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 Davison Kempner Capital Management LLC; Scotia Pacific Company LLS, 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 Company; the United States of America; and 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

BRIEF OF APPELLEE UNITED STATES OF AMERICA

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(1) 08-40746; *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 Davison Kempner Capital Management LLC; Scotia Pacific Company LLS, 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 Company; the United States of America; and California State Agencies, -- Appellees.*

(2) The undersigned counsel of record certifies that the listed persons and entities (on the following pages) 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.

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STATEMENT REGARDING ORAL ARGUMENT

On August 5, 2008, this Court granted oral argument. On August 25, 2008, this Court scheduled oral argument for Monday, October 6, 2008.

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GLOSSARY

Bankruptcy Code	11 U.S.C. § 101 *et seq.*
Bankruptcy Court	U.S. Bankruptcy Court for the Southern District of Texas
Confirmation Findings	Bankruptcy Court Docket No. 3088
ESA	Endangered Species Act of 1973
Final Confirmation Order	Bankruptcy Court Docket. No. 3088
FWS	U.S. Fish and Wildlife Service
HCP	Habitat Conservation Plan
Marathon	Marathon Structured Finance Fund L.P.
MRC	Mendocino Redwood Company, LLC
MRC/Marathon Plan or the Reorganization Plan	The Confirmed Plan
NMFS	National Marine Fisheries Service
NMFS and FWS	Federal Wildlife Agencies
Palco	Pacific Lumber Company
Scopac	Scotia Pacific Company

The United States Department of Justice, on behalf of the U.S. Fish and Wildlife Service ("FWS") and the National Marine Fisheries Service ("NMFS"), hereby files this Brief as Appellee.

STATEMENT OF JURISDICTION

The United States accepts the statement of jurisdiction in Appellants' Opening Brief. Appellants' Br. 1.

INTEREST OF THE UNITED STATES

The Federal Wildlife Agencies (NMFS and FWS) have a focused and important interest in this appeal, as the agencies that are jointly responsible for the protection and recovery of endangered and threatened species pursuant to the Endangered Species Act ("ESA"), 16 U.S.C. §§ 1531 et seq. This case involves redwood forests and other timberlands located in northern California that were previously the assets of Debtor Scotia Pacific Company ("Scopac"), and which have now been transferred to the newly-created Humboldt Redwood Company, LLC.

Harvest of timber from these lands will invariably entail "take" of listed species. Any such "take" of listed fish and wildlife species is prohibited by the ESA and the agencies' regulations. See 16 U.S.C. § 1538(a)(1)(B) and (G). Under the regulations, "take" includes "significant habitat modification or degradation that actually kills or injures wildlife."

50 C.F.R. § 17.3 (FWS regulations); Babbitt v. Sweet Home Chapter of Communities for a Great Oregon, 515 U.S. 687, 708 (1995) (upholding this regulatory definition); see also 50 C.F.R. § 222.102 (NMFS regulations).

Under the ESA, the only way such "take" may lawfully occur in the context of timber harvesting activities on these lands is pursuant to a "Habitat Conservation Plan" ("HCP") and associated "Incidental Take Permits" issued by NMFS and FWS, pursuant to ESA section 10. See 16 U.S.C. § 1539. Debtors Scopac, Pacific Lumber Company ("Palco"), and Salmon Creek, LLC, entered into an HCP and obtained such permits. See Appellee 191 (Implementation Agreement with Regard to Habitat Conservation Plan, February, 1999).

The confirmed Reorganization Plan that is under appeal here called for the creation of "Newco" and "Townco." See Appellant 331 (Dkt. 3300). These new entities have now been created. Scopac and Palco have been dissolved, and the assets of these debtors have been transferred to the new companies. See MRC/Marathon Motion to Dismiss 3. The Company referred to in the plan as "Newco" is now the Humboldt Redwood Company, LLC. The company referred to in the plan as "Townco" is now Town of Scotia, LLC.

The Federal Wildlife Agencies have strict regulations governing the issuance or transfer of incidental take permits under the ESA. Under the FWS regulations, the Director of the FWS must deny an incidental take permit if the applicant falls within any of the specific, disqualifying factors in 50 C.F.R. § 13.21(b) and (c), and may deny the permit if the agency determines that the "applicant is not qualified" based on review of "all relevant facts or information available." 50 C.F.R. § 13.21(b)(5) and (d); see also 50 C.F.R. § 222.303(e)(1)(v) (NMFS regulations containing same requirement).

