UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

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

* *

DAILY COPY
MAY 15, 2008

* *

On the 15th day of May, 2008, the above entitled and numbered cause came on to be heard before said Honorable Court, RICHARD S. SCHMIDT, United States Bankruptcy Judge, held in Corpus Christi, Nueces County, Texas.

Proceedings were reported by machine shorthand.

(COPY)

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* * * * * *

I N D E X

THE CLERK: All rise.
THE COURT: Be seated. Send in the call.
All right. Let's see. This morning we have Tom Walper.
(No response.)
THE COURT: Kevin Franta.
(No response.)
THE COURT: Andy Black.
MR. BLACK: Present, Your Honor.
THE COURT: Alan Tenebaum.
MR. TENEBAUM: Present, Your Honor.
THE COURT: Michael Neville.
(No response.)
THE COURT: Alan Gover.
MR. GOVER: Present, Your Honor.
THE COURT: Ruth Van Meter.
MS. VAN METER: Present, Your Honor.
THE COURT: Carey Schreiber.
MR. SCHREIBER: Present, Your Honor.
THE COURT: George Lamb.
MR. LAMB: Present, Your Honor.
THE COURT: Marc Pfeuffer.
MR. PFEUFFER: Here, Your Honor.
THE COURT: Eric Waters.
MR. WATERS: Present, Your Honor.
THE COURT: Ira Herman. Ira Herman.

(No response.)
THE COURT: Joli Pecht.
MS. PECHT: Present, Your Honor.
THE COURT: Erin Ross.
MS. ROSS: Present, Your Honor.
THE COURT: Edgar Washbum.
(No response.)
THE COURT: Brett Young.
MR. YOUNG: Present, Your Honor.
THE COURT: James Delaune.
(No response.)
THE COURT: Christopher Johnson.
MR. JOHNSON: Present, Your Honor.
THE COURT: Francine Montagna.
MS. MONTAGNA: Present, Your Honor.
THE COURT: Ephraim Diamond.
MR. DIAMOND: Present, Your Honor.
THE COURT: Dan Kamensky.
(No response.)
THE COURT: Frank Bacik.
SPEAKER: He'll be joining shortly, Your Honor.
THE COURT: Wendy Laubach.
MS. LAUBACH: Present, Your Honor.
THE COURT: Rocky Ho.

SPEAKER: He will be joining shortly, Your Honor.

THE COURT: John Driscoll.

MR. DRISCOLL: Here, Your Honor.

THE COURT: Jonathan Bolton.

MR. BOLTON: Present in the courtroom.

THE COURT: All right. David McLaughlin.

MR. McLAUGHLIN: Present, Your Honor.

THE COURT: Clara Strand.

MS. STRAND: Here, Your Honor.

THE COURT: Marti Murray.

MS. MURRAY: Yes, Your Honor.

THE COURT: Jacob Cherner.

MR. CHERNER: Your Honor.

THE COURT: Was that here?

MR. CHERNER: Yes.

THE COURT: Thank you. Dominic Santos.

MR. SANTOS: Present, Your Honor.

THE COURT: Todd Hanson.

MR. HANSON: Present, Your Honor.

THE COURT: Daniel Zazove.

MR. CRANE: He is not here, this is Ken Crane.

THE COURT: All right. Heather Muller.

MS. MULLER: Present, Your Honor.

THE COURT: Wei Wang.
MR. WANG: Present, Your Honor.
THE COURT: Peter Laurinaitis.
MR. LAURINAITIS: Present, Your Honor.
THE COURT: And Nathan Rushton.
MR. RUSHTON: Present, Your Honor.
THE COURT: Is there anyone I didn't call? Wait a minute, here's an extra. Francine -- they're both on here. Okay. Anyone I didn't call?
MR. BARB: Your Honor, Matthew Barb from Milbank Tweed is on.
THE COURT: All right. Matthew Barb. All right. Who else?
MR. CARRANZA: Kevin Carranza.
THE COURT: All right.
MR. HERMAN: This is Ira Herman. I don't know if you called me or not.
THE COURT: Anyone else?
MR. CRANSHAW: Your Honor, this is David Cranshaw from Morris, Manning & Martin in Atlanta representing Timberland Operating Partnership, potential purchaser.
THE COURT: All right. Anyone else? All right. In the courtroom. Starting over here.
MR. JORDAN: Your Honor, Shelby Jordan,

Pete Holzer on behalf of the Palco debtors, along with co-counsel Baker Botts, Luckey McDowell.

THE COURT: All right.

MS. COLEMAN: Good morning, Your Honor. Kathryn Coleman and Eric Fromme of Gibson, Dunn & Crutcher, along with co-counsel Kyung Lee of Diamond McCarthy for Scotia Pacific.

THE COURT: All right.

MR. FIERO: Good morning, Your Honor. John Fiero of Pachulski Stang for the Committee, along with Max Litvak.

MR. BRILLIANT: Good morning, Your Honor. Allen Brilliant and Brian Hale on behalf of Mendocino Redwoods Company.

THE COURT: All right.

MR. JONES: Good morning, Your Honor, Evan Jones of O'Melveny & Myers representing Bank of America.

MR. STERBACH: Good morning, Your Honor, Charles Sterbach for the U.S. Trustee.

MR. PASCUZZI: Good morning, Your Honor, Paul Pascuzzi for the California State Agencies.

MS. KELLER: Good morning, Your Honor, Robin Keller of the Lovells firm for Babson Capital, a noteholder.

THE COURT: All right.

MR. SPIERS: Good morning, Your Honor, Jeff Spiers for Maxxam.

MR. GREENDYKE: Good morning, Judge, Bill Greendyke of Fulbright & Jaworski on behalf of Bank of New York as Indenture Trustee. I am joined today by Zack Clement, Todd Shields, Jonathan Bolton at counsel table, and Mr. Gerber will be appearing shortly.

MR. PACHULSKI: Good morning, Your Honor, Isaac Pachulski of Stutman, Treister & Glatt appearing on behalf of Aurelias Capital Management, Davidson Kemper Capital Management and Angelo Gordon and Company, timber noteholders.

THE COURT: All right.

MR. PENN: Good morning, Your Honor, John Penn along with David Neier and Steve Schwartz on behalf of Marathon.

THE COURT: All right.

MR. JORDAN: Your Honor, let me, if I can, review for the Court what you have on the docket today and a suggestion, I believe. I have discussed this with the noteholders and I think this schedule will work. It's sort of the way it was filed, in any event.

