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.	:	

BRIEF FOR APPELLEES MENDOCINO REDWOOD COMPANY, LLC AND MARATHON STRUCTURED FINANCE FUND L.P.

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. Civ. P. 7.1, Mendocino Redwood Company, LLC and Marathon Structured Finance Fund L.P. state that no publicly held company owns 10% or more of their stock.

Marathon Structured Finance Fund L.P. is an affiliate of a Marathon Asset Management, LLC, ("MAM") a Delaware limited liability company that is privately held and an investment advisor registered with the SEC under the Investment Advisors Act. All of the funds that MAM advises are privately held.

All of the equity in Mendocino Redwood Company LLC is privately held.

TABLE OF CONTENTS

Page

TABLE OF CONTENTS (continued)

TABLE OF CONTENTS (continued)

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES:

STATUTES:

OTHER AUTHORITIES:

JURISDICTIONAL STATEMENT

For the reasons set forth in the Motion to Dismiss filed on November 14, 2008 by Appellees Mendocino Redwood Company LLC ("MRC") and Marathon Structured Finance Fund L.P. ("Marathon"), this Court lacks subject-matter jurisdiction over the instant appeal by the Indenture Trustee and Noteholders (collectively, "Indenture Trustee")[1] from the Bankruptcy Court's denial of the Indenture Trustee's Motion for a Superpriority Administrative Expense Claim Pursuant to Section 507(b) of the Bankruptcy Code (the "507(b) Motion").

We show in this brief that, if the Court denies the Motion to Dismiss and reaches the merits, the ruling below should be affirmed.

PRELIMINARY STATEMENT

The Cash Collateral Orders issued by the Bankruptcy Court granted the Indenture Trustee a "claim under 11 U.S.C. § 507(b) to the extent of the postpetition diminution of its respective interests in the Prepetition Collateral and the Cash Collateral." As we show herein, the Indenture Trustee's 507(b) Motion failed for three separate reasons that require affirmance of the judgment below.

First, the Bankruptcy Court correctly found as a factual matter that the Indenture Trustee received the full Petition Date value of both parts of its collateral – the Timberlands and the Cash Collateral – and thus had not suffered any post-petition diminution of its collateral.

With regard to the Timberlands, the Court examined their fair market value and expressly found that the Indenture Trustee failed to carry its burden of proving that there had been a decline in the fair market value of the Timberlands between the Petition Date (January 18, 2007) and the confirmation hearing date (June 6, 2008). That factual determination is amply supported

[1] The Indenture Trustee is the Bank of New York Mellon Trust Company, N.A. The Noteholders include Appellants Indenture Trustee, Angelo, Gordon & Co. L.P., Aurelius Capital Management, L.P., and Davidson Kempner Capital Management LLC, and CSG Investments, Inc.

by the record and thus not clearly erroneous. In particular, the record established that (1) discount rates are a far more significant driver of value in the case of the Timberlands than short-term cyclical variations in timber prices; (2) the discount rate applicable to the Timberlands had declined between the Petition Date and the confirmation hearing, thereby raising the value of the Timberlands by an amount that more than offset any reduction in value resulting from the decline in log prices; and (3) the volume of harvestable trees in the Timberlands also increased over the course of the case, thereby further increasing their value. The Bankruptcy Court also rejected the Indenture Trustee's argument that the Court had previously found, in connection with its earlier confirmation ruling, that the Timberlands' value had declined during the case.

With regard to the Cash Collateral, the Bankruptcy Court protected the Indenture Trustee against any post-petition diminution by increasing the amount due to the Indenture Trustee under the MRC/Marathon Plan by $3.6 million, resulting in a cash payment to the Indenture Trustee in an amount equal to the value of its collateral (both the Timberlands and the Cash Collateral) as of the Petition Date. To calculate the additional $3.6 million, the Bankruptcy Court started with the value of the Cash Collateral on the Petition Date, which was $48.7 million. The Court then deducted $36.2 million, which was the amount owed to Bank of America ("BofA") who had a superior security interest on the same collateral. The Court then deducted $8.9 million, which was the amount that the Indenture Trustee had already received during the bankruptcy case in the form of payment of its professionals' fees. The Indenture Trustee does not dispute the first of these deductions and the second deduction was clearly correct both factually and as a matter of bankruptcy law, as the Indenture Trustee's own counsel acknowledged on the record during the proceedings below.

Those fact-based rulings are sufficient to require that the Bankruptcy Court be affirmed, but there are two additional legal reasons why the Indenture Trustee's appeal should be rejected. First, in an effort to create an appealable issue of law, the Indenture Trustee asserts that the Bankruptcy Court erroneously made its determination that the Timberlands' value had not declined using foreclosure rather than fair market value. To the contrary, as already noted, the Bankruptcy Court in fact expressly found that the fair market value of the Timberlands had not declined. But the Bankruptcy Court also noted that caselaw holds that foreclosure value is the proper legal standard under Section 507(b) (R. 383, Dkt. 3483, pp. 23:16-25:1), and indeed the Indenture Trustee's obligation here was to show a diminution in the foreclosure value of the Timberlands. Because the Indenture Trustee adduced no evidence to show a decline in foreclosure value, the Bankruptcy Court's order denying the 507(b) motion should be affirmed for this additional reason.

Second, under Section 507(b), the Indenture Trustee had to prove not only that there was a diminution in the value of its collateral, but also that the diminution arose from the Debtor's use of the collateral during the bankruptcy case. Here the Indenture Trustee did not even argue that the Timberlands had declined in value because of their use; instead, it merely argued that their value had declined as a result of a decline in the price of logs or a general decline in the valuation of many assets. For this additional reason, the 507(b) Motion was meritless and the ruling below should be affirmed.

ISSUES PRESENTED

1. Whether the Bankruptcy Court committed clear error in finding as a fact, based on extensive live testimony and documentary evidence, that the Indenture Trustee had not proved

that the fair market value of the Timberlands had declined from the Petition Date to the confirmation hearing.

2. Whether the Bankruptcy Court failed to protect the Indenture Trustee against a decline in the value of its Cash Collateral after the Petition Date, even though it required that the MRC/Marathon Plan pay the Indenture Trustee the net value of its Cash Collateral on the Petition Date.

3. Whether the Section 507(b) motion also failed because where, as here, the creditor was seeking to liquidate the collateral, Section 507(b) required the creditor to prove a decline in the foreclosure value (rather than the fair market value) of its collateral, and here the Indenture Trustee came forward with no evidence of foreclosure value.

4. Whether the 507(b) Motion also failed because Section 507(b) only applies where the decline in the collateral's value arose from the Debtor's use of the collateral, and here the Indenture Trustee did not even argue that the supposed decline in the Timberlands' value was caused by the Debtor's use of the Timberlands.

STATEMENT OF FACTS

I. BACKGROUND

A. Scopac Issues the Timber Notes.

The Pacific Lumber Company ("Palco") owned and operated a sawmill, a cogeneration plant, and the Town of Scotia, California. R. 306, Dkt. 3088, p. 2.[2] Palco also owned 100% of the stock of Scotia Pacific Company LLC ("Scopac"). Scopac owned and operated over 200,000

[2] Citations to the items listed individually in the Index to the Record as lodged by the Clerk of the Bankruptcy Court are listed both to "R.", the record number in that Index, and to "Dkt.", the docket number in the Bankruptcy Court. Other items designed by the parties are to the number assigned in their designations: *i.e.*, "Appellant __" or "Appellee __".

acres of timberlands (the "Timberlands") consisting of redwoods, Douglas fir and other conifers in Humboldt County, California. *Id*.

In July 1998, Scopac issued $867.2 million aggregate principal amount of secured notes due at various times through June 20, 2028 (the "Timber Notes"). R. 8, Dkt. 25 ¶ 8. The Bank of New York Mellon Trust Company, N.A., served as the Indenture Trustee for the holders of Timber Notes. On July 20, 1998, Scopac also borrowed a one-year, renewable line of credit from Bank of America ("BofA"), as agent for itself and certain other lenders ("Scopac Line of Credit"). *Id*. ¶ 11. As of the Petition Date, both the Timber Notes and the Scopac Line of Credit were secured by substantially all of Scopac's assets, primarily consisting of the Timberlands and approximately $48.7 million in cash and cash equivalents (the "Cash Collateral"). *Id*. ¶ 13. The Indenture under which the Timber Notes are issued provided that the BofA claims under the Scopac Line of Credit were required to be paid in full, including postpetition interest, before the holders of Timber Notes could receive any payment. Appellant 269 § 5.3(c).

B. Scopac Files For Bankruptcy

On the Petition Date, Scopac, Palco, and other affiliated entities (collectively, the "Debtors"), filed voluntary petitions for relief pursuant to chapter 11 of Title 11 of the United States Code, 11 U.S.C. § 101, *et seq*. (the "Bankruptcy Code") with the United States Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court"). R. 306, Dkt. 3088 ¶ 3. The Debtors continued to operate their businesses and manage their properties as debtors in possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

C. The Cash Collateral Orders

Several times during the proceeding, the Bankruptcy Court entered Orders authorizing Scopac to use cash collateral in accordance with submitted budgets (the "Cash Collateral

Orders").[3] As relevant here, the Cash Collateral Orders granted to BofA and the Indenture Trustee, respectively, "a superpriority cost of administration priority claim ***under 11 U.S.C. § 507(b) to the extent of the postpetition diminution of their respective interests in the Prepetition Collateral and the Cash Collateral***." *E.g.*, R. 33, Dkt. 454 ¶ 28 (emphasis added). The Orders, however, further provided that the liens and superpriority claims "shall be subject to and subordinate to" a "Carve-Out for payment of allowed consultants and professional fees and disbursements incurred by the consultants and professionals retained, pursuant to Bankruptcy Code §§ 327 and 328, by Scopac and any committee appointed under 11 U.S.C. § 1102 ...." *Id.* ¶ 32.[4]

In issuing these Orders, the Court made clear that nothing in the orders constituted "a finding of fact or conclusion of law as to the amount, validity, enforceability, perfection, priority, or allowance" of the Indenture Trustee's claim or its collateral. *Id.* ¶ 16.