Pursuant to the confirmed Reorganization Plan, the Federal Wildlife Agencies and the newly-created companies under the plan entered into an Assignment and Assumption Agreement wherein the agencies approved the transfer from the Debtors to Humboldt Redwood Company and the Town of Scotia of the HCP and incidental take permits. This Agreement became effective July 30, 2008. See Harwood Decl. ¶ 3 (Exhibit 1).[1] As part of the HCP, roadwork, road storm-proofing, and road upgrading is required to

[1] The Harwood declaration is attached to this Brief as Exhibit 1. This is the same declaration that was also submitted to this Court as an Exhibit to the United States' Response to the MRC/Marathon Motion to Dismiss. A Copy of the Assignment and Assumption Agreement was also attached to the Motion to Dismiss, but is not resubmitted here.

prevent erosion that would harm the listed fish species. The Bankruptcy Court noted that there was an approximate $14.5 million backlog of this needed roadwork. Appellant 368 (Dkt. 3381 at 19). Any relief granted by this Court that would impair this work from going forward would involve a substantial risk of environmental harm.

Moreover, any relief granted by this Court that resulted in the unwinding of the MRC/Marathon plan would create uncertainty as to whether a new landowner (or new landowners) would even be qualified such that the Federal Wildlife Agencies could approve yet another transfer of the HCP and the ESA incidental take permits. See Harwood Decl. ¶ 4.

STATEMENT OF THE ISSUES

In their opening brief, Appellants Bank of New York Trust Company, as Indenture Trustee for the Timber Notes, and certain of the Timber Noteholders (hereinafter, "Indenture Trustee"), list eight legal issues for this Court's consideration on appeal.[2] Appellants' Br. 1-3. As a practical matter, however, the issue presented here is fundamentally that the Indenture Trustee objects to a confirmed reorganization plan under which it is to

[2] An appellant abandons all points not mentioned in its original brief. See The Piney Woods Country Life School v. Shell Oil Company, 905 F.2d 840, 854 (5th Cir. 1990); Nissho-Iwai Co. v. Occidental Crude Sales, Inc., 729 F.2d 1530, 1539 n.4 (5th Cir. 1984).

receive "a minimum of $513.6 million of the $740 million owed under the timber notes." Appellants' Br. 11.

At bottom, the Indenture Trustee's appeal is primarily a challenge to the Bankruptcy Court's factual finding of the fair market value of its collateral – the timberlands at issue here – as worth "no more than $510 million." See Appellants' Br. 15-16; Appellant 285 (Dkt. 3088, 61-63, ¶¶ 218 to 240) ("Confirmation Findings"). Thus, the primary issue presented here is really a factual question as to whether the Bankruptcy Court correctly ascertained the fair market value of the timberlands.

STATEMENT OF THE CASE

This is a direct appeal of a Final Confirmation Order entered by the United States Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court") on July 8, 2008, confirming a reorganization plan for the Debtors (primarily Palco and Scopac) proposed by Mendocino Redwood Company, LLC ("MRC"), Marathon Structured Finance Fund L.P. ("Marathon") and the Official Committee of Unsecured Creditors, and rejecting a competing plan for Scopac alone proposed by the Indenture Trustee. Appellant 332 (Dkt. 3302) ("Final Confirmation Order").

Scopac owned and operated approximately 211,000 acres of timberlands (the "Timberlands") in Humboldt County, California. Palco –

which is Scopac's parent company – owned and operated a sawmill, a cogeneration plant, and the Town of Scotia. On January 18, 2007, these Debtors filed voluntary petitions for reorganization relief. See 11 U.S.C. § 101 et seq. (the "Bankruptcy Code"). The bankruptcy cases were procedurally consolidated and jointly administered pursuant to Federal Rule of Bankruptcy Procedure 1015. See Appellant 7 (Dkt. 21). After almost a year of litigation, the Bankruptcy Court entered an order terminating the Debtors' exclusivity period and allowing for additional plans to be filed by the Indenture Trustee, Marathon, and the Creditors' Committee. See Appellant 164 (Dkt. 2004). Subsequently, the Bankruptcy Court proceedings ultimately came down to two competing reorganization plans: the "MRC/Marathon Plan" and the competing plan for Scopac alone proposed by the Indenture Trustee.