The first thing on the docket is 2834, motion by the Palco debtors to approve a global settlement. That's the 9019 motion that's been the topic

of a couple weeks ago, the term sheet circulated at that discovery hearing last week and the hearing today.

In response to that, there are no objections except for the noteholders, that's docket No. 2889. I say that for the people on the phone so in case someone did have an objection that I missed. That's the only objection that we're aware of. The second matter, or maybe groups of matters I can -- will include these together, the Indenture Trustee in an emergency motion to reopen evidentiary record 2873. Your Honor, that starts at tab 4 in the Court's notebook.

THE COURT: All right.

MR. JORDAN: And I will offer to the Court copies of these pleadings. That starts at tab 4 and it includes what I will announce what I think will be in the notebook also in the way of proffers that have been furnished to us in the last day or this morning. It also is Indenture Trustee's expedited motion to deem modification of the trustee's plan non-material 2775. And the Indenture Trustee's expedited motion to deem additional modifications to plan nonmaterial, that's docket 2815. There is in respect to the motion to reopen evidence, three proffers that have been furnished. You should have copies of those.

THE COURT: I have not seen those. Where

are they?

MR. HOLZER: Your Honor, they came in late last night. We didn't have time to get them in our book.

THE COURT: Okay. You can hand them up. Thank you.

MR. JORDAN: What you should have is the Timber Star Operating Partnership, Your Honor. For the parties on the phone, I don't have docket numbers. Yes, I do. Just a minute. I'm sorry. The Timber Star, which was the fellow that you called in last -- two weeks ago, that's docket No. 2904. Daniel Kamensky for Lehman Brothers. I don't have a docket number for that one for the parties on the phone. Does anybody have any of those?

THE COURT: Daniel Kamensky, Red Emerson and something called a notice of interest to purchase.

MR. JORDAN: Which was the -- that's what's termed Timber Star operating partnership. I'm not sure who that is, but that's what it's titled and that was the fellow that was on the phone. Wolf, I think, is his name. So, Your Honor, what I think we have agreed we should do is first of all take the 9019 motion, next take up the motion to reopen the evidence, and third, to take the motion s to deem modifications of the plan nonmaterial in that order. It is our estimation after

talking to the noteholders that we won't spend but several hours on all of these projects and for that, Your Honor, you have a notebook and I want to be sure the parties on the phone are aware that these are the briefs that we have given to the Court, copies are given to the Court for your reading pleasure. That is the PBGC brief, the state agency California brief, Scopac's brief, the unsecured creditor's committee brief, the Marathon/Mendocino, Palco joint brief and the noteholder brief. So by my account, there are six briefs which you should have and we don't have any indication there were other pleadings filed.

MR. JONES: Your Honor, I apologize, Evan Jones for Bank of America.

THE COURT: We have a Bank of America brief also.

MR. JONES: Thank you, Your Honor.

THE COURT: But it's not really a brief.

MR. JONES: It's a very brief brief, Your Honor.

THE COURT: Go ahead, what are the name of the securities?

MR. JONES: The auction rate securities.

THE COURT: Auction rate securities, thank you.

MR. JONES: Thank you, Your Honor.
THE COURT: All right.
MR. JORDAN: Your Honor, so I think the first matter to take up would be the evidentiary portion.
THE COURT: The motions to deem the modifications immaterial are really just arguments. I don't know that you believe that the modifications are material or immaterial or not, but they're just arguments as to whether or not I should confirm their plan if they're not material. If they're not immaterial, I can't -- even if I wanted to confirm the plan, if they're immaterial, then I can confirm their plan if I want to. Isn't that right?
MR. JORDAN: You may want to clarify. There is in connection with those a declaration of William Greendyke. We don't intend to call him and cross-examine him on it.
THE COURT: But I might want to cross.
MR. GREENDYKE: I was afraid of that. We asked for the declaration to be taken notice of and we'll do whatever the Court wants with regard to that.
THE COURT: Which is fine. I'm just saying isn't that really a legal argument about it? You know, there may be some evidence that you wanted on that.
MR. GREENDYKE: Yes, correct on both

counts, whether it was resolicitation was necessary or not or whether the modifications are immaterial or not. They are legal, they don't require any evidence.

THE COURT: Got you.

MR. JORDAN: And, Your Honor, we may have remarks in closing about the sufficiency of the evidence, the declarations and that but we have no -- we certainly don't intend to put on any other --

THE COURT: So you agree to the admission of Mr. Greendyke's --

MR. JORDAN: Yes.

THE COURT: -- declaration and no one is wanting to cross-examine him?

MR. NEIER: It's very tempting, Your Honor.

THE COURT: Anyone else? All right.

MR. JORDAN: So, Your Honor, we can begin --

THE COURT: That's done then. So we're going to start now with the 9019 motion. We have the proffer of Mr. Clark.

MR. JORDAN: Gary Clark, that's right. I think we have a few minutes opening and then --

THE COURT: You want to say something about it first? Okay. Go ahead.

MR. McDOWELL: Good morning, Your Honor, Luckey McDowell with Baker Botts on behalf of Palco debtors. I would like to take about five minutes for an opening just to set the stage and then we'll put Mr. Clark on the stand, prove up his proffer and open him up for cross-examination, Your Honor.

The term sheet which is in tab 2 of the Court's notebook is a multifaceted term sheet. It has a bunch of agreements between debtors and nondebtors as well as agreements between nondebtors and nondebtors. Although it has a number of agreements, I'm going to give the Court an example of the agreements between the nondebtors. It includes releases between MRC and Maxxam, it includes a tax indemnity between Maxxam and MRC. Those type of things don't require Court approval and we are not seeking Court approval of the nondebtor agreements, agreements that don't involve the debtors today.

All we're seeking approval for today are those actions which the debtors took, and even then there are two categories of actions. One of the categories, granting the releases, requires Court approval and that's the subject of the 9019 motion. The other category of the actions that were taken by the Palco debtors, supporting a plan, withdrawing a plan, all of those types

of things that are done in the ordinary exercise of their fiduciary duties do not require Court approval, otherwise we could not have filed any of our first four plans that we filed in the case. Those are just normal exercises of duties that the debtors take.

Having limited the scope of today's hearing, Mr. Clark's testimony will provide a background to the Court of how this settlement came together. He'll talk about the compressed timetable that the parties were under, the middle -- Mr. Clark will testify that the negotiations really began in the middle of the confirmation hearings, the middle of the second week of confirmation hearings. The Court will recall that we asked for a recess on Tuesday afternoon to continue those discussions and the discussions went throughout the night at the business level, and then the following day on Wednesday, the lawyers really began their efforts, rolling up their sleeves and drafting the documents. Mr. Clark will testify that that process took all night long and that the agreement was eventually signed on the early hours of Thursday morning, May 1st.