D. The Competing Reorganization Plans

After almost a year of intense proceedings, the Bankruptcy Court terminated the Debtors' exclusive period to file and solicit acceptance of a plan of reorganization. Exclusivity was terminated with respect to Marathon, which was a secured creditor of Palco, the Official Committee of Unsecured Creditors ("the Committee"), and the Indenture Trustee. Five proposed plans of reorganization were filed — a plan prepared jointly by MRC, an experienced operator of

[3] R. 8, Dkt. 25; R. 9, Dkt. 74; R. 20, Dkt. 308; R. 33, Dkt. 454; R. 67, Dkt. 863; R. 85, Dkt. 1294; R. 128, Dkt. 1784; R. 142, Dkt. 1974; R. 205, Dkt. 2485.

[4] The orders also gave BofA and the Indenture Trustee "a first priority, perfected replacement lien and security interest in all the property of Scopac of the same type as the pre-petition collateral in which BofA and the Indenture Trustee do not have a lien because of the operation of Section 552 of the Bankruptcy Code, as well as in the cash collateral of Scopac, to the extent of the postpetition diminution of its interests in the Prepetition Collateral and the Cash Collateral ...." *E.g.*, R. 33, Dkt. 454 at ¶ 28. The Court further ordered "additional adequate protection" in the form of payments equal to (1) post-petition interest (calculated at the non-default interest rate), fees, and expense payments due under the Scopac Line of Credit to BofA and (2) post-petition fees and expenses due to the Indenture Trustee under the Indenture, to the extent funds were available. *Id.* ¶ 29. The Indenture Trustee was, however, not granted interest payments or adequate protection payments measured by interest due under the Indenture in any Cash Collateral Order.

redwood timberlands in neighboring Mendocino County, and Marathon (the "MRC/Marathon Plan"); a plan filed by the Indenture (the "Indenture Trustee Plan"); and three alternative plans filed by the Debtors. The Debtors' plans were ultimately withdrawn and, thus, only the MRC/Marathon Plan and the Indenture Trustee Plan were considered for confirmation.

The MRC/Marathon Plan provided for the reorganization of both Palco and Scopac. It was accepted by more than 95% of unsecured creditors in number and more than 99% in dollar amount, excluding the Noteholders (*id.* ¶ 76) and supported by the Committee, several California State Agencies, California Governor Arnold Schwarzenegger, Congressman Mike Thompson, and a litany of political groups and environmental organizations, all of which have a vested interest in the future operations of the Timberlands. *Id.* ¶¶ 78-92. Key elements of the MRC/Marathon Plan included:

- The Debtors' commercial timberland and sawmill operations were integrated into a new entity, now referred to as Humboldt Redwood Company ("HRC").
- MRC and Marathon contributed $610 million in cash into HRC. $7.5 million of these funds are allocated to improve operations at the mill. Marathon converted its $160 million of senior secured prepetition and postpetition debt into equity.
- MRC is managing HRC in a responsible and sustainable manner pursuant to a business plan developed by MRC that assumes all environmental obligations. MRC and its affiliates are experienced and environmentally conscious operators of integrated commercial redwood timberlands, sawmill and lumber distribution businesses located in nearby Mendocino County.
- HRC assumed the Debtors' pension plan, allowing current and future retirees to receive full benefits.
- The Indenture Trustee received $513.6 million cash on account of its secured claim and will be eligible for additional distributions from a litigation trust on account of its unsecured deficiency claim. The Indenture Trustee retained any lien it has on the Headwaters Litigation (Debtors' litigation against the State of California), which was placed in a separate trust for its benefit.
- All administrative and priority claims of the Debtors will be paid in full.

- General unsecured creditors have been provided $10.6 million in cash, yielding them with substantial recoveries (estimated at 75-90%), and will be eligible for further distributions from a litigation trust. Distributions to unsecured creditors have commenced.

Id. ¶¶ 28-45, 76-91. By contrast, the Indenture Trustee Plan provided for a liquidation of Scopac and failed to provide for any resolution of Palco. R. 306, Dkt. 3088, ¶¶ 227-29.

E. The Bankruptcy Court Values the Timberlands and Makes Confirmation Findings.

The Bankruptcy Court held nine days of hearings consisting of trial testimony and argument on various dates between April 8, 2008 and May 15, 2008 (the "Confirmation Hearing") to consider confirmation of the various proposed plans. The key question in those hearings was the value of the Timberlands. Over 25 fact and expert witnesses testified and hundreds of exhibits were admitted into evidence. On June 6, 2008, the Bankruptcy Court issued Findings Of Fact And Conclusions Of Law Regarding (A) Confirmation Of MRC/Marathon Plan; (B) Denial Of Confirmation Of The Indenture Trustee Plan And (C) Denial Of The Motion To Appoint A Chapter 11 Trustee (the "Confirmation Findings"). R. 306, Dkt. 3088. Those Confirmations Findings contained detailed evaluations of the appraisal testimony. *Id.* ¶¶ 92-218. Based on the evidence, the Bankruptcy Court concluded that the value of the Timberlands as of confirmation was "not more than $510 million" and that, subject to a few technical modifications, the MRC/Marathon Plan complied with all of the requirements of the Bankruptcy Code and thus was confirmable. *Id.* pp. 61, 118. By contrast, the Court concluded that the Indenture Trustee's Plan could not be confirmed for a number of reasons, including that it had not been proposed in good faith and was not feasible. *Id.* pp. 118-19.

II. THE INDENTURE TRUSTEE'S 507(b) CLAIM

On May 1, 2008, as the Confirmation Hearing neared its end, the Indenture Trustee filed a five-page Motion to Grant Indenture Trustee a Superpriority Administrative Expense Claim

Pursuant to Section 507(b) of the Bankruptcy Code (the "507(b) Motion"). R. 258, Dkt. 2814. The 507(b) Motion asserted that the Indenture Trustee was entitled to a "superpriority administrative expense claim for the diminution of value of its collateral." *Id.* ¶ 9. No specific amount was attached to the claim except to state that it "include[d] but [was] not limited to the over $20 million in professional fees and other expenses paid by Scopac." *Id.*

It was not until a June 6, 2008 status conference, after the Bankruptcy Court had issued its Confirmation Findings, that the Indenture Trustee, for the first time, advised the Court that its 507(b) claim could exceed several hundred million dollars. R. 309, Dkt. 3108, pp. 14-15, 19-20, 25-26, 41; R. 310, Dkt. 3120, pp. 12-13. Because the parties and Court recognized that the MRC/Marathon Plan was not feasible and therefore could not be confirmed if the Indenture Trustee had a 507(b) claim of that sort, confirmation of the Plan was delayed pending resolution of the 507(b) Motion.

A. The 507(b) Hearing

Accordingly, as a part of the confirmation proceedings, the Bankruptcy Court held a hearing on the 507(b) Motion from June 30, 2008 through July 2, 2008 (the "507(b) Hearing"). The Court heard testimony from several fact and expert witnesses and received documentary evidence on the issue of whether there had been any diminution in the value of the Indenture Trustee's collateral from the Petition Date to the Confirmation hearing.

The principal issue in contention was whether the value of the Timberlands had declined since the Petition Date. Witnesses for MRC and Marathon testified that the value of the Timberlands had increased, not decreased. As more fully set forth below, Richard La Mont, whom the Court had found to be "an experienced appraiser of timberlands" and "a credible witness whose testimony deserves significant weight and whose conclusions are given great weight by the Court," testified that any decline in the Timberlands' value resulting from the

decline in log prices had been more than offset by the increase in their value resulting from the decline in the applicable discount rate and from an increase in the volume of harvestable timber. See pages 16-18 *infra*. In addition, MRC Chairman Alexander L. Dean, Jr., who has extensive experience with California redwood timberlands, similarly testified that the value of the Timberlands had increased over the course of the case due to the decline in the discount rate applicable to the Timberlands, the effect of which dwarfed the effect of the decrease in log prices. See pages 18-19 *infra*. By contrast, the Indenture Trustee offered two witnesses who opined that the Timberlands' value had declined but whose opinions suffered from numerous defects and were not accepted by the Court. See pages 19-22 *infra*.

B. The Bankruptcy Court's 507(b) Findings

On July 7, 2008, the Bankruptcy Court issued an oral ruling in which it denied the 507(b) Motion but at the same time found that the payment to the Indenture Trustee under the Plan for its secured claim should be increased from the $510 million figure set forth in the Confirmation Findings to $513.6 million to capture the value of the Cash Collateral on the Petition Date. R. 383, Dkt. 3483, p. 28:16-18. In doing so, the Court made separate findings with respect to the Timberlands and the Cash Collateral after noting that the burden of proof was on the Indenture Trustee to establish its claim. *Id.* p. 20:2-4.

With respect to the Timberlands, the Court found that the "Indenture Trustee[] failed to meet its burden of proof or provided insufficient evidence that there was any change in value to the timberlands." *Id.* p. 22:17-19. As an initial matter, the Court stated that, because "the interest that [a] secured creditor has a right to is the right to foreclose," "the case law suggests that the appropriate value to protect is the foreclosure value of the property and not the fair market value of the property." *Id.* p. 23:19-23. The Court observed that the Indenture Trustee

had come forward with "no evidence as to a decline in the foreclosure value" of its Timberlands collateral. *Id*. p. 24:23-25:2.