On June 6, 2008, the Bankruptcy Court issued its 119-page Findings of Fact and Conclusions of Law. Appellant 285 (Dkt. 3088) ("Confirmation Findings"). In the Confirmation Findings, the Bankruptcy Court concluded that, subject to "three technical corrections," the MRC/Marathon Plan complied with the Bankruptcy Code and was confirmable, provided that the Indenture Trustee was paid at least $510 million in cash on the effective date. Id. at 114, 119. Further, the Bankruptcy Court found that the

Indenture Trustee Plan was not confirmable under 11 U.S.C. § 1129(a)(3) and (11) because it was "not proposed in good faith" and was "not feasible." Id. at 119.

On July 8, 2008, the Bankruptcy Court entered the Final Order confirming the MRC/Marathon Plan. The Final Confirmation Order incorporates by reference the Court's June 6, 2008 Confirmation Findings. On July 9, 2008, Appellants filed notices of appeal of the Final Confirmation Order. Appellant 334, 335, 343, 344, 346 (Dkt. Nos. 3304, 3305, 3314, 3315, and 3317). The Bankruptcy Court certified a direct appeal to this Court, and this Court granted Appellants' Petition for leave to Appeal under 28 U.S.C. § 158(d).

STATEMENT OF THE FACTS

In the proceedings below, the Federal Wildlife Agencies commented favorably on the MRC/Marathon plan, and noted significant concerns and unanswered questions respecting the IT Plan. See Appellee 62 (Dkt. 2599, Federal Wildlife Agencies' Comments on and Limited Objections to Proposed Plans of Reorganization ¶ 7).

The MRC/Marathon Plan provided not only for successful reorganization of the Debtors' businesses, but also for assumption of and compliance with all environmental laws, regulations, permits, and

obligations. See Appellant 331 (Dkt. 3300, MRC/Marathon Plan §§ 2.5 and 7.13); Appellant 332 (Dkt. 3302, Final Confirmation Order, 41-42); Appellant 285 (Dkt. 3088, Confirmation Findings 16, ¶ 34). These include obligations under the ESA permits covering the approximately 211,000 acres of redwood forests and other forestlands at issue in this case. These ESA permits provide for the continued protection of the threatened and endangered species occurring on the timber lands, including the coho salmon, Chinook salmon, northern California steelhead, northern spotted owl, marbled murrelet, and the western snowy plover.

The plan proposed by the Indenture Trustee, while it purported to comply with environmental laws, did not provide similar assurances. See Appellant 175 (Dkt. 2211, Indenture Trustee Plan). The Bankruptcy Court found that the Indenture Trustee plan was designed "to effectuate a foreclosure of the Timberlands." Appellant 285 (Dkt. 3088, Confirmation Findings 118). This plan was built around a sale of the timberlands at auction to an as-yet-unknown and undetermined buyer whose capability to operate these lands in compliance with the ESA and other environmental requirements was unknown and uncertain. Thus, the Bankruptcy Court found that "there is no reasonable likelihood that the necessary regulatory approval will be obtained." Id. Likewise, the plan did not provide for the

operation of the timberlands – including their environmental stewardship – during the "10 month marketing and sale process" while the Indenture Trustee sought a buyer. Id.

The ultimate issue at the confirmation trial was the value of the timberlands. See Appellant 285 (Dkt. 3088, Confirmation Findings 8). The Bankruptcy Court's Confirmation Findings include thirty pages summarizing the substantial testimony of expert witnesses regarding the value of the timberlands. See id. 31-61. The Bankruptcy Court ultimately found the value of the timberlands to be not more than $510 million. Id. at 31.