Mr. Clark will also testify that there was -- it's a multi-party agreement, primarily one of the highlights of the agreement were the plan modifications that followed from MRC. Mr. Clark will also testify that

those plan modifications were made possible in large part by concessions that Maxxam made. One of the ones that you'll hear about today is a tax indemnity that Maxxam provided. Mr. Clark will testify that when you have a $500 plus million transaction, there's a lot of uncertainty about potential tax implications.

You will not hear testimony about what the tax liabilities are. What you're going to hear about is that no one knows what the tax liabilities are. And that created the uncertainty and that the prior plan that MRC and Marathon had proposed dealt with that uncertainty by issuing notes and reduction in the value of notes over time if those tax liabilities ever came, came to pass.

The indemnity really set the stage to allow for a full cash payment all at once because you no longer had the likelihood of a tale of some type of liability coming in the future from the tax side of things. So from MRC's perspective, they now could take the adjustment immediately up front, the risk had been removed and they were able to move forward with all cash payment. And while that was made possible by Maxxam, Maxxam was not willing to provide that indemnity without the releases that were part of this deal and that's really, when you look at the timing, that's when the Palco debtors became intimately involved in the

negotiations and the approval of the process. Giving and granting and receiving all these releases. The global piece that the parties are trying to buy. It's important to note that the releases in the settlement agreement are only between the signatories to the settlement agreement.

The agreement does not release direct claims held by third-parties. There's a third-party in Scotia that has a claim against any of these parties and it's a direct claim, that party still has that claim after this bankruptcy case to the extent that this settlement agreement is not going to change that. The settlement agreement is not part of the plan. Palco debtors, Maxxam, they are not getting releases under the plan. They are not beneficiaries of an exultation clause. Only the releases that are here are limited to the 9019 plan.

And, again, Mr. Clark will testify that the intent was to achieve global peace among all the parties that are signing this because every one of these parties has been through not just this contested fight over the last year and a half, certainly it accelerated over the last month, but Maxxam has had a history of being the defendant in allegations that oftentimes are without merit at the end of the day and Mr. Clark will testify about those. But they want to have peace. They

want to be able to walk away from this transaction and not continue to be -- I mean, to defend litigation, especially litigation that doesn't have any merit.

It's important to note the objections that were not filed to this motion. No Palco creditor filed an objection to the 9019 motion. Not only did the Committee not file an objection, the Committee actively supports the settlement motion. Scopac is not objecting to the settlement motion. The U.S. Trustee's office has not filed an objection to the 9019 motion, who by the way, the parties did consult with prior to this time and we're standing here today with no objection on file. Only the Indenture Trustee has filed a pleading. And I, standing here today, still don't know for sure if it's an objection.

Every time they file a pleading it's a place holder saying we don't know for sure, we need to explore further. They want to perhaps call additional witnesses on the stand today. I still don't know for sure whether or not they even have an objection, let alone what the basis of the objection would be. For proofing the settlement --

THE COURT: The settlement is conditioned on approval of the plan.

MR. McDOWELL: Yes, Your Honor.

THE COURT: So there is no settlement if the plan is not confirmed.

MR. McDOWELL: The releases that the Palco debtors are granting, the portion of the settlement that this Court is being asked to approve is conditioned on confirmation of the MRC/Marathon plan. If that plan is not confirmed and does not go effective, the releases never take place.

THE COURT: Okay. Is there something beyond that -- I mean, the rest of the settlement is not conditioned upon the confirmation of the plan.

MR. McDOWELL: That's right. The agreements between the nondebtors, the agreements specifies which ones become active when, but there are many agreements between the nondebtor parties that became ineffective immediately upon signing. There are other portions of the agreement, including there's a part, I believe, that has to deal with log purchases that doesn't become effective until and unless some other events happen. Those are, again, between nondebtor parties that's all I can say are old enough and ugly enough to cut their own deal and doesn't require Court approval.

Lastly, the standards for approving the 9019 motion falls within this Court's discretion. The Fifth Circuit has obviously indicated an indication that

they favor settlement stating that settlements are a normal part of the process of reorganization or desirable and a wise method of bringing to a close proceedings otherwise lengthy, complicated and costly and we certainly have had a lengthy, complicated and costly fight to date.

The question that the Court has to answer is whether or not the settlement is fair and equitable as a whole. In looking at that, cases have pointed to three things, the probability of success, complexity, duration, expense and inconvenience. And lastly, all other factors bearing on the wisdom of the compromise. And that's where I think most of the Court's inquiry on this particular 9019 motion is going to focus. And even there it gives us a couple of other ideas of what that catchall, all other factors bearing on the wisdom of the compromise really means.

First of all, is it in the best interest of the creditors giving proper difference to their reasonable views. And that's why it was very important to us to have the Committee support on the settlement. The Committee was consulted in every step of the way by all parties. And standing here -- at the time that it was signed and standing here today, the Committee continues to support the settlement as fair and

equitable. The second factor bearing on the wisdom of the compromise is was it the product of an arm's length negotiation without evidence of collusion or fraud. Those are the types of things that we have seen a little bit of mud thrown on the wall to see what sticks by the noteholders and place holder objections.

We have gone through great lengths in the proffer of Mr. Clark to address those issues. We don't believe there's anything at all that gets anywhere close to any of those elements. In fact, what Mr. Clark is going to testify is that the process was bifurcated. Anyone who had any connection with the Maxxam entities were not part of the deliberations, the Palco debtors. Palco debtors spent approximately one hour deliberating in the board meeting on whether to approve this settlement.

Mr. Clark will testify that it was an easy decision given the way the dominoes were falling at this point. And at the end of the day, I think the Palco debtors were extremely happy to be able to support a plan that is going to keep the business in place, it is going to preserve the jobs of the employees, keep the enterprise going and also pay the noteholders in cash $530 million, 74 percent of their claim off the day of their claim as of the date it was filed. That is a much

better improvement than what we were faced with a month ago where we had notes, certain adjustments based on uncertain tax plans over a long period of time.

THE COURT: I think now you're arguing the plan. All right.

MR. McDOWELL: I'm finished, Your Honor. I'd like to put Mr. Clark --

THE COURT: Well, let's see if we got -- the Committee wants to say something. Go ahead.