The Bankruptcy Court, however, did not rest its ruling the absence of evidence of a decline in the foreclosure value of the Timberlands. To the contrary, it went on to find that "even looking at the fair market value" (*id*. p. 25:1-2), the value of the Indenture Trustee's Timberlands collateral had not declined. In doing so, the Bankruptcy Court made express findings regarding the credibility of each of the witnesses and weighed the evidence that each witness presented accordingly. *Id.* pp. 17:11-19:25, 22:20-25:23. The Court found that "discount rates are a far bigger indicator of a change in value than change in the price of logs" and that the evidence showed that "the discount rate has gone down since [the bankruptcy] filing." *Id*. p. 25:13-17. Considering all of the factors, the Court found that "the value of the forests has remained relatively constant since filing," which it found to be "consistent with the long-term approach to valuing commodities like this forest whose worth is based on constantly growing timber, the unique nature of these acres in this place, and with this type of wood." *Id*. pp. 25:24-26:5.[5]

The Bankruptcy Court then examined the Cash Collateral. The Court accepted the Indenture Trustee's claim that value of the Cash Collateral was less at the time of Confirmation than on the Petition Date. *Id.* pp. 27:17-28:2. Based on the unrebutted testimony, the Court found that, on the Petition Date, the Cash Collateral that was "the security for the Indenture Trustee equaled [$]48.7 million." *Id.* p. 27:6-11.[6] In order to protect the Indenture Trustee

[5] In making this determination, the Court expressly rejected the argument that its Confirmation findings had been "tantamount to a finding that the price of the forests had declined" as being "not true." *Id.* p. 26:7-10. See pages 24-25 *infra*.

[6] The comparative balance sheets attached to the Young Proffer (Appellant 449) showed that on Petition Date Scopac had cash of $46,888,930 and accounts receivable of $1,834,401.

against any diminution in this value during the bankruptcy case, the Court determined that under the MRC/Marathon Plan, the Indenture Trustee had to receive the net value of the $48.7 million in Cash Collateral that existed as of the Petition Date.

In order to calculate that net value, the Court first deducted the $36.2 million owed on the BofA loan, which was secured by the same collateral and had priority over the Indenture Trustee. The Indenture Trustee does not dispute the propriety of this deduction. That left $12.5 million in Cash Collateral available to the Indenture Trustee as of the Petition Date. *Id*. p. 27:12-16. Second, the Court subtracted $8.9 million that Scopac had already paid to the Indenture Trustee during the case through payments made to its professionals. *Id*. p. 28:6-10. Deducting that amount from the remaining $12.5 million meant that the Indenture Trustee was entitled to receive an additional $3.6 million under the Plan to account for its interest in the Cash Collateral on the Petition Date. *Id*. The Court added that amount to the previously determined value of the Timberlands, $510 million, and ruled that the MRC/Marathon Plan could be confirmed if the Indenture Trustee was paid "a minimum of $513.6 million" on its secured claim against Scopac. *Id.* p. 28:6-18.[7] Through this analysis, the Court ensured that the Indenture Trustee received the value of its collateral on the Petition Date and therefore did not suffer any post-petition diminution that could have entitled the Indenture Trustee to a claim under Section 507(b).

The Bankruptcy Court entered an order denying the Indenture Trustee's 507(b) claim on July 8, 2008, R. 356, Dkt. 3303. On the same day, the Court also entered the Confirmation Order which provided for payment of $513.6 million to the Indenture Trustee and which confirmed the Plan based on, *inter alia*, its ruling that the "Indenture Trustee does not have

[7] Believing that there was not enough evidence regarding the claims in the so-called Headwaters Litigation, the Court had previously required that the Indenture Trustee retain any lien it may have in its proceeds. R. 306, Dkt. 3088, p. 8. The Indenture Trustee does not challenge this ruling.

507(b) superpriority administrative claim as a result of the confirmation of the MRC/Marathon Plan." R. 355, Dkt. 3302, p. 14.

STANDARD OF REVIEW

On appellate review, the Bankruptcy Court's findings of fact cannot be overturned unless clearly erroneous, and due regard must be given to the opportunity of the Bankruptcy Court to judge the credibility of the witnesses. Fed. R. Bankr. P. 8013; *see In re Webb*, 954 F.2d 1102, 1104 (5th Cir. 1992). Pursuant to the clearly erroneous standard, an appellate court "must defer to [the bankruptcy] court's findings unless, after review of all the evidence, [the appellate court is] left with a firm and definite conviction that the bankruptcy court erred." *Zielinski v. Hill (In re Hill)*, 972 F.2d 116, 118-19 (5th Cir. 1992). This standard requires an appellate court to uphold findings of fact as long as the trier of fact's "account of the evidence is plausible in light of the record viewed in its entirety," even if the appellate court is "convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently." *Anderson v. City of Bessemer City, N.C.*, 470 U.S. 564, 573-74 (1985). Conclusions of law are reviewed *de novo*. *See Drive Fin. Services, L.P. v. Jordan*, 521 F.3d 343, 346 (5th Cir. 2008).

ARGUMENT

As noted above, the Cash Collateral Orders issued by the Bankruptcy Court granted the Indenture Trustee "a superpriority cost of administration priority claim under 11 U.S.C. § 507(b) to the extent of the postpetition diminution of its respective interests in the Prepetition Collateral and the Cash Collateral." Section 507(b) of the Code, as referenced in the Orders, provides in pertinent part as follows:

> If the trustee, under section … 363 … of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section arising … from the use … of such property under

> section 363 of this title …, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

11 U.S.C. § 507(b).

Accordingly, as relevant here, the Indenture Trustee had to satisfy three criteria in order to establish a Section 507(b) superpriority claim: (1) that the debtor provided the Indenture Trustee with adequate protection of the Bankruptcy Code that ultimately proved inadequate; (2) that the Indenture Trustee has an allowable administrative expense claim pursuant to section 503(b); and (3) that the Indenture Trustee's claim arose from the use of its collateral under Section 363. *See Ford Motor Credit Co. v. Dobbins*, 35 F.3d 860, 865 (4th Cir. 1994); *In re Quality Beverage Co.*, 181 B.R. 887, 895-97 (Bankr. S.D. Tex. 1995); *In re Discount Family Boats of Texas, Inc.*, 233 B.R. 365, 371 (Bankr. E.D. Tex. 1999); *In re Lovay*, 205 B.R. 85, 87 (Bankr. E.D. Tex. 1997); 4 *Collier on Bankruptcy* ¶ 507.12[1] (15th ed. rev. 2008).

As we now show, there are three separate, independent reasons why the ruling below should be affirmed.

I. THE BANKRUPTCY COURT'S FACTUAL FINDINGS THAT (A) THE FAIR MARKET VALUE OF THE TIMBERLANDS DID NOT DECLINE DURING THE BANKRUPTCY CASE AND (B) THAT THE INDENTURE TRUSTEE RECEIVED THE FULL VALUE OF THE CASH COLLATERAL AS OF THE PETITION DATE ARE SUPPORTED BY AMPLE EVIDENCE AND HENCE NOT CLEARLY ERRONEOUS.

A. The Court's Finding That The Indenture Trustee Did Not Prove That The Timberlands Had Declined In Value Is Not Clearly Erroneous.

The Bankruptcy Court found that the "Indenture Trustee[] failed to meet its burden of proof or provided insufficient evidence that there was any change in value to the Timberlands." R. 383, Dkt. 3483, p. 22:17-19. Instead, the Court found that "the value of the forest has remained relatively constant since the filing" of the Petition. *Id.* p. 26:1-7. Attacking this finding, the Indenture Trustee argues (at 25) that the "Bankruptcy Court ignored the substantial evidence showing a decline in the value of the Timberlands" between the Petition Date and the

confirmation hearing. Ironically enough, that argument ignores the evidence in the record showing that, far from decreasing in value, the Timberlands had actually increased in value during that interval, and also ignores the Bankruptcy Court's factual findings based on that evidence. R. 383, Dkt. 3483, p. 26:6-7.

1. The Evidence Amply Supports The Factual Finding That There Was No Decline In The Value Of The Timberlands.

The Indenture Trustee's argument is based on the assertion that, because the price of logs declined from the Petition Date to the confirmation hearing, the value of the Timberlands did too. That assertion does not follow as a matter of either logic or, more importantly, record evidence. To the contrary, as we now show, the Bankruptcy Court correctly found from the evidence that (a) the increase in the Timberlands' value resulting from a decline in the applicable discount rate more than offset any effect from the drop in log prices; and (b) still other factors, including an increase in the volume of harvestable timber, also weighed against finding any decline in the value of the Timberlands.

a. The Evidence Supports The Finding That The Discount Rate Declined, Thereby Causing An Increase In The Value Of The Timberlands That More Than Offset Any Decline In Value Resulting From The Drop In Log Prices.

Contrary to the Indenture Trustee's assertion that a change in the price of logs translates into a corresponding change to the value of the Timberlands with the price of logs, the Bankruptcy Court made factual findings that "under the appropriate analysis for the value of a forest, the discount rate is a far bigger indicator of a change in value than the change in the price of the logs"; that "[s]ignificant evidence suggests that the discount rate has gone down since filing"; and that "lowering the discount rate results in a value of the forest being higher at confirmation." R. 383, Dkt. 3483, p. 25:13-22. As we now show, these findings have ample record support and hence are not clearly erroneous.

La Mont. MRC's and Marathon's principal valuation witness was Richard La Mont. Appellee 276. La Mont is the President of Resource Programming, Inc., a timber resource consulting company providing timber and timberland appraisal services, econometric forecasting, and resource based programming and database management to the forest product industry. He is a certified general appraiser licensed in California, Oregon and Washington, and since 1991 has apprised timberlands in the Pacific Northwest worth over $11 billion as part of both acquisitions and third-party valuations. He is a member of the Appraisal Institute, Society of American Appraisers and Society of American Foresters and has written numerous articles regarding timber harvest, timber supply forecasting, and forest products market analysis. *Id.* ¶¶ 6-12. In the Confirmation Findings, the Bankruptcy Court found La Mont to be "an experienced appraiser of timberlands" and a "credible witness whose testimony deserves significant weight and whose conclusions are given great weight by the Court." R. 306, Dkt. 3088, ¶¶ 132, 134.