SUMMARY OF ARGUMENT

Appellants present their challenge to the Bankruptcy Court's judgment by alleging various legal errors. However, at its core, the bulk of this appeal is nothing more than a challenge to the factual finding of the Bankruptcy Court regarding the value of the timberlands – the Indenture Trustee's collateral. This Court should reject the Indenture Trustee's challenges to the Bankruptcy Court's finding of fact regarding the fair market value of the timberlands as worth no more than $510 million, and defer to the Bankruptcy Court's determination. The evidence below fully supports the Bankruptcy Court's conclusion regarding the value of the

timberlands. This factual finding of the Bankruptcy Court is entitled to great deference from this Court. See, e.g., In re Webb, 954 F.2d 1102, 1104 (5th Cir. 1992), rehearing denied (Apr. 1, 1992).

ARGUMENT

The Indenture Trustee argues that the issues presented to this Court are legal issues subject to *de novo* review. The Federal Wildlife Agencies submit that the Indenture Trustee has gone to considerable lengths to present what is, at bottom, a challenge to a factual determination made by the Bankruptcy Court as a purported set of legal issues.

I. Standard of Review.

When directly reviewing an order of the Bankruptcy Court, this Court applies the same standard of review that would have been used by the district court: "Findings of fact are reviewed for clear error, and conclusions of law are reviewed *de novo*." Drive Financial Services, L.P. v. Jordan, 521 F.3d 343, 346 (5th Cir. 2008); Fed. R. Bankr. P. 8013. In reviewing the Bankruptcy Court's findings of fact for clear error, "due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." In re Webb, 954 F.2d at 1104. A factual finding of a bankruptcy court is clearly erroneous only if "the reviewing court on the entire evidence is left with the definite and firm conviction" that the

bankruptcy court's factual finding was in error. Id. (quoting Anderson v. City of Bessemer, 470 U.S. 564 (1985)).

II. The Bankruptcy Court Correctly Determined the Value of the Timberlands.

Appellants state that the Bankruptcy Court's finding that the fair market value of the Timberlands is "not more than $510 million" was "a valuation testified to by no expert." Appellants' Br. 15. While no expert testified to that precise value, the Indenture Trustee ignores the import of the combined expert testimony, which does support this finding.

The Confirmation Findings summarize the testimony of several expert witnesses. In particular, the Bankruptcy Court placed significant reliance on the testimony of Richard N. LaMont, the timberland valuation expert for Marathon. See Appellant 285 (Dkt. 3088, Confirmation Findings 31-41). Mr. LaMont estimated the fair market value of the Timberlands at $430 million. Id. at 31. The Court found Mr. LaMont's testimony credible and that it deserved "significant weight." Id. at 41. The Court did not find that *any* of the other expert witnesses on valuation presented testimony deserving of such weight. For example, while one of the experts for the Indenture Trustee estimated the value of the timberlands at $605 million, the Bankruptcy Court found that this testimony was flawed and that this valuation opinion was entitled to "little weight." Id. at 46.

The Bankruptcy Court thus "carefully weighed" the expert testimony, summarized in thirty pages in the Bankruptcy Court's Confirmation Findings, before reaching the conclusion that the value of the timberlands is "not more than $510 million." Id. at 61. This estimate was reasonable and well within the range of valuation testimony at trial. Cf. U.S. v. 6,162.78 Acres of Land, More or Less, 680 F.2d 396, 398 (5th Cir. 1982) (noting that, in the context of an appellate court's review of a jury's determination of value in a condemnation proceeding, the role of the reviewing court is confined to a determination as to "whether the verdict was within the range of the evidence").

In weighing the valuation testimony, the Bankruptcy Court also understood that the proper determination of the sustainable yield of timber from these lands was a critical building block of a proper valuation of them, and that the restrictions placed upon silvicultural activities on these lands by state and federal environmental laws (including the ESA) were key considerations in the sustainable yield calculus. Id. at 66-68, ¶¶ 241-248.

In summary, the Bankruptcy Court properly weighed the evidence, and determined the value of the timberlands by evaluating the significant testimony and analyses of several expert witnesses. The Bankruptcy Court's

resulting valuation of the timberlands was not "clearly erroneous" and should not be disturbed on appeal.

III. The Bankruptcy Court's Determination of the Value of the Timberlands is Consistent with the Supreme Court's *203 North La Salle Partnership* Decision.

Appellants incorrectly argue that the valuation process applied by the Bankruptcy Court "conflicts with the Supreme Court's strong preference for using markets – rather than judicial valuations – to determine value[.]" Appellants' Br. 38 citing Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 457 (1999) ("LaSalle").