MR. LITVAK: Good morning. Max Litvak of Pachulski Stang on behalf of the Creditor's Committee. Just very briefly, I want to just second everything that Mr. McDowell just said. We, the Committee, are supportive of this settlement and I just want to point out the question you asked Mr. McDowell is about the releases and we were really focused on what it was that the Palco debtors were giving up in connection with the settlement. And as best as we can tell, all it is is the releases. They're releasing Maxxam. But the releases only go effective upon confirmation of the Mendocino/Marathon plan; not any plan, just the Mendocino/Marathon plan. The other aspect --

THE COURT: What kind of investigation have you done into the transfer between Palco and Maxxam?

MR. LITVAK: Your Honor, we have looked

into the transfers. Basically within the year or two prior to the bankruptcy, as best as we can tell, the bulk of the transfers relate to lump sum log sales. Basically it was sales of lumber, timber. There was nothing there that stood out from our perspective in terms of something that we could pursue that we had an interest in pursuing immediately. For instance, this is something that would have gone into the litigation trust under the Mendocino/Marathon plan. It's something that we had started looking at. We had not completed our due diligence when this settlement was before us.

THE COURT: There have been no allegations that I have seen in this court about transfer to Maxxam or upstream out of the debtors.

MR. LITVAK: Right. It was the other way around.

THE COURT: Now, there has certainly been allegations. You know, this is not evidence and it's not something I would consider but there's certainly lots of allegations about transfers that -- in other words, cutting down the forest and using the money upstream.

MR. LITVAK: That's right.

THE COURT: Now, how does this settlement impact any of those allegations or have there been any due diligence or any kind of investigation into those

kinds of issues?

MR. LITVAK: We have done some due diligence. You know, we probably would have done more, but given the timing of this settlement, based on what we found and what we have looked at, we haven't seen anything material that the Palco debtors are giving up here.

THE COURT: Okay.

MR. LITVAK: And one other thing that I would point out, and that is the Maxxam releases of Palco do go effective upon your approval of the settlement. So -- and they have substantial claims which they have asserted against Palco which are in the range of $40 million or more.

THE COURT: All right. Anyone else want to say anything? All right. Go ahead. And have you decided now, are you against the settlement?

MR. SHIELDS: Your Honor, despite their efforts to trivialize our objection, I had a hand in it before it was filed and it's not a mere place holder, it's an objection. And it may have been vague, but we had to deal with what we had to look at. And by the way, I'm Todd Shields.

THE COURT: But now you're ready to be very specific.

MR. SHIELDS: Well, I'll be as specific as I can be.

THE COURT: Okay.

MR. SHIELDS: Todd Shields, Bank of New York, Indenture Trustee for the timber noteholders. What we heard was a little bit of an opening statement, not really that much of an introduction of Mr. Clark. But what I would say, Your Honor, is they're trying to get you to look the wrong way. They're trying to act like this is all set up and it's all been established. And the Indenture Trustee is the only objecting party that's got to come in here and prove that this isn't a good settlement, and of course that turns the whole process on its head.

Under the authorities that they cited in their motion itself, they've got a duty to give you a specific factual record that allows you to make an informed, independent judgment that this compromise, this settlement makes sense and that it's fair and equitable to the creditors and so forth, and apparently they're going to do it with a totally conclusory affidavit of Gary Clark. They're not going to present any other witnesses, any other testimony, even though under the term sheet we know that MRC/Marathon agreed to be a joint movant on this 9019 but ultimately didn't end up being.

There are not going to be any other witnesses. I would say if I pass cross-examination and we went on the affidavit or declaration of Gary Clark, you would be bound to conclude that they have not carried their burden showing that these releases ought to be approved.

Frankly, Your Honor, I believe that the purported settlement that we have here, which they say is a global settlement, but in fact, is a collusive interested party agreement in part between Maxxam and Palco. We know their relationship, we know what Maxxam can cause Palco to do. The cases say any sort of a compromise between interested parties has to be given very high scrutiny. They say there are four different parties with four different agendas and they made an agreement and that shows this is arm length. Well, they are not four different parties with four different agendas. They are two aligned parties on the debtor Maxxam side and there's Marathon and MRC on the other side.

And, Your Honor, I believe that what they have presented here has very little to do with -- that their primary agenda in presenting this to you is not so much to get approval for the debtor giving releases, I think what they're trying to do is build some sort of momentum in support of the Marathon/MRC plan to make you

believe that they didn't agree to do all of this.

THE COURT: I don't think -- I don't think anybody would contest that.

MR. SHIELDS: Contest what?

THE COURT: That's what happens in every bankruptcy.

MR. SHIELDS: I'm sorry.

THE COURT: Of course they're trying to build momentum towards their client. Really it's just confirming the plan, not the settlement. I mean, this settlement is a minor little deal. If the plan is confirmable, it would be very difficult not to approve this settlement.

MR. SHIELDS: It may not be --

THE COURT: If the plan is not confirmable then it doesn't really matter.

MR. SHIELDS: Two quick points in response. Number one, they argued to you and they have it in their papers, Your Honor, that somehow the tax indemnity that Maxxam has offered to give was crucial to what MRC and Marathon did. And that it's all -- it depends somehow that's not going to really occur if you don't approve these releases. But if you look at the term sheet, Your Honor, when they signed the agreement on May 1, Maxxam unconditionally gave the tax indemnity for

whatever it may really be worth. And I suspect with a company with $200 million of loss carried forward, it's wind addressing but we'll see in examining Mr. Clark.

Your Honor, you should not approve the exchange of these purported mutual releases between Maxxam and Palco. They haven't shown you that it's fair to the creditors. They said, well, you know, we're not growing to estop or release any third-party's claim but what will they have to recover against if there's been a mutual release between Palco and Maxxam? And Gary Clark --

THE COURT: Well, does Scopac have claims against Maxxam?

MR. SHIELDS: Yes, we do. No, not against Maxxam. We have claims against Palco.

THE COURT: Do you have any claims against Maxxam?

MR. SHIELDS: Not that I'm aware of.

THE COURT: So you believe that Palco has claims against Maxxam that if they're released would be -- you have claims against Palco and that that would --

MR. SHIELDS: No, it's not so much that, Your Honor. We're vitally interested in this Court having -- it's your decision. And they have to give you

a record and you have to make a determination. And we're vitally interested in helping you develop the record that will allow you to do that because after all, one of the core obligations in this settlement agreement is that the Palco debtors and Maxxam are all uncoupling from the Palco and other debtor plans that heretofore were before the Court and are lining up behind the MRC/Marathon plan and are coveting to support and defend that plan and oppose any other competing plan. So the whole exercise is designed to defeat the Indenture Trustee's plan. So we have adequate incentive to help you develop the record.