In the 507(b) hearing, La Mont testified as to the change in the value of the Timberlands from the Petition Date to April, 30, 2008, the date of his appraisal used in connection with the Confirmation Hearing. In doing this analysis, La Mont used the same methodology that he had used to develop his April 30, 2008 appraisal but made certain adjustments to reflect circumstances as they existed on the Petition Date, including adjustments to the discount rate, log prices, and amount of harvestable timber. Appellee 276 ¶ 13. La Mont opined that, considering all of these factors, the fair market value of the Timberlands had increased by approximately $65 million from the Petition Date to April 30, 2008 and had not significantly changed thereafter. Appellee 276 ¶¶ 5, 30, 37; R. 350, Dkt. 3283, pp. 358:16-21.

La Mont determined that the relevant discount rate had fallen from the Petition Date to the confirmation hearing on the basis of his review of timberland sales between 2004 and 2007. Appellee 276 ¶ 16; R. 350, Dkt. 3283, pp. 360:6-20, 381:23-25. He then confirmed his discount rate analysis by speaking with other experts in the field and reviewing their presentations. Appellee 276 ¶¶ 17-18; R. 350, Dkt. 3283, pp. 360:21-363:20. Specifically, he testified that the appropriate discount rate for valuing the Timberlands was 8% in January 2007 was 7% in April 2008. Appellee 276 ¶¶ 17-19. La Mont explained that, notwithstanding other developments in the general economy, such as the subprime crisis, the appropriate discount rate for timberlands had declined because timberlands are "a very good hedge against all sorts of economic risk because of the inherent nature of the trees' growth; God gives you three-plus percent growth rate. And, there's a scarcity of timberlands and there is an abundance of buyers out there ...." R. 351, Dkt. 3287, p. 93:16-19. The Bankruptcy Court credited La Mont's testimony regarding the applicable discount rate, finding it was based on a "comprehensive analysis of discount rates using sales, publications, and other techniques ...." R. 383, Dkt. 3483, p. 25:18-19.

La Mont further explained that the decline in the discount rate between the Petition Date and the confirmation hearing resulted in an increase in the value of the Timberlands because it meant that future earnings are discounted less in calculating their present value. Appellee 276 ¶ 20. The effect of a change in the discount rate is particularly significant because the standard forecast period for valuing income from timberlands is 50 years. *Id.* Thus, La Mont testified that the decline in the discount rate from the Petition Date to the Confirmation Hearing had resulted in an increase in the value of the Timberlands of some $60 million. *Id.* ¶¶ 14-21, 24; R. 350, Dkt. 3283, pp. 364:17-23, 381:23-25.

La Mont further testified that this $60 million increase in value caused by the decline in the applicable discount rate far more than offset any decrease in the value of the Timberlands due to the short-term decline in timber prices. Appellee 276 ¶¶ 21, 23. Specifically, La Mont determined that the post-petition decline in timber prices would have reduced the Timberlands' fair market value by approximately $10 million. *Id*. ¶ 21.[8]

In addition, La Mont testified that the growth of trees and the reduction of regulatory restrictions on the Timberlands between the Petition Date and April 2008 had increased the Timberlands' value by another $15 million. Appellee 276 ¶¶ 5, 25-29. Combining this $15 million increase with the $60 million increase resulting from the discount rate change, and subtracting the $10 million effect of the decline in log prices, La Mont testified that the value of the Timberlands had increased between the Petition Date and April 30, 2008 by approximately $65 million. *Id*.

Dean. La Mont's testimony was supported by the testimony of Alexander L. "Sandy" Dean, Jr., Chairman of the Board of Directors of MRC and its affiliates. Dean has extensive experience in the timber industry and its economics. Appellee 275 ¶ 3. He testified that, based on his experience at MRC and his knowledge of the Debtors and industry economics, the value of the Timberlands had increased, not decreased, between January 2007 and June 2008. *Id.* ¶ 4. He said that using MRC's contemporaneous pricing assumptions and projections from January 2007, MRC's Model valued the Scopac Timberlands as of the Petition Date at $45 million less

[8] The Indenture Trustee attacks La Mont's use of Pacific Rim Wood Marketing Data. Br. pp. 29-30. La Mont, however, fully explained the basis for his pricing determinations, including why he had concluded that the Pacific Rim data "was the best representation of long-term pricing for the redwood market." R. 351, Dkt. 3287, pp. 70:2-78:10, 70:17-19. Moreover, the Court found La Mont to be a credible witness and, as noted above, also found that the increase in value resulting from the change in the discount rate dwarfed any impact resulting from a change in log prices. In a footnote (p. 29-30 n.27), the Indenture Trustee points out that Mr. La Mont erroneously described a portion of his methodology. The Bankruptcy Court determined that Mr. La Mont had simply "forgot what he had done." The Court tellingly added: "All of that goes to the weight to be given his testimony, of course, but, remember, he valued [the Timberlands] at [$]425 to 430 [million]. I didn't accept that. I found the value at [$]510 [million]" R. 128, Dkt. 3483, p. 18:11-14.

than the value that MRC had calculated in proposing the MRC/Marathon Plan in 2008. *Id.* ¶ 10; R. 336, Dkt. 3284, p. 189:7-19. He explained that, "[w]hile a modest, cyclical decline in log price (10% to 15%) has a relatively minor impact on valuation, even a minor change in the discount rate affects the present value of all future cash flows, and thus significantly changes any timberland valuation." Appellee 275 ¶ 13; *see also* R. 336, Dkt. 3284, p. 181:4-9. Indeed, a change in the discount rate "has the most significant effect on the value that MRC (or any buyer) would pay for the Scopac timberlands." *Id.* ¶ 12. In this regard, Dean testified that the discount rate used by investors to value commercial timberlands had declined since the Petition Date, resulting in higher valuations. Appellee 275 ¶ 12. Specifically, the discount rate for timberland purchases had declined by at least 1% from January 2007 to June 2008. *Id.* ¶ 14.[9] That change in the applicable discount rate – from 8% at the Petition Date to 7% at Confirmation – resulted in an increase of $65 million in the value of the Timberlands from the Petition Date to the confirmation hearing. *Id.*[10]

Fleming. At the 507(b) hearing, the Indenture Trustee principally relied upon its valuation expert, James Fleming, to support its contention that the value of the Timberlands had declined between the Petition Date and the confirmation hearing. At the confirmation hearing, Fleming had opined that the Timberlands' value on October 1, 2007 was $605 million. R. 306, Dkt. 3088, ¶ 163. The Court concluded in its detailed Confirmation Findings, however, that "Fleming's analysis has significant flaws." R. 306, Dkt. 3088, ¶¶ 139-163. Those flaws

[9] The Indenture Trustee argues that this testimony was undermined by an e-mail that Dean sent indicating that "yield" would have been lower six months previously. To the contrary, Dean testified that "yield" is the "current return that you make on an investment in one given year," while the "[d]iscount rate is the rate at which you would decrease the value of future yields to bring back to the present." R. 1336, Dkt. 3248, pp. 178:22-179:9.

[10] The Indenture Trustee wrongly argues (at 36) that Dean's projection in his testimony of a harvest of 55 million board feet (MMBF) is contrary to an e-mail he sent in 2006 where he said one might expect the harvest rate to increase "perhaps to 100 [MMBF]." Appellant 417, p. UBS672. As Dean explained without rebuttal, the e-mail was prepared in connection with a proposed purchase of Palco that ascribed no value to Scopac and was sent at a time when MRC had not performed due diligence on the Timberlands. R. 336, Dkt. 3248, p. 178:8-12.

included using a 10-year forecast model as opposed to the "typical" 50-year forecast model (*id.* ¶¶ 96, 140); not using any computerized modeling, which is "the industry standard," but instead using a simple Excel spreadsheet (*id.* ¶¶ 99, 141); and utilizing only one harvest scenario and not looking at the available geographic information system database (*id.* ¶¶ 143-44). The Court found that "Fleming was unable credibly to explain these flaws during his testimony at the Confirmation Hearing," and thus accorded "his valuation opinion ... little weight." *Id.* ¶ 164.

The Court's criticisms of his methodology notwithstanding, Fleming used the same methodology in the 507(b) hearing that he had used in his testimony in the confirmation hearing to reach his conclusion that the Timberlands were worth $646 million as of the Petition Date. Appellant 384, pp. 1-2; R. 350, Dkt. 3283, p. 124:14-18. Moreover, the only variable that Fleming changed in his 507(b) valuation from his earlier valuation was the price of timber. R. 350, Dkt. 3283, p. 120:5-8. That change resulted his opining that the value of the Timberlands had declined between the Petition Date and October 2007. Fleming acknowledged, however, that his analysis stopped as of October 1, 2007 — a full eight months prior to confirmation. He had made "no analysis" of the value of the Timberlands to assess whether there had been "a value change between October 1, 2007, and [the 507(b) hearing]." R. 350, Dkt. 3283, pp. 119:7-13, 120:5-8. As such, his testimony did not even relate to the issue presented by the Motion.

Fleming, moreover, used the same discount rate in valuing the Timberlands as he had used in valuing them in his October 2007 appraisal. R. 350, Dkt. 3283, p. 136:5-15. The discount rate he chose was the Baa corporate bond rate even though he had no knowledge about what investments were reflected in that bond rate or whether that bond rate included any timber investments. *Id.* p. 146:10-15. Moreover, he "did not look" at any trends in discount rates for timberlands inside or outside of California; nor did he look at any of the available timber indices

in determining what discount rate to use. *Id.* pp. 136:15-21, 146:16-18. Based on these facts, the Bankruptcy Court correctly rejected his discount rate on the ground that Fleming "simply used a bond chart to pick a discount rate." R. 383, Dkt. 3483, p. 25:22-23.

