment terms were already part of the plan, whereas here the Court would have to make up repayment terms from whole cloth.

or took any other steps in reliance on the termination of the lien. *Id.* at 34. Here, by contrast, MRC (which has invested substantial new money) and numerous other third parties (which likewise have relied on the Plan's termination of the Noteholders' lien) would be severely prejudiced if a new $226 million lien were imposed.[7]

The New $40 Million Payment. The Noteholders also ask this Court to order that HRC pay them an additional $40 million for funds that were allegedly wrongfully paid to other creditors pursuant to the Plan. Requiring such a payment would destroy the reorganized company's finances and the Plan, as just shown, and would fundamentally change the terms on which MRC and Marathon agreed to fund the reorganization. It is not surprising, therefore, that the Noteholders do not cite any case in which a reorganized debtor or its shareholders have been ordered to pay a creditor amounts that have been paid to third parties under a substantially consummated plan. In cases such as *SI Restructuring*, *supra*; *In re Grimland, Inc.*, 243 F.3d 228 (5th Cir. 2001); *In re EDC Holding Co.*, 676 F.2d 945 (7th Cir. 1982); and *In re Int'l Environ. Dynamics, Inc.*, 718 F.2d 322 (9th Cir. 1983), the creditor sought relief against the entities that had allegedly been wrongfully paid, not the reorganized debtor. Only in *In re Chateaugay Corp.*, 10 F.3d 944 (2d Cir.

[7] Moreover, even though recent, *PW* has been widely criticized for its chilling effect on §363 sales. See, *e.g.*, John M. Trott and Erik M. North, *Clear Channel Outdoor, Inc. v. Nancy Knupfer, Chapter 11 Trustee; DB Burbank, LLC*, 2008 A.B.A. Sec. Real Prop. Tr. & Est. Law eRep., http://www.abanet.org/rpte/publications/ereport/2008/4/PTrottandNorth.pdf.

1993), did a creditor seek payments from the reorganized debtor. But there the challenged aspect of the plan had benefited the debtor at the expense of the creditor. *Id.* at 951. That is not the case here, where the Noteholders seek amounts that went to other creditors.

The Exculpation Provision. The Noteholders challenge the exculpatory provisions of the Plan that the Bankruptcy Court found were "fair, reasonable and necessary to the successful effectuation to the ... Plan" and "an integral element of the settlements and transactions incorporated into the ... Plan." Excerpt-G p.117. Challenges to releases are equitably moot when, as here, the releases are integral to a substantially consummated reorganization plan. See *In re SLI Inc.*, 2006 U.S. App. LEXIS 5188, at *9 (3d Cir. Mar. 1, 2006); *In re Metromedia Fiber Network*, 416 F.3d at 145; *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1049 (7th Cir. 1993). As in those cases, "the bargain struck" by MRC and Marathon would have been different if the Plan had not included the exculpation provision, and hence the Noteholders' challenge to that provision is equitably moot now that the Plan has been substantially consummated and MRC and Marathon have performed their side of the bargain. *In re Metromedia Fiber Network*, 416 F.3d at 145.

The cases cited by the Noteholders are not to the contrary. In *In re Continental Airlines*, 203 F.3d 203, 215 (3d Cir. 2000), there was no evidence or findings that the challenged releases "bore any relationship" to the reorganization.

And this Court's recent decision in *Hilal* rested on the need to preserve claims concerning the conduct of professionals who "bear fiduciary responsibilities" to the estate. 534 F.3d at 501. MRC and Marathon owed no fiduciary duties to the debtors or to the Noteholders. Moreover, gross negligence and willful misconduct are excluded from the exculpation provision. Excerpt H, Attachment §10.3.

D. MRC and Marathon Have Not Acted Inequitably.

The Noteholders' assertion that MRC and Marathon have acted inequitably rehashes their meritless challenges to the Plan and hence is immaterial to the issue of mootness. Two points are worth making, however. First, the undisputed evidence establishes that because of the Debtors' precarious financial condition, it was imperative that the Plan be consummated as quickly as possible. Dean Declaration ¶ 5, 67 (Exh. 1 to Motion).[8] Second, the Noteholders' charges are refuted by the Bankruptcy Court's unchallenged factual findings that the "MRC/Marathon Plan was proposed in good faith" while, in marked contrast, the Noteholders' Plan was "not proposed in good faith ...." Excerpt-G pp.112, 118.[9]

CONCLUSION

This appeal should be dismissed.

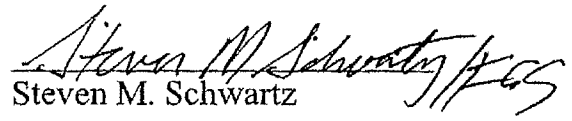
---

[8] The Noteholders argue (at 12) that they had proposed arrangements that would have maintained the status quo through 2008 while their appeal was pending, but they fail to mention that the Bankruptcy Court expressly found their proposal to be "inadequate." R.6:52, 68.

[9] The Motion also showed that the Noteholders are judicially estopped from denying that their appeal is moot. MRC and Marathon rest on the arguments made in the Motion, which already rebutted the contentions that the Noteholders now advance.