THE COURT: I understand. But to the extent that they have got Palco, you've got Scopac. See, I mean, Palco didn't even file a brief but Scopac filed a brief on your side.

MR. SHIELDS: Your Honor, we'll talk to Mr. Clark in a minute and you have his declaration. But notice in talking and in answering your question, you're right on point of inquiring about interested parties and upstreaming of monies from Palco to Maxxam.

Gary Clark's affidavit only talks about the money exchanges between Palco and Maxxam in the last four years. I guess the suggestion is, well, the statute of limitations would prevent anything else. But, of

course, financial transfers are only part of the claims that might exist for the Palco estate against Maxxam. How about the directors and officers potential liability for running this company into bankruptcy. Dominating, controlling it and running it into bankruptcy. That's going to be lost. You know, they have a litigation trust under the MRC/Marathon plan.

THE COURT: But focusing as to the Scopac officers and directors, correct?

MR. SHIELDS: No, Your Honor. What I'm focusing on right now is a friend of the Court trying to help you have the record you need to look at this. Is the --

THE COURT: I appreciate the help you're giving me.

MR. SHIELDS: Thank you, Your Honor.

THE COURT: That's always a good thing. But what I would prefer to know is how is this going to harm you? I mean, it only comes into effect in the event that it's confirmed, number one, the plan is confirmed. It could have been originally terms of the plan and had it been terms of the plan, I mean, it would have been part of the overall plan confirmation process, and releases are given all the time in plans.

But just -- I mean, if everybody that this

impacts is in agreement with the release, that's a whole different issue than if there are people who actually are impacted by it that don't agree with it. So I'm trying to figure where this impacts you so that -- you've got your bankruptcy guy coming up.

MR. GREENDYKE: I got a bankruptcy guy here. Judge, this is Bill Greendyke. I think the answer to the Court's question is obviously the Indenture Trustee is a creditor of Scopac and Scopac has claims against Palco. Administrative type claims against Palco. To the extent that assets are in Palco --

THE COURT: That has to be paid either way.

MR. GREENDYKE: It impacts our recovery. And I think the thrust of what he's saying, I won't speak for Mr. Shields, is we don't know the answers to all the questions that you pose to Mr. Litvak.

THE COURT: That's fair. That's fair.

MR. SHIELDS: Thank you. One last point before we let Mr. Clark -- let me question him a little bit. Your Honor, the Marathon/MRC plan proposes to set up a litigation trust and claims that the Palco estate might have against the officers and directors of Maxxam, could, if they're there, and no one has testified that they have investigated those and that they're not

present. Then those could be recoveries that would benefit the unsecured creditors of Palco.

THE COURT: Palco, but you're not an unsecured creditor of Palco.

MR. SHIELDS: I know. One last point. Among the documents that were produced in response to our subpoena relating to 9019 was a communication that went back and forth that pointed out if you exchange these releases between Maxxam and Palco, you are going to neuter the litigation trust that MRC/Marathon is setting up for the potential benefit of Palco creditors. So when they say in their papers, well, we're not estopping anyone from making their claim, there will be a release from the Palco estate against Maxxam that would preclude those claims, if they're there, ever being litigated for the benefit of Palco creditors. That's all I have. I appreciate your indulgence.

THE COURT: Yes, sir.

MR. PACHULSKI: Your Honor, if the Court will indulge me. May I offer a different answer to the question you just asked?

THE COURT: Sure. But you have to come forward.

MR. PACHULSKI: Absolutely. Again, for the record, Isaac Pachulski for certain noteholders.

Your Honor, Your Honor stated that if the plan is confirmed, this settlement is a no brainer. Actually, if you really --

THE COURT: I didn't say it was a no brainer.

MR. PACHULSKI: But it was easy.

THE COURT: I said it would be easier to approve if the plan is confirmable and it doesn't matter if the plan is not confirmed.

MR. PACHULSKI: Well, actually it's harder if the plan is confirmed, and let me explain why. I'm not going to get into plan arguments, but the way the plan works, they take Scopac's causes of action and Palco's causes of action and you heard counsel for the creditor's committee admit that whatever claims there are against Maxxam have gone through a litigation trust and they commingle them into a single litigation trust. What nobody mentions, Your Honor, is that under the plan, the creditors of Scopac and Palco share ratably in that litigation trust.

THE COURT: That benefits you because you don't want the plan confirmed.

MR. PACHULSKI: Wait. Excuse me, Your Honor. But if the plan is confirmed, in fact, the only thing that the unsecured deficiency claim of the Scopac

noteholders gets is access to litigation trust. Unlike other creditors, we don't get any cash. As the Court will recall, we're going to have substantial deficiency claim, okay?

THE COURT: Right.

MR. PACHULSKI: That deficiency claims shares pro rata in the litigation trust.

THE COURT: Right.

MR. PACHULSKI: That means under the plan the Scopac creditors will have the primary economic interest in that litigation trust. Well, if you take away that cause of action that belongs to the litigation trust, you have taken away something that is going to belong primarily not to the Palco creditors who are getting paid 90 cents in cash under the plan, it's primarily going to belong to the Scopac noteholders. So what you have here is a settlement that says upon confirmation of the plan that makes the Scopac noteholders the primary beneficiaries of a litigation trust, we are going to take away an asset of litigation trust.

THE COURT: Let me ask this. Since you brought this up, let me ask you, are there any Palco creditors that share in the litigation trust?

MR. PACHULSKI: Yes, but let me explain

why the sharing is diminimus. The way the plan works, according to the disclosure statement, the Palco unsecured creditors who are, I don't know exactly now, get about -- get 75 to 90 percent of their claims in cash. They share in that litigation trust in their deficiency which is peanuts. Their deficiency will be a few million dollars because they get cash.

The Scopac noteholders unsecured deficiency claims are the only unsecured creditor class in this case other than intercompany claims that don't get cash. So the only recourse they have is through this litigation trust, so think how this works. We, the people who they say don't have any interest, have $200 million of claims which share ratably in the litigation trust. They, the Palco creditors, will have $2 million of claims in the litigation trust, and they're going to take away this claim from the litigation trust and with a straight face they tell the Court we have no interest in the claim.