The Indenture Trustee argues (at 14-15) that the Bankruptcy Court must have "failed to read or simply ignored Mr. Fleming's 9-page analysis of discount rates." But the analysis in question was essentially a discussion of alternative corporate bond and treasury bond rates, with a discussion of which such rate should be selected. Appellant 384, pp. 75-81. There was no analysis of how those rates were applied in the marketplace to the purchase of large timberlands. Moreover, at the 507(b) hearing, Mr. Fleming himself agreed with counsel for the Indenture Trustee that "what [he] used in deriving the discount rate in both instances was the [Baa] bond [rate] ...." R. 350, Dkt. 3283, pp. 213:25-214:3. Furthermore, although the Indenture Trustee contends (at 10) that Fleming had "confirmed the reasonableness" of his choice of discount rates by examining published rates for other real estate investments, what he actually looked at were investments in apartment buildings, office buildings, and shopping malls. And even as to those investments, he made no effort to see if the discount rates changed between the Petition Date and the date of his analysis, October 1, 2007. *Id.* p. 158:8-24.

In short, as had been true in the Confirmation Hearing (R. 306, Dkt. 3088, ¶ 164), "Fleming was unable credibly to explain" the numerous flaws in his analysis in the 507(b) hearing.[11] Thus, the Bankruptcy Court surely did not commit clear error in not accepting Fleming's testimony that the value of the Timberlands had declined.

Radecki. The Indenture Trustee also proffered testimony from Joseph Radecki that certain macroeconomic factors should have had the affect of decreasing the value of timberlands

[11] Indeed, in his closing argument at the 507(b) hearing, counsel for the Indenture Trustee acknowledged that Mr. Fleming had not been "loquacious" in defending his opinions. R. 342, Dkt. 3274, pp. 16:25-17:4.

generally, without providing any dollar estimate as to the amount of any such alleged decline. Appellant 389. Radecki is not an economist or a financial analyst, but an investment banker specializing in financial restructuring. On cross-examination, Radecki conceded, *inter alia*, that he was not "an expert on timberlands"; he had "never previously valued timberlands"; he had never "calculated a ... discount rate used for valuing a timberland"; he "didn't call anyone who is an expert in discount rates for timberlands to find out whether discount rates in the timberland business had changed during the bankruptcy period"; he did not know "how inflation affects the value of timberlands"; he was not aware that appraisers of timberlands generally use 50-year models; he had "never done a timber harvest analysis"; and he did not know "whether the demand for purchasing timberlands has changed over the last two years ...." R. 350, Dkt. 3283, pp. 20:8-10, 21:16-18, 21:25-22:1-2, 22:12-18, 22:22-25, 25:17-20, 27:9-11, 72:5-15. Moreover, he had not looked at the timberland index of the National Council of Real Estate Investment Fiduciaries (NCREIF) (*id.* pp. 52:14-53:11) and he conceded between there was a "very low" correlation between the NCREIF timberland index, on one hand, and the S&P 500 index, the Lehman U.S. Aggregate Bond Index, and the Citigroup 3-month T-bill index, respectively, on the other (*id.* pp. 65:15-66:13). Indeed, Radecki had reviewed documents received either from counsel to the Indenture Trustee or a former colleague for only about four hours before providing a summary of his opinion. *Id.* pp. 35:22-36:2. Based on all of these admissions, the Bankruptcy Court's decision to give no weight to Radecki's testimony because he "was not able to tie [his opinion] with any specificity to this case, to this county, to the redwood forests, or this industry specifically" was well supported. R. 383, Dkt. 3483, pp. 23:13-15.

* * * * *

In sum, the record strongly supports the Court's factual findings that the applicable discount rate had declined, resulting in an increase in the Timberlands' value that more than offset the much smaller decrease in value resulting from a decline in log prices.

b. Other Factors Also Weighed Against Finding A Decline In The Value Of The Timberlands.

The CEO of Scopac, Jeffrey Barrett, testified that, in 2007, the total standing timber volume increased by more than 55.5 million board feet ("MMBF") above and beyond the 74.2 MMBF of delivered harvest. Appellant 450 ¶ 11(a); *compare* Exhibit A *with* Exhibit B; R. 351, Dkt. 3287, pp. 128:4-12. Of that 55.5 MMBF of increased timber inventory, 35.9 MMBF consisted of conifer volume, 6.8 MMBF of which was second growth redwood. Appellant 450 ¶ 11. La Mont opined that this additional growth increased the value of the Timberlands by approximately $5 to $7 million. Appellee 276 ¶ 26.

Barrett also testified that in 2007, after the Petition Date, a significant amount of additional timber was freed up from restrictions on harvesting in two watershed areas (Upper Elk and Bear River). Appellant 450 ¶¶ 21-24. This included 45.3 MMBF of redwood, the most valuable conifer species on the property. *Id.* ¶¶ 22-25. Lifting those restrictions increased the timber available for harvesting and thereby increased the value of the Timberlands as of the confirmation hearing by approximately $10 million. Appellee 276 ¶ 29.[12]

Based on this testimony, the Bankruptcy Court found that "from filing to confirmation, the forest grew so that there are more trees" and that the "tree planting and the watershed analysis did free up more areas for harvesting, which ultimately will lead to more value." R.

[12] In addition, Scopac had made capital improvements to its roads. Appellant 450 ¶¶ 27-28; R. 351, Dkt. 3287, pp. 141:45-143:12. Scopac continued to make capital improvements in 2008. Appellant 450 ¶ 29; R. 351, Dkt. 3287, pp. 141:25-143:12. In 2007, Scopac also conducted reforestation on the Timberlands in the form of replanting and vegetation management. Appellant 450 ¶¶ 30-31; R. 351, Dkt. 3287, pp. 144:17-145:11. Scopac continued to spend money on reforestation improvements in 2008. Appellant 450 ¶ 32; R. 351, Dkt. 3287, p. 144:8-16.

383, Dkt. 3483, pp. 25:1-3, 25:9-12. Likewise, the Court rejected Mr. Fleming's contrary view that there were "more trees to harvest at filing" than at the time of the confirmation hearing as being "contrary to all the testimony in this case." *Id.* p. 23:1-5. These well-supported factual findings further buttress the Bankruptcy Court's ultimate finding that Indenture Trustee failed to prove that there was a decline in the value of the Timberlands between the Petition Date and the confirmation hearing.

* * * * *

In sum, ample record evidence established that any decline in value due to log prices was more than offset by the increase in value due to both the change in the applicable discount rate and the increase in the volume of harvestable timber. For these reasons, the Bankruptcy Court's finding that Indenture Trustee failed to show that the Timberlands declined in value is not clearly erroneous and should be affirmed.

2. The Bankruptcy Court Had Not Previously Found That The Value Of The Timberlands Had Decreased Following The Petition Date.

The Indenture Trustee argues (at 19-20) that the Bankruptcy Court had previously found that the value of the Timberlands had declined during the bankruptcy case. As the Court expressly found, that argument relies on a mistaken reading of the Confirmation Findings.

a. The Court's Prior Criticism Of Mr. Fleming's Opinion.

The Indenture Trustee first argues (at 39) that because the Bankruptcy Court in its Confirmation Findings (R. 306, Dkt. 3088, ¶¶ 156-58) had criticized Mr. Fleming's testimony for not taking into account the decline in log prices between October 2007, the date of his appraisal, and the confirmation hearing more than six months later, the Court had already found that the value of the Timberlands had decreased between the Petition Date and the confirmation

hearing. *E.g.*, Br. 19-20, 38-39. But the Indenture Trustee does not even mention that the Bankruptcy Court specifically considered and rejected this argument, stating:

> The IT [Indenture Trustee] has argued that finding number 158 of my findings was tantamount to a finding that the price of the forest had declined. ***This is not true.*** To the extent the finding is unclear, the Court will clarify that this was merely pointing out the fallacy of Mr. Fleming's methodology. Because he chose to use a ten-year rather than a 50-year methodology, the initial price of the timber significantly drives the final outcome of the value. ***The Court was merely pointing out the flaw; not adopting the approach, nor was I was opining that his result was reasonable; only pointing out [a] small change in prices changes the value [in Fleming's methodology] from [$]605 to [$]452 [million].***

R. 383, Dkt. 3483, p. 26:8-19 (emphasis added).

Thus, all the Court did in its Confirmation Finding was state a further reason why it had not accepted Fleming's valuation: Fleming had used a 10-year model, rather than the 50-year model normally used in appraising timberlands; his appraisal thus was particularly sensitive to short-term, cyclical variations in price; and yet he had not taken the price decline into account in appraising the Timberlands. Put otherwise, the fact that the Court criticized Fleming for, among other things, using a log-price-sensitive model and then not taking log price changes into account does not mean that the Court made a ruling that, due to the change in log prices, the value of the Timberlands had declined. To the contrary, the Confirmation Findings did not contain any such ruling – period.

b. The Court's December 2007 Statement

The Indenture Trustee also implies that the Bankruptcy Court suggested at one point that the Timberlands were worth more than $758 million. Br. 26 (quoting R. 143, Dkt. 1984, p.86:7-16). This assertion is simply wrong.

First, the statement as quoted by the Indenture Trustee makes clear that the Court was making no finding, for the Court said: "***We don't know specifically***, although there is ***some indication***[] the value of the [forest] is way more than $758 million" (emphasis added). The

Court then added the caveat of "***[w]hether that is true or not***, I mean nobody's offered to come in and buy it yet for anything more than $758 million ...." *Id.* (emphasis added). This is, to say the least, not the language of judicial findings.