Respectfully submitted,

September 15, 2008



Steven M. Schwartz

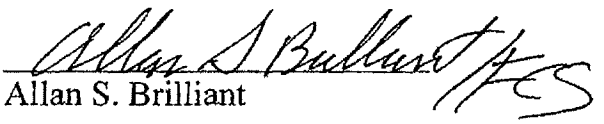


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Exhibit D

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

In re:	JOINTLY ADMINISTERED
SCOTIA DEVELOPMENT, LLC et al.,	Case No. 07-20027-C-11
Debtors.	Chapter 11

STATEMENT OF ISSUES TO BE PRESENTED
ON APPEAL FROM CONFIRMATION ORDER
[Relates to Docket Nos. 3314, 3317]

Pursuant to Rule 8006 of the Federal Rules of Bankruptcy Procedure, appellants CSG Investments, Inc. ("CSG") and Scotia Redwood Foundation, Inc. ("Scotia Redwood" and together with CSG, the "Appellants"), each holders of secured "Timber Notes" issued by debtor Scotia Pacific Company, LLC ("Scopac"), respectfully submit the following statement of the issues to be presented on and determined in their appeal from the "Judgment and Order (I): Confirming First Amended Joint Plan of Reorganization for the Debtors, as Further Modified, with Technical Amendments, Proposed by Mendocino Redwood Company, LLC, Marathon Structured Finance Fund L.P., and Official Committee of Unsecured Creditors, (II) Denying Confirmation of Indenture Trustee Plan, and (III) Denying Motion to Appoint Chapter 11 Trustee" [Dkt. No. 3302] (the "Confirmation Order"):

Issue 1: Whether the Bankruptcy Court erred as a matter of law in concluding that the First Amended Joint Plan of Reorganization for the Debtors, as Further Modified, with Technical Amendments, Proposed by Mendocino Redwood Company, LLC, Marathon Structured Finance Fund L.P., and Official Committee of Unsecured Creditors (the "Marathon/MRC Plan") satisfied the "fair and equitable" requirements of 11 U.S.C. § 1129(b);

Issue 2: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan provided Class 6 creditors the realization of the "indubitable equivalent" of their secured claims;

Issue 3: Whether the Bankruptcy Court erred as a matter of law in concluding that the Indenture Trustee had no right to "credit bid" and in holding contrary to established doctrines of statutory interpretation that the general provisions of 11 U.S.C. § 1129(b)(2)(A)(iii) control over the more specific provisions of 11 U.S.C. § 1129(b)(2)(A)(ii) with respecting to "cashing out" a secured creditor;

Issue 4: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan could cause the transfer of assets of Scopac that secured the Appellants' claims free and clear of the Appellants' claims and without providing any compensation for such transfer of assets;

Issue 5: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan did not unfairly discriminate against Class 9 claims;

Issue 6: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan satisfied 11 U.S.C. § 1129(b) and the "absolute priority" rule despite the fact that it provides for distributions of assets to junior creditors of Scopac and of Pacific Lumber Company ("Palco") (the parent company of Scopac), without first satisfying the senior claims of the holders of Timber Notes in full;

Issue 7: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan satisfied the "best interests of creditors" test set forth in 11 U.S.C. § 1129(a)(7);

Issue 8: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan did not result in a de facto and unauthorized substantive consolidation of the estates of Scotia and Palco;

Issue 9: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan's separate classification of the general unsecured claims contained in Class 8 from the general unsecured claims contained in Class 9 is permissible;

Issue 10: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan satisfied the "good faith" requirement of 11 U.S.C. § 1129(a)(3);

Issue 11: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan satisfies 11 U.S.C. § 1129(a)(9) because it does not adequately provide for payment in full of the Indenture Trustee's superpriority claim asserted under 11 U.S.C. § 507(b) and because it purports to cancel intercompany administrative claims of Scotia asserted against Palco;

Issue 12: Whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan's release provisions do not violate 11 U.S.C. §§ 1129(a)(1) and 524(e);

Issue 13: Whether the Bankruptcy Court erred in determining that the value of the Timberlands as of the Confirmation Date was only $510 million notwithstanding evidence of a "stalking horse" offer to acquire the Timberlands for $603 million;

Issue 14: Whether the Bankruptcy Court erred as a matter of law in permitting the proponents of the Marathon/MRC Plan to make material modifications to the Marathon/MRC Plan after the confirmation hearing without first re-soliciting acceptances of the modified Marathon/MRC Plan as required by 11 U.S.C. §§ 1125 and 1127 and affording secured creditors the opportunity to elect treatment under 11 U.S.C. § 1111(b);

Issue 15: Whether the Bankruptcy Court erred as a matter of law in determining that the Indenture Trustee's proposed plan of reorganization was not confirmable;

Issue 16: Whether the Bankruptcy Court erred in determining that the Indenture Trustee's proposed plan of reorganization would not be confirmed under 11 U.S.C. § 1129(c).

Issue 17: Whether the Bankruptcy Court erred as a matter of law in ruling that the failure to make an election under 11 U.S.C. § 1111(b) essentially waived any rights to credit bid under 11 U.S.C. § 1129(b)(2)(A)(ii).

Dated: July 21, 2008

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing Statement of Issues to be Presented on Appeal of Confirmation Order has been served on this the 21st day of July, 2008 to the parties on the attached service list via regular United States mail.

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Exhibit E

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

IN RE:	Civil Action No. 08-259
SCOTIA DEVELOPMENT LLC., *et. al.*,	Bankruptcy Case No. 07-20027-C11
Debtors.	

ORDER DISMISSING APPEAL

Upon consideration of the Motion of Appellees Mendocino Redwood Company, LLC ("MRC") and Marathon Structured Finance Fund L.P. ("Marathon") to dismiss this appeal (the "Motion"), any responses thereto, any reply by MRC and Marathon, and the arguments of counsel, after due deliberation and sufficient cause appearing therefore, the Court finds that notice of the Motion was proper and that the Motion should be GRANTED. It is therefore

ORDERED, that the Motion is hereby GRANTED and this appeal is hereby DISMISSED because this Court lacks subject matter jurisdiction over this appeal; and it is further

ORDERED, that even if this Court had subject matter jurisdiction over this appeal, it would dismiss this appeal as equitably moot.

Dated: _____

_____
Chief Judge Hayden Head
United States District Court