We are the ones who have the only interest in that claim and they are going to take it away. And conditioning this on the confirmation of the plan is really perverse because what they're saying is that the very act that gives us interest in that claim will destroy the claim. And just as an aside, Your Honor, one

other point just for the record, I think counsel for the creditors committee made the admission that runs this case into a Wiko problem.

If you recall, the Wiko the Court reversed in part because they said it was inappropriate for factual development to be cut short by -- pressed by time pressure, by the pressure of the party to the settlement to get it done and the Court said, no, we appreciate that you want to get things done quickly. If I heard counsel for the committee correctly -- and I'm not going to put words in his mouth -- he said they did some due diligence on the claims against Maxxam, they would have liked to do more, but they don't have time because they have to get the settlement approved today.

But regardless of that, Your Honor, the Scopac noteholders have a primary standing to object to this settlement because under the plan they would get primary interest in these claims. And thank you for hearing me out.

THE COURT: Thank you. Yes, sir.

MR. NEIER: Good morning, Your Honor, David Neier on behalf of Marathon. I would like to quote to you or cite to you Greendyke on bankruptcy law. Mr. Greendyke pointed out if you take something away from a class that has already overwhelmingly rejected the

plan, you haven't harmed them whatsoever. He made that point when he was talking about the --

THE COURT: That's the issue as to whether it's a material change plan requiring renoticing or something of that sort.

MR. NEIER: Correct. But they haven't lost anything. They simply lost the right to a gift that they didn't need in the first place or have a right to in the first place so they haven't lost anything at all. It was true that -- or it is true under our plan we have one litigation trust because to have two litigation trusts would be just ridiculously expensive and foolhardy. You'd have litigation trustees tripping over themselves. They are the overwhelming beneficiaries in that trust but it's similarly to their unsecured claims.

THE COURT: This at a later time. But the real issue there is, I suspect, and a more serious issue, not that this isn't serious, is whether or not that by doing that, and it's one little simple trust, litigation, by doing that you've, in essence, substantially consolidated these cases to the extent that their claim at least. Everybody else, who cares. But to their claim, I mean, if you're going to give -- if you're going to have them have to share with the people in the Palco case, whatever recovery that they might be entitled out

of the Scopac's claim to litigation, be it the Headwaters litigation or others, then have you -- is that a technicality, despite how much that lawsuit might be worth or worth -- and I suspect that at least one person in the jury box will say it's not worth much. But there are plenty of people who have testified that can get to -- if you can get to damages that it's worth a lot.

MR. NEIER: Actually, everybody testified that it's worth zero. Gary Clark testified as the CFO that as a matter of GAP, it was worth zero. And Mr. Cherner, the noteholders' witness, testified that with respect to the Beal bid, the lawsuit would have to be dismissed or settled because you shouldn't fight with your regulators. So everybody has testified that the lawsuit is absolutely worthless.

THE COURT: Well, we'll argue that later. But are you telling me then that your argument for why it's not a substantive consolidation is because it's worth zero?

MR. NEIER: No. The reason I'm telling you that it's not substantive consolidation is because we were giving the noteholders a benefit. That is, Palco's potential actions against Maxxam. We have now taken away that benefit. They never had a right to it in the first place because they are not creditors of Palco. Okay.

They're not -- sorry, they're not -- they're not --

THE COURT: But you are also giving the Palco creditors a portion of their recovery in, say, the Headwaters litigation.

MR. NEIER: Actually, we're not because the Headwaters litigation is being retained and we're paying full value for all of the collateral to the noteholders. The Headwaters litigation is not going into litigation.

THE COURT: We'll go over all that when we get to the --

MR. NEIER: But the one point I wanted to make to answer Your Honor's question is if we were looking at just the litigation trust and the Scopac creditors' share of that litigation trust, the Scopac unsecured creditors, other than the noteholders, are $500,000. That's the estimate that everyone has relied on that was prepared by the debtors for the Scopac unsecured creditors. Their claim, of course, is $800 million, okay? Even when you look at their deficiency claim, it's $200 million. So we're talking about $500,000 compared to $200 million. We are literally talking about less than one percent. With respect to something that 's being taken away from them to the benefit of other creditors at the Scopac level, it's

diminimus and it's simply to have one litigation trustee.

THE COURT: Okay. Call that --

MR. NEIER: I would be remiss in saying that with respect to Mr. Pachulski's arguments, and they're very fine legal arguments, we don't think he has any standing to address this Court. He is simply a participant in the Indenture Trustee's case. It should be the Indenture Trustee who is the claimant. Simply holding debt or being a noteholder does not give him standing to address this Court. He hasn't filed any objections, he hasn't filed any pleadings in the case, he simply filed a notice of appearance of pro hac and a 2019, that doesn't give him standing to address this Court. So we object to him addressing this Court, making arguments before this Court and addressing this Court with respect to the confirmation.

THE COURT: Okay. Thank you. I have never run my court quite that way.

MR. NEIER: I understand.

THE COURT: I understand that that is a policy of many courts and probably ought to be what I do. But I'm a little freer than that so he's here. He's got a beard, he gets to talk.

MR. NEIER: And I appreciate that.

THE COURT: All right. I did want --

although you just now raised your hand, I wanted to -- since you're new, I think, at least I haven't noticed you making an appearance, and you said you were a noteholder and seemed to be sitting on this side of the court, I thought I should find out what your position is, if any.

MS. KELLER: Your Honor, I just wanted to know if I could speak without having a beard.

THE COURT: Yes, you may. But you have to get near a microphone, especially since I asked you to speak, too, so I don't think anybody will object.

MS. KELLER: Thank you, Your Honor. I did file a notice of appearance and a joinder on behalf of Babson Capital who is a timber noteholder.

THE COURT: To what percentage, do you want to say?

MS. KELLER: That they own $11 million of the notes, Your Honor. And we just filed a statement in support of the Indenture Trustee's plan and in support of their objection to confirmation.

THE COURT: Okay. So you're just sitting over here because it was the only seat available?

MS. KELLER: That is correct. I was told to sit over there.

THE COURT: All right. That's fine.

MS. KELLER: And if I may speak later, I

just have a couple of minutes of comment. Thank you.

THE COURT: You may. All right.

Mr. Clark.

(Gary Clark was sworn in by the Clerk.)

THE COURT: All right. And you are in fact Gary L. Clark?

THE WITNESS: Yes, Your Honor.

THE COURT: And this is your proffer?

THE WITNESS: Yes, Your Honor.

THE COURT: Is it true and correct to the best of your knowledge?

THE WITNESS: Yes.

THE COURT: All right. You may be seated. Anything else?