Second, the only "indication" that the Timberlands were worth more than $758 million came from the contentions of Scopac, reflecting what the Bankruptcy Court later characterized as Scopac's "terminal optimism." R. 383, Dkt. 3483, p. 19:6-7. Indeed, the Bankruptcy Court found that the valuation opinions of the Debtors' experts were entitled to "little weight." R. 306, Dkt. 3088, ¶ 218. No other party to this proceeding, including the Indenture Trustee, introduced testimony appraising the Timberlands at anything close to $758 million.

Finally, the passage quoted by the Indenture Trustee was not made on the Petition Date or anywhere near it. It was made almost a year later, on December 21, 2007, and hence it has no relevance to the 507(b) issue of whether the value of the Timberlands declined from the Petition Date to the confirmation hearing.

3. The Indenture Trustee's Attacks On The Witnesses For MRC And Marathon Are Refuted By The Court's Credibility Determinations.

Although the Indenture Trustee argues at length (at 29-34) that the witnesses for MRC and Marathon were not credible, the Bankruptcy Court – which heard the witnesses testify in open court both during the Confirmation Hearing and the 507(b) Hearing – specifically found otherwise. R. 383, Dkt. 3483, pp. 11:19-19:25. As noted above, Bankruptcy Rule 8013 provides that "due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." As we now show, the Indenture Trustee's arguments do not begin to overcome the Court's credibility findings in favor of MRC's and Marathon's witnesses.

First, even though it was produced in the normal course of extensive discovery, the Indenture Trustee trumpets (at 30) that its "uncovered" an e-mail (Appellant 437) sent by Dean

in September 2007 that supposedly shows MRC's "cynical view" as to the reliability of appraisals. The Bankruptcy Court considered the e-mail and its context as well as Dean's live testimony and found that it did not affect the Court's valuation of the Timberlands. R. 383, Dkt. 3483, pp. 12:18-13:16, 16:13-16:15.

Next, the Indenture Trustee argues (at 32-33) that Dean's e-mail of March 6, 2008 (Appellant 429) contradicts La Mont's opinion that growth of the forests had increased the Timberland's value. In that e-mail, Dean stated that an affidavit from Jeffrey Barrett, Scopac's CEO, showed that Scopac had harvested almost all of the redwood growth for the year. But La Mont's testimony as to growth in the forest included growth in Douglas fir stands, rather than redwoods. R. 351, Dkt. 3287, pp. 84:5-88:11. In any event, the Bankruptcy Court did not base its ruling that there had been no decline in the Timberlands' value on a finding that the volume of timber had increased. Instead, it found that "even after harvesting, there is either more, or, ***if you believe Sandy Dean's e-mail, there is at least as much***" timber. R. 383, Dkt. 3482. p. 23:5-8 (emphasis added).

The Indenture Trustee next asserts (at 26) that, in 2005, "an MRC affiliate indicated that it was seeking to acquire Scopac's Timberlands for in the range of $600-$700 million" (citing Appellant 263, p. 3). The cited document actually is a report prepared by UBS in 2004 when UBS was trying to solicit possible buyers for the Timberlands. Dean testified without rebuttal that MRC did not give UBS those numbers; instead, MRC made an <u>unquantified</u> expression of interest without having undertaken any due diligence at a time when Scopac was operating at a higher production level. R. 254, Dkt. 2797, pp. 190:3-192.

Finally, the Indenture Trustee asserts (at 26) that, in 2006, MRC had negotiated a "lengthy term sheet to acquire all of the equity in Palco (which would include all of Palco's

interest in Scopac), implying a valuation of $781 million for Scopac's assets." This assertion is based on testimony of Glenn Daniel, an employee of the Indenture Trustee's financial adviser (R. 257, Dkt. 2810, pp. 353:24-355:20) – testimony that the Court found to be "unreliable" in its Confirmation Findings. R. 306, Dkt. 3088, ¶ 167. Daniel testified that he was assuming that, by proposing a purchase of Palco for $20 million, MRC was implicitly valuing Scopac at least equal to the amount of its debt. To the contrary, Dean testified that MRC at the time in fact valued Scopac at "zero" because MRC had determined that Scopac was worth less than its outstanding debt and would eventually need to be reorganized. R. 336, Dkt. 3248, pp. 176:17-177:9.

4. The Bankruptcy Court Did Not Base Its Decision On Improper Hindsight.

The Indenture Trustee argues (at 34-37) that the Bankruptcy Court improperly admitted appraisal testimony that relied on "hindsight" as to the value of the Timberlands on the Petition Date. This argument is both factually and legally mistaken.

As a matter of fact, the testimony in question did not make use of hindsight. The Indenture Trustee argues first (at 34) that La Mont relied on PowerPoint presentations created in mid-2008 to support his conclusion that the discount rate had declined from the Petition Date to the confirmation hearing. In fact, La Mont made his own analysis showing a decline in the discount rate based on data from 2006 and early 2007, and merely confirmed that opinion by speaking to other experts and reviewing the PowerPoint presentations. Appellee 276 ¶¶ 16-18; R. 350, Dkt. 3283, pp. 360:6-363:20, 381:23-25. Moreover, the PowerPoints, while prepared in 2008, referenced data from 2004-2007. *See* Appellee 280; Appellee 281; Appellee 282. Using that contemporaneous data does not involve hindsight merely because the PowerPoints that compiled the data were prepared in 2008.

Second, the Indenture Trustee argues that the timber harvest rates in La Mont's and Dean's valuations were tainted by the use of after-developed evidence of Scopac's actual harvest rate. They contend (at 35-36 & n.36) that a rate of 100 MMBF should have been used because Scopac at the time of the Petition was estimating that this would be its 2007 harvest and because Scopac had previously harvested 145 MMBF and 99 MMBF in 2005 and 2006, respectively.[13] At the outset, that argument is refuted by the fact that the Indenture Trustee's own expert (Fleming) did not use a rate of 100 MMBF in his valuation, but rather used a rate of 82 MMBF. Appellant 381 ¶ 90. Moreover, the fact that La Mont and Dean did not employ Scopac's hyper-inflated projections does not mean that they used hindsight. To the contrary, as they testified, they simply obtained information as to the factors that affected the value of the Timberlands as they existed on the Petition Date. R. 351, Dkt. 3287, pp. 78:12-80:9, 374:7-377:8 (La Mont); R. 336, Dkt. 3248, p. 178:8-12 (Dean). Any person who had done an appraisal of the Timberlands as of the Petition Date would have conducted the same due diligence that led La Mont and Dean to conclude that the Timberlands could not sustain harvests at a level of 100 MMBF.

Moreover, as a matter of law, nothing forbids the use of subsequent information where it is necessary to determine the value of the item being appraised on the date in question. Indeed, the absurdity of the Indenture Trustee's legal argument that there must be an ironclad bar on any use of after-developed evidence in appraising assets is shown by the fact that its own expert, Mr. Fleming, acknowledged at the 507(b) hearing that he had no pricing data for logs as of the Petition Date in January 2007 and therefore used data from March and May of 2007. R. 350, Dkt. 3283, p. 171:4-24. Thus, under the rule now urged by the Indenture Trustee, the testimony of its only valuation expert should have been excluded.

[13] Scopac in fact harvested 74.2 MMBF in 2007. R. 195, Dkt. 2418, ¶ 5.

Indeed, the Fifth Circuit has noted that the Bankruptcy Code "leaves valuation questions to judges on a case-by-case basis." *Fin. Sec. Assurance Inc. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans Ltd. P'ship)*, 116 F.3d 790, 799 (5th Cir. 1997) (finding that "the Bankruptcy Code does not prescribe any particular method of valuing collateral"); *see also Roblin Indus., Inc. v. Ford Motor Co. (In re Roblin Indus., Inc.)*, 78 F.3d 30, 38 (2d Cir. 1996) ("The matrix within which questions of solvency and valuation exist in bankruptcy demands that there be no rigid approach taken to the subject."). In doing so, courts have declined to follow the rule that the Indenture Trustee urges of foreclosing the use of any use of after-developed evidence in appraising property. *See In re Roblin Indus., Inc.*, 78 F.3d at 37 ("[T]he ***later 1986*** appraisal of $18 million was evidence that the value of the GFM machine in ***April 1985***, even if sold in place, would have been substantially less than the earlier appraisal of $22-23 million.") (emphasis added); *In re Coated Sales, Inc.*, 144 B.R. 663, 668 (Bankr. S.D.N.Y. 1992) ("[T]he court may consider information '***originating subsequent to the transfer date if it tends to shed light on a fair and accurate assessment of the asset or liability as of the pertinent date (transfer date).***'") (emphasis added, citation omitted).

What the caselaw actually precludes is the use of *post hoc* evidence that would have required the use of "perfect hindsight" in appraising the property — that is, evidence that "was neither anticipated nor foreseeable" at the relevant time. *WRT Creditors Liquidation Trust v. WRT Bankruptcy Litig. Master File (In re WRT Energy Corp.)*, 282 B.R. 343, 383 (Bankr. W.D. La. 2001). Here, there is no published index showing the discount rate for purchases of large institutional tracks of timberlands; that rate can only be determined by after-the-fact analysis of actual transactions in the timber market.

The cases cited by the Indenture Trustee are inapposite. They involved the question of whether pre-bankruptcy transactions should be set aside because, looking in hindsight, the debtor was insolvent at the time. *See, e.g.*, *In re Heritage Org., LLC*, 375 B.R. 230, 284 (Bankr. N.D. Tex. 2007); *WRT Creditors Liquidation Trust*, 282 B.R. at 383. The context here is completely different and falls under the cases cited above.

5. The Indenture Trustee's Judicial Estoppel Argument is Meritless.

Finally, the Indenture Trustee argues (at 37-42) that MRC and Marathon should be judicially estopped from contending that the Timberlands did not decline in value over the course of the case. That argument has no basis in fact or law. MRC and Marathon never took the position in the confirmation hearing that the Timberlands' value had decreased from the Petition Date to the confirmation hearing. Likewise, as shown above, the Bankruptcy Court never made any such finding. As such, there is no basis whatsoever to judicially estop MRC and Marathon from contending in response to the 507(b) Motion that the Timberlands' value had not decreased between the Petition Date and the confirmation hearing.