The Indenture Trustee's argument is based on a flawed reading of LaSalle. In LaSalle, the Supreme Court rejected a reorganization plan that permitted a debtor's pre-bankruptcy equity holders to contribute new capital and receive ownership interests in the reorganized entity, where that opportunity was extended "exclusively to the old equity holders under a plan adopted *without consideration of alternatives*." 526 U.S. at 437 (emphasis added). Importantly, the LaSalle Court rejected a Plan that had been "crammed down" on the dissenting class, after having been proposed by the Debtor during the exclusivity period provided by 11 U.S.C. § 1121(b) and (c). Id. at 438. Fundamental to the Court's reasoning was that the plan at

issue there had been insulated both from broader market scrutiny *and from competing plan proposals*. Id. at 456.

Here, unlike in LaSalle, the Bankruptcy Court proceedings started with consideration of five plans, which were ultimately reduced to two. Indeed, the Bankruptcy Court expressly found that it only made its valuation determination "after exposure to the market," Appellant 285 (Dkt. 3088, Confirmation Findings 9), explaining that the "marketing done pre-petition, the termination of exclusivity and the various expressions of interests of other potential bidders are a sufficient market test." Id. at 115. Moreover, the Indenture Trustee could have proposed a plan that would have provided for the reorganization of all debtors, but it declined to do so. Instead, the Indenture Trustee elected to propose a plan for Scopac alone, which was not confirmable as a matter of law under 11 U.S.C. § 1129(a)(3) and (11) because it was "not proposed in good faith" and was "not feasible." Id. at 118. Nor did the Indenture Trustee challenge the finding that this plan was not confirmable in its opening brief in this appeal.

Finally, it is worthwhile to note the unique character of the working timberlands at issue here. Unlike residential real estate, which is more influenced by the subjective tastes of consumers, the Bankruptcy Court could reasonably determine the value of these timberlands based on

objective considerations, such as the value of the timber resource and the sustainable yield of timber over time. Sustainable yield, in turn, is a factor which can only be determined with reference to objective factors such as the costs associated with compliance with the environmental laws.

In summary, the approach to valuation taken by the Bankruptcy Court was appropriate here and not in conflict with the Supreme Court's decision in LaSalle.[3]

CONCLUSION

For the foregoing reasons, the United States of America respectfully asks this Court to affirm the Bankruptcy Court's Confirmation Order.

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[3] The United States also notes that this appeal is properly dismissed as equitably moot. Currently pending before this Court is the MRC/Marathon Motion to Dismiss this Appeal on equitable mootness grounds. The United States filed a response in support of this motion, explaining that this Court should dismiss this appeal as equitably moot, as any relief that would impair the substantial reliance interests on the confirmed and substantially consummated MRC/Marathon Plan is, as an equitable matter, no longer available. See, e.g., In re Manges, 29 F.3d 1034, 1039 (5th Cir. 1994), rehearing denied (Sept. 27, 1994), cert. denied, 513 U.S. 1152 (1995) (explaining that an appeal of a plan of reorganization may be deemed equitably moot based on consideration of three factors: "(i) whether a stay has been obtained; (ii) whether the plan has been 'substantially consummated,' and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan").

Dated: September 8, 2008

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, in compliance with Fed. R. App. P. 31 and 5th Cir. R. 31, the original and seven paper copies of the foregoing Brief for Appellee United States, along with one digital version on a diskette that has been scanned for viruses and is virus-free, were sent to the Court via Federal Express on September 8, 2008; and, that on this 8th day of September, 2008, I have served upon the following, by electronic mail pursuant to agreement of the parties, copies of this brief.

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the page or type-volume limitations of Fed. R. App. P. 32(a)(7) and Fifth Cir. R. 32 because, pursuant to Fed. R. App. P. 32(a)(7)(A), the brief does not exceed 30 pages, and because, pursuant to Fed. R. App. P. 32(a)(7)(C)(B), the attached Brief for the Appellee United States contains 3,153 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) because this brief has been prepared in a monospaced typeface (using 14-point Times New Roman font), using Microsoft Word 2003, and does not contain more than 10.5 characters per inch.

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