MR. McDOWELL: Pass the witness, Your Honor.

THE COURT: All right. Yes, sir.

CROSS-EXAMINATION

BY MR. SHIELDS:

Q. Todd Shields for Fulbright & Jaworski for Bank of New York Indenture Trustee for the timber notes. Good morning, Mr. Clark.

A. Good morning, Todd.

Q. How are you doing?

A. Good.

Q. I'm going to be -- I've got a lot of stuff. I'm not going to cover a lot of it because I think the extensive opening statements we ended up having framed a lot of the issues and I don't think the Court needs to hear a whole lot more. But I do have a few things. You do have your proffer in front of you?

A. I do not.

THE COURT: Here you go.

Q. (By Mr. Shields) It's actually a declaration.

A. Yes, I do have it.

Q. Okay. I apologize in skipping around, but I'm going to try to shorten this up quite a bit, so I'm just going to hit some high points.

First of all, you refer in your declaration, Mr. Clark, to the settlement agreement and in specific, to the releases that would be given by Maxxam to the Palco debtors and by the Palco debtors to Maxxam and their officers, directors and professionals and so forth, as necessarily eliminating years of potential litigation between those parties.

My follow-up question is: Other than the fact that Palco and Maxxam and everyone that's a party to this settlement agreement and lots of other folks in the courtroom are all parties to these joint bankruptcy cases, is there any specific litigation now pending

between the Palco debtors and any of the Maxxam entities?

A. No.

Q. Has there been any that's threatened?

A. No.

Q. Mr. Clark, would you agree with me that any time two parties exchange comprehensive mutual releases, the effect of it is to eliminate potential litigation, whatever substance there may be in the word potential, right? That's all you're saying?

A. Yes, I believe that's true.

Q. Okay. With respect to the releases that Palco -- the Palco debtors are asking the Court to approve, that would be the Palco debtors' release of the Maxxam entities, their officers, their directors and their professionals, correct?

A. Yes, I believe so.

Q. All right. And just to make it clear, Maxxam has not conditioned the release that it will give to the Palco debtors on receiving a mutual release back from the Palco debtors, correct? And I can point you to the term sheet where I draw that conclusion, but --

A. Please do that.

Q. Okay.

MR. SHIELDS: Simon, okay. Look at -- Simon, if you put up the term sheet in the --

THE CLERK: It's on. I'm not sure you're -- we've got it on the counsel computer number one. We've got the projector on.

THE COURT: So it's working now. It will be a second.

Q. (By Mr. Shields) All right. I'm referring to page 3 of 11 of the term sheet. It's the part that says "release and covenant not to sue with respect to Palco debtors" under the general heading of concessions by the Maxxam entities. It says, "effective upon entry of an order by the bankruptcy court approving this term of this agreement, each of the Maxxam entities" and then it goes on and completely releases the Palco debtors from the released claims and so forth.

Now, you were involved in all of this. Is it your understanding as refreshed by reading this that the only condition on the Maxxam entities providing the release to the Palco debtors is that the Court approves -- enters an order approving that term of the settlement agreement that we're looking at? That's what it says, right?

A. Yes, it does.

Q. Okay. And by contrast, if we look over at the concessions by the Palco debtors --

MR. SHIELDS: Simon, this is 4 of 11, page

4 of 11 of the term sheet.

Q. (By Mr. Shields) Where it says "releases and covenants not to sue," it says "effective upon the later to occur of approval of the settlement motion and the effective date of the MRC/Marathon plan, each of the Palco debtors will" and then it talks about the release that will go to the Maxxam entities, their officers, directors and professionals.

Is it your understanding that notwithstanding that the Maxxam release of the Palco debtors only requires Court approval of a portion of the settlement agreement, the Palco debtors release to Maxxam is conditioned upon both approval of the settlement motion and confirmation, or effective date is the way it's worded, of the MRC/Marathon plan, correct?

A. That's not a distinction that I was aware of at the time.

Q. But it's -- that's the way you understand the agreement as it's written and made binding, right?

A. This morning, yes.

Q. All right. Now, do you also understand that the agreement between the parties to the settlement agreement, the so-called term sheet regarding global settlement and plan support, that the tax indemnity that Maxxam provided was provided unconditionally effective

immediately with the execution of this term sheet?

A. Yes.

Q. Okay. And likewise, the agreement that MRC and Marathon made to amend their plan in the respects referred to as Exhibit A to this term sheet, that was a promise that was made May 1 and carried out when they filed the amended plan on May 3, right? That's already occurred?

A. I'm not sure of the dates, but yes.

Q. Okay. Now, on the question of arms length negotiations and so forth, you have said in your affidavit that the attorneys' fees -- this is paragraph 14 if you want to look at your declaration -- "the amount of professional fees the debtors' estates have incurred in these cases is further evidence that this global resolution is an arm's length agreement" and then you recite that the Palco debtors' estates has spent more than $16 million on professional fees and the Scopac estate has spent another $23.5 million on professional fees.

Help me understand why that level of attorney fee expenditure reflects arm's length dealings between entities that were proposing a joint plan until May 1st. They weren't litigating things against each other, they were joined together in proposing a joint plan, weren't

they?

A. Yes, they were.

Q. And certainly while it was a very intensive effort to reach what you called a global settlement, that's not -- didn't create any significant portion of this level of attorneys' fees referred to in paragraph 14 of your declaration, did it?

A. I'm sorry, could you repeat the question?

Q. Okay. Well, the point is you're not representing to the Court that any significant portion of these attorneys' fees were incurred in Palco and Maxxam dealing with each other at arm's length, are you? I mean, until May 1, you were an officer of both Palco and Scopac, weren't you?

A. I'm not sure I can answer your question because I think there's more than one question there.

Q. Okay. Well, then let me just limit it to this. Looking at paragraph 14 and the reference to almost $40 million in attorneys' fees as incurred by Palco's debtors and Scopac as being some evidence that this global resolution is an arm's length agreement, you're not representing to the Court that any significant portion of that was related to these negotiations that ended up in the global agreement, are you?

A. Some of the attorneys' fees -- in a sense this

is to date, which is the date of the proffer, would include estimates of attorney fees that were incurred through two weeks ago, yes.

Q. Okay. But you weren't adverse until May 1. There was an arm's length dealing until May 1. You were proponents of a joint plan, weren't you?

MR. McDOWELL: Objection, Your Honor. The question seems to be ambiguous as to who he was adverse to. He doesn't specify.