B. The Bankruptcy Court Protected The Indenture Trustee Against A Post-Petition Decline In The Cash Collateral By Giving It The Value Of That Collateral As Of The Petition Date, Less Proper Deductions.

Apart from its meritless arguments about the value of the Timberlands, the Indenture Trustee also argues (at 42-46) that the Bankruptcy Court failed to protect its Cash Collateral against diminution between the Petition Date and the confirmation hearing. This argument is equally incorrect.

The Indenture Trustee acknowledges (at 43) that Cash Collateral was $48.7 million on the Petition Date – as the evidence showed. See Appellant 449 (attaching Dkt. 3192, p. 2). Accepting the Indenture Trustee's assertion that the amount of the Cash Collateral had declined from the Petition Date to the confirmation hearing, the Bankruptcy Court protected the Indenture

Trustee against any such decline. The Court did so by calculating the amount that the Indenture Trustee had to receive under the MRC/Marathon Plan based on the net value of the $48.7 million in Petition Date Cash Collateral. R. 383, Dkt. 3483, p. 27:3-28:14. Specifically, the Bankruptcy Court calculated how much of that $48.7 million Petition Date value was due to the Indenture Trustee under the MRC/Marathon Plan, ignoring any decline in value during the bankruptcy case and thereby protecting the Indenture Trustee against any diminution in the amount of the Cash Collateral after that Petition Date.

In performing that calculation, the Court properly made two deductions. First, because BofA's $36.2 million claim was secured by the same collateral and had priority in payment, the Bankruptcy Court deducted that amount, leaving the Indenture Trustee entitled to $12.5 million of the $48.7 million. *Id.* p. 27:12-16. The Indenture Trustee does not challenge this deduction.

Second, the Court ruled that the $12.5 million figure had to be reduced to account for the $8.9 million that Scopac had already paid to the Indenture Trustee for its professionals' fees during the case. *Id.* at 28:6-28:10. Put otherwise, although the Indenture Trustee was entitled to receive $12.5 million to reflect its interest in the Cash Collateral as of the Petition Date, that amount was offset by the $8.9 million that the Indenture Trustee had already been paid by the Debtors. Subtracting the $8.9 million from the $12.5 million in Cash Collateral, the Court correctly determined that the Indenture Trustee had to be paid an additional $3.6 million under the MRC/Marathon Plan to account for its net interest in the Cash Collateral as of the Petition Date. *Id.* Accordingly, the Confirmation Order was modified to increase the amount due to the Indenture Trustee on its secured claim from $510 million (the value of the Timberlands as found by the Bankruptcy Court) to $513.6 million. *Id.*

It is clear that the Bankruptcy Court was right in holding that the $8.9 million amount previously paid for the Indenture Trustee's professionals' fees had to be deducted from the amount to be paid to the Indenture Trustee. The Indenture Trustee would have been entitled to the payment of its legal fees by the Scopac estate *only if* it had proved that it was oversecured — that is, that the value of the collateral securing its claim was greater than the amount of its claim. *See* 11 U.S.C. § 506(b). The Indenture Trustee acknowledges (at 4-5) that the reverse is true — that the amount it was allegedly owed ($740 million) far exceeded the value of its collateral as found by the Bankruptcy Court ($510 million for the Timberlands and $48.7 million for the Cash Collateral).[14] In fact, counsel for the Indenture Trustee acknowledged before the Bankruptcy Court that the Indenture Trustee was not entitled to payment of its legal fees unless it could prove that it had been oversecured. On July 3, 2007, the following colloquy took place:

> Mr. Clement: ... If we're found to be undersecured, then we will simply have had these fees paid out of collateral. And given the existing state of the law, it will be difficult to add those fees that were paid out of collateral to the overall size of the claim in the undersecured setting. We understand both of those.
>
> The Court: Okay. ***And you're saying by that that your clients have agreed that to the extent that they are undersecured, then your fees come out of their collateral***.
>
> Mr. Clement: ***That is the understanding that I think all parties involved here have,*** is that if we're oversecured, the amount of these fees get added to the claim. And ***if we're undersecured the amount of these fees will have paid out of our client's collateral in all likelihood***.

R.73, Dkt. 1067, pp. 11:24-12:12 (emphasis added). That was a correct statement of the law, and any effort by the Indenture Trustees to argue otherwise is meritless.[15]

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[14] Indeed, the Indenture Trustee was undersecured even under its own expert's Petition Date valuation of the Timberlands at $646 million.

[15] In addition, the plain language of the cash collateral orders establishes that the payment of fees and expenses to the Indenture Trustee was provided "as additional adequate protection," and not as an entitlement under section 506(b). *See e.g.*, R. 33, Dkt. 454. Thus, it is clear that the Indenture Trustee's professional fees must be either disgorged or deducted from its collateral. *See, e.g.*, *Confederation Life Ins. Co. v. Beau Rivage Ltd.*, 126 B.R. 632, 640 (N.D. Ga. 1991) (undersecured creditors whose collateral has not depreciated over the course of the case

The Indenture Trustee complains (at 44-45) that the $8.9 million had been paid from proceeds generated by the Cash Collateral during the case, and hence should not have been subtracted from the Cash Collateral itself. As a threshold matter, however, the Indenture Trustee did not argue that it was entitled to operating income as "proceeds of collateral" in support of its 507(b) claim in the Bankruptcy Court, and thus this argument cannot be raised on appeal. Indeed, the Indenture Trustee specifically acknowledged in the court below that the fees paid to its professionals should be subtracted from its cash collateral. R. 328, Dkt. 3211, ¶ 12.

Moreover, as the Indenture Trustee's own brief admits (at 45), "nearly all of this cash" – the operating income or so-called proceeds – was used to pay estate professionals over the course of the bankruptcy case. The payment of such professionals was entirely proper, because the Cash Collateral Orders contained a "Carve-Out" that expressly provided that payment to those professionals would take priority over any payment of the Cash Collateral to the Indenture Trustee. Specifically, the Cash Collateral Orders provided that any liens and superpriority granted to the Indenture Trustee "shall be subject to and subordinate to" a "Carve-Out for payment of allowed consultants and professional fees and disbursements incurred by the consultants and professionals retained, pursuant to Bankruptcy Code §§ 327 and 328, by Scopac and any committee appointed under 11 U.S.C. § 1102 ...." *E.g.*, R. 33, Dkt. 454, ¶ 32. In addition, any other cash from operating income was properly used by the Debtors pursuant to the Cash Collateral Orders and in accordance with Court-approved budgets to fund operations and pay administrative costs of the bankruptcy case. As such, the Indenture Trustee's complaint is refuted by the very Cash Collateral Orders that are the foundation of its 507(b) Motion.

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are not entitled to adequate protection payments, and any payments made to such creditors reduce required distributions under a plan).

The Indenture Trustee's argument fails for the further reason that Section 507(b) does not entitle the Indenture Trustee to protection of the proceeds of its collateral. As the express language of the Cash Collateral Orders at issue here makes clear, Section 507(b) only protects against a post-petition decline in the value of the collateral due to the Debtor's use of the property. *See also In re Stembridge*, 394 F.3d 383, 387 (5th Cir. 2004) ("Adequate protection, properly defined, is the amount of an asset's decrease in value from the petition date") (citing *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 370 (1988)).[16] Court-approved use of cash collateral created during the case to pay administrative expenses of the estate is irrelevant for determining a 507(b) claim.

* * * * *

In summary, the Bankruptcy Court made well-supported factual findings (A) that the fair market value of the Timberlands did not decline during the bankruptcy case and (B) that the Indenture Trustee received the full value of its interest in the Cash Collateral as of the Petition Date. Because those findings are not clearly erroneous, the 507(b) Order should be affirmed.

II. THE 507(b) MOTION ALSO FAILED AS A MATTER OF LAW BECAUSE THE RELEVANT VALUE UNDER SECTION 507(b) IS FORECLOSURE VALUE AND THE INDENTURE TRUSTEE CAME FORWARD WITH NO EVIDENCE OF A DECREASE IN FORECLOSURE VALUE

As shown above, the Indenture Trustee is mistaken in asserting that the Bankruptcy Court's decision depended on its conclusion that the relevant criterion under Section 507(b) is a decline in the liquidation value of the collateral. To the contrary, the Court specifically made a fully-supported factual finding that, even if fair market value is the correct test, the Indenture Trustee failed to show a decline in the fair market value of its collateral.

[16] None of the cases cited by the Indenture Trustee (at 46) is to the contrary. They all deal with motions as to whether various legal costs should be treated as administrative claims under Section 503(b) on the ground that they benefited the bankruptcy estate. The Indenture Trustee did not establish that its professional fees were entitled to such treatment in the Bankruptcy Court, and does not argue the point here.

As we now show, however, the correct test under Section 507(b) is actually liquidation value, rather than fair market value, The Indenture Trustee, however, failed to come forward with any evidence relating to foreclosure value, and hence by definition it failed to satisfy its burden of showing a decline in foreclosure value. This provides an additional basis for affirming the Bankruptcy Court's ruling.

A. In The Circumstances Here, The Relevant Value For Section 507(B) Is Liquidation Value, Not Fair Market Value.

As the Bankruptcy Court observed, where – as here – a secured creditor asserts that it lost its right to foreclose on the collateral at the outset of the case, "the case law suggests that the appropriate value to protect is the foreclosure value and not the fair market value." R. 383, Dkt. 3483, pp. 23:20-23; 24:16-19. In particular, the Bankruptcy Court quoted the following passage from *In re Stembridge*, 287 B.R. 658, 662 (Bankr. N.D. Tex. 2002), *rev'd on other grounds*, 394 F.3d 383 (5th Cir. 2004):

> With regard to the provision of adequate protection, the secured creditor is entitled to have its interest protected against diminution by reason of the estate's ongoing possession and use of the creditor's collateral. The interest of the secured creditor is properly valued from the secured creditor's perspective. In other words, ***the secured creditor must be protected such that the total value realizable from its collateral through foreclosure does not decrease as a result of the delay imposed by the bankruptcy case*** on enforcement of its rights.

R. 336, Dkt. 2502, 23:1-11 (emphasis added). Indeed, this passage was quoted verbatim by the Indenture Trustee in its original 507(b) Motion. R. 258, Dkt. 2814, pp. 3-4. In other words, liquidation value is the appropriate measure under Section 507(b) "on the theory that the secured creditor should be granted the same value as if he had the collateral in his hands to liquidate as of the date of commencement of the proceeding." *In re Modern Warehouse, Inc.*, 74 B.R. 173, 177 (Bankr. W.D. Mo. 1987). *See also In re Johnson*, 247 B.R. 904, 910 (Bankr. S.D. Ga. 1999) ("Foreclosure value, not replacement value, should be the basis of the super priority

administrative expense claim."); *In re Ralar Distributors, Inc.*, 166 B.R. 3, 8-9 (Bankr. D. Mass. 1994) ("The value relevant for adequate protection purposes, however, is not book value. It is liquidation value realizable by the creditor."), *aff'd*, 182 B.R. 81 (D. Mass. 1995), *aff'd*, 69 F.3d 1200 (1st Cir. 1995).[17]

Notably, the Indenture Trustee does not cite any case holding that an adequate protection claim under 507(b) turns on fair market value rather than liquidation value. Instead, the Indenture Trustee relies (at 22-23) on *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), but that case is inapposite because it did not involve a valuation for purposes of Section 507(b). *Rash* held that the use of foreclosure value was inappropriate in a completely different context — namely, valuing an asset for a cram down under a chapter 13 plan in which the debtor would retain the property. *Id.* at 962. The Fifth Circuit has held that "*Rash* interprets § 506(a) ***with respect to cram-downs only***." *In re Stembridge*, 394 F.3d at 386 n.5 (emphasis added). Moreover, post-*Rash* decisions in cases involving adequate protection or 507(b) claims have continued to use foreclosure value. *See In re Stembridge*, *supra*, 287 B.R. 658; *In re Johnson*, *supra.*

B. The Indenture Trustee Failed To Come Forward With Evidence Based On Liquidation Value And Therefore Necessarily Failed To Satisfy Its Burden Of Proof.

Once it is recognized that the relevant value under Section 507(b) is liquidation value, then it necessarily follows that the judgment below must be affirmed. This is so because the Indenture Trustee admittedly failed to come forward with any evidence regarding the liquidation value of the Timberlands, and hence necessarily failed to satisfy its burden of proof on this issue.

[17] The Indenture Trustee argues (at 23 n.18) that *Ralar* is distinguishable because it was a foreclosure case. As the quote in the text shows, however, the court held that liquidation value is the relevant value for adequate protection purposes — not that liquidation value was relevant because it was a liquidation case.

The Indenture Trustee apparently made a strategic decision not to come forward with evidence of the liquidation value of the Timberlands; nothing prevented the Indenture Trustee from doing so. Indeed, at the Confirmation Hearing, MRC/Marathon presented evidence establishing the liquidation value of the Timberlands as of April 30, 2008. R. 306, Dkt. 3088, pp. 40-41.

In short, the Indenture Trustee had the burden to show a decline in the liquidation value of the Timberlands; it failed to come forward with any evidence to satisfy that burden; and that failure provides an additional, alternative basis for affirming the judgment below.

III. THE 507(b) MOTION ALSO FAILED BECAUSE IT DID NOT ESTABLISH THAT ANY SUPPOSED DECLINE IN THE VALUE OF THE TIMBERLANDS AROSE FROM THE DEBTORS' USE OF THE TIMBERLANDS.

Yet another fundamental defect in the 507(b) motion is that not only did the Indenture Trustee fail to establish that the value of the Timberlands declined, it did not even argue that the value of the Timberlands declined ***because of the Debtors' use***. As we now show, that failure was also fatal to its 507(b) Motion and provides an additional ground for affirmance.

As quoted above, Section 507(b) expressly requires the creditor to establish, among other things, that it has an administrative claim "arising … from the use … of such property under section 363" of the Bankruptcy Code. As a result, it is not enough for the creditor to establish that the collateral declined during the course of the case; instead, the creditor must also establish that the collateral was used and that the diminution in value arose from that use.

The Indenture Trustee's 507(b) claim plainly fails to satisfy this requirement. First, as set forth above, the Indenture Trustee's entire argument is that the value of the Timberlands declined due to a change in general economic conditions — specifically, a decline in the price of logs. By definition, thus, the Indenture Trustee has not established a diminution of the value of the Timberlands that arose from the Debtors' use of the Timberlands during the bankruptcy case.

Moreover, extensive caselaw makes clear that a claim for diminution will not lie for collateral that is not actually used. *See, e.g., In re Five Star Partners, L.P.*, 193 B.R. 603, 612-13 (Bankr. N.D. Ga. 1996) (holding that 503(b)(1)(A) was not satisfied where the debtor merely held title to property because collateral "left in the hands of the Debtor" does not yield any actual benefit to the estate); *see also In re Henson*, 57 F. App'x 136, 138-39 (4th Cir. 2003) (denying creditor's motion for administrative expenses under 503(b)(1)(A) where there was no evidence presented that the debtors used the collateral to operate a business or make an economic profit); *In re Stembridge*, 287 B.R. at 669 ("most courts hold that mere retention of a creditor's collateral by the estate, without actual use, does not result in any claim under section 503(b)(1)"), *rev'd on other grounds*, 394 F.3d 383 (5th Cir. 2004).[18]

Here, Scopac merely retained the vast majority of the Timberlands, without making any use of it. The Indenture Trustee came forward with no evidence to demonstrate, much less to quantify, any decline in value to that small portion of the Timberlands. Moreover, as

[18] *See also Grundy Nat'l Bank v. Rife*, 876 F.2d 361, 363-65 (4th Cir. 1989) (interpreting Section 503(b) as carrying through the "prevailing rule under the pre-1978 Bankruptcy Code," that "a debtor's estate is obligated to pay for collateral it controls and uses for the benefit of the estate"); *In re Carpet Center Leasing Co.*, 991 F.2d 682, 688 (11th Cir. 1993) (giving creditor the right to an administrative expense for the diminution in the value of its collateral because "[t]he debtor in the case at bar enjoyed more than mere potential post-petition use of collateral…the Trustee actively used [the creditor's] collateral throughout its post-petition possession"), *opinion amended by* 4 F.3d 940, 688 (11th Cir. 1993); *In re Blackwood Associates*, 153 F.3d 61, 68 (2d Cir. 1998) (holding that "[i]n essence § 507(b) means that a secured creditor has superpriority for a claim in the amount that the debtor's use of the collateral during the time of the stay diminished the value of the collateral"); *In re Subscription Television of Greater Atlanta*, 789 F.2d 1530, 1531-32 (11th Cir. 1986) (affirming the district court's decision to allow an administrative expense claim only for the 17 days during which the Trustee operated and used the creditor's services, not for the entire 60-day period during which the Trustee had the option of using the creditor's services but did not do so for 43 days); *Ford Motor Credit Co.*, 35 F.3d at 866 ("[*T*]*he mere potential of benefit to the estate is insufficient* for the claim to acquire status as an administrative expense.") (italics in original); *In re Mid Region Petroleum, Inc.*, 1 F.3d 1130, 1133 (10th Cir. 1993) (finding that a creditor is not entitled to a Section 503(b) administrative expense based on mere opportunity since "[a]lthough [the retention of the collateral was] advantageous to the trustee, it is not the type of benefit which is provided administrative expense protection because a benefit to the estate results only from use of the leased property"); *In re Lovay*, 205 B.R. at 87 ("The mere possibility of any kind of benefit to the estate does not rise to the level of an administrative expense."); *In re ICS Cybernetics, Inc.*, 111 B.R. 32, 36 (Bankr. N.D.N.Y. 1989) ("[T]he mere potential of benefit to the estate is insufficient for the claim to acquire status as an administrative expense."); *Kinnan & Kinnan Partnership v. Agristor Leasing*, 116 B.R. 162, 167 (D. Neb. 1990) (holding that debtor's control of broken equipment was insufficient to meet the test of "actual" and "necessary" under Section 503, even though the debtors "could have" used the collateral for storage or other purposes).

demonstrated in detail above, the evidence established and the Bankruptcy Court found (1) that new growth replaced all of the harvested volume, if not more, and (2) that the Timberlands were worth at least as much, if not more, as of the confirmation hearing as they were on the Petition Date.

In short, the Indenture Trustee did not even argue, much less actually prove, that the purported diminution in the value of the Timberlands arose from the Debtors' use of the Timberlands. Nor can the Indenture Trustee argue that it does not need to prove that any decrease in value was due to the use of the Timberlands because its administrative claim is based on its inability to foreclose due to the automatic stay. The Indenture Trustee never sought relief from the automatic stay. Accordingly, and as the plain terms of the Cash Collateral Orders confirm, the Indenture Trustee received protection only for a diminution caused by the use of its collateral. *See, e.g., In re Callister,* 15 B.R. 521, 533 (Bankr. D. Utah 1991). As such, this provides yet another ground for affirming the ruling below.

CONCLUSION

For the reasons stated in MRC's and Marathon's separate Motion to Dismiss, this appeal should be dismissed. If the Court reaches the merits, it should affirm the Bankruptcy Court's Order denying the Indenture Trustee's 507(b) Motion for reasons stated above.

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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