THE COURT: Well, I guess -- I guess the question and what he's trying to -- and I don't purport to be in the ballpark of litigation techniques, but it is a fair question as to how does the expenditure of attorneys' fees relate to the arm's length transaction here. I don't know if that's the question you want answered or not.

MR. SHIELDS: That's the question.

THE COURT: But I would like that question answered.

THE WITNESS: My feeling is that by coming to this settlement and coming to this agreement, we would reduce the professional fees and the legal fees.

THE COURT: Well, that's another issue. Yeah, it might well be that there have been lots of attorneys fees spent and settling would eliminate

attorneys fees and the cost of attorneys fees is one of those things, but you say in your proffer that that shows that it's an arm's length transaction. I don't see how that happens. How do you get there?

THE WITNESS: I'm not sure I can answer that this morning.

THE COURT: Okay.

Q. (By Mr. Shields) There's reference in your declaration to the Palco debtors allegedly receiving a benefit if they get a release from the Maxxam entities because there is a $42 million claim. I'm referring to paragraph 29 of your declaration. "Furthermore, if the Court approves the settlement motion and the MRC/Marathon plan is confirmed and becomes effective, under the terms of the settlement agreement, the Maxxam entities will grant the Palco debtors a release which results in the elimination of over $40 million in unsecured claims." Now, my follow-up question, I have just a couple.

Number one, although it's not, I think, identified with any specificity in your 9019 motion or even really in your declaration. What you're referring to there are unsecured claims that the Maxxam entities have against the Palco debtors based on cash advances that were made in the last few years to the Palco debtors, correct?

A. It's based on the fact that Maxxam entities made loans to Palco entities, Palco debtors, starting in October of 2005. And that's in -- approximately $40 million, and it's an unsecured claim, yes.

Q. Okay. And in fact, it's explicitly made subordinate to the secured debt that the Palco debtors have, right?

A. I believe unsecured is subordinate, yes.

Q. Okay. And there's no prospect that approval of the releases that is being asked for here is going to save any litigation with respect to that $40 million in claims because those are going to be discharged if the MRC/Marathon plan is confirmed, right?

A. That's a legal conclusion. I don't know that I can answer that.

Q. Well, it's not a legal conclusion. It's in the joint disclosure statement that all the parties, including your employer, filed in this case. It provides that intercompany debts and loans will be discharged if the MRC/Marathon plan is confirmed. And if that's true, the release that Maxxam entities will give to the Palco debtors about those claims doesn't save any litigation, it's not really worth anything, right?

A. Based on what you said, that would be true.

Q. All right. Just -- this will be my last line

of questions. You heard the Court ask questions of counsel for the unsecured creditors committee about what investigation, if any, may have been made with respect to upstreaming of money from -- and I may be imprecise in recapitulating the Court's -- recapping the Court's statements, I apologize. But upstreaming money from the Palco debtors to Maxxam or possible claims that the Palco debtors may have against Maxxam or the Maxxam officers, directors. And you do address that in part in your declaration, but you have limited your coverage of that in your testimony by declaration to financial transactions within the last four years, correct? I'm talking about paragraphs 22 and 23 and 24, right?

A. No. What I was trying to do was be responsive to the four years prior to the filing, which is my understanding of the statute of limitations. But my own review of -- I mean, I've been there all that time. I have been there longer than the last four years. I have no qualms in my investigation and my memory and in being involved in those transactions. I do not believe that there were anything, any transactions that took place that did not comply with the law, that were not legal, that were not approved by the Board of Directors, that were not approved by the lenders at the time or a part of the credit agreements or permitted by the creditors at

that time. I don't believe there's anything there. That's my belief.

Q. That's what you said in your declaration in 2004. But my follow-up is this: Number one, claims that might exist against the Maxxam officers, directors and so forth wouldn't be limited to just the financial transactions that Maxxam and the Palco debtors may have had, right? There could be other ways in which liability or claims might exist?

A. I would expect that's the case, but my comment that I just made, it was intended to include those from my perspective.

Q. Okay. Well, your declaration doesn't. But one point on this, Mr. Clark.

A. Yes.

Q. You've made an investigation that you say went back to 2004. You've also told --

A. 2003.

Q. 2003. I'm sorry. I stand corrected. I'm not trying to vary from what you've said on that. But you've been with Palco since 1993. Now, you have been an officer of Palco all that time, you're an officer now. Whatever investigation you've done is by no means an independent investigation on behalf of persons that might be interested in asserting claims against Maxxam because

you're not a disinterested party, right? You're not claiming you are?

A. I'm just claiming that I did an investigation and I look back and what I think is to be the case. And for the financial transactions, I asked our financial advisor, Crossroads, to confirm and go back through the statute of limitations through 2003 and review those transactions and confirm that what I had said was accurate.

MR. SHIELDS: Objection, nonresponsive.

MR. McDOWELL: Your Honor, that was responsive.

MR. SHIELDS: Well, it is what it is.

THE COURT: I'm not sure.

MR. McDOWELL: It may be a fact he didn't like, but it was responsive.

THE COURT: I think you pretty much elicit responses when you ask the questions. If you want to ask more pointed questions, you can get more pointed responses.

MR. SHIELDS: I understand. I really was trying to shorten this up.

THE COURT: I understand.

MR. SHIELDS: And point out that if he would just answer my questions, it will go faster.

Q. (By Mr. Shields) You're not holding yourself out as having made an independent investigation of these transactions given your position as someone that Maxxam can fire at will, as they did when you were an officer of Scopac a month ago, right?

A. Again, I think there's more than one question there.

Q. Okay. Then I'll break it down into two. A month ago you held the same positions in Scopac and Palco, right?

A. That's correct.

Q. And you along with every other officer of Scopac, were told, invited, you were told that you served at the sufferance of Maxxam and they no longer needed your services and please submit your letter of resignation and you did, right?

A. Mostly correct, but --

Q. I'll take mostly. Let me move to the next one.

A. With respect to me, that's true.

Q. Okay. And likewise, you serve at the sufferance of Maxxam as an officer of Palco to this very day?

A. I'm not sure I understand your use of the word sufferance. I suppose at their pleasure.

Q. I'm just trying to establish that you're not

independent. You didn't go out and hire some independent group to do a special investigation and opine to the board of Palco about this. You handled it yourself. And I'm not impugning your integrity here or anything else, I just want to establish that you're not holding yourself out to be independent in that regard, right?

A. Yes.

MR. SHIELDS: Okay. Thanks. That's all I have.

THE COURT: All right. Any redirect? Or any other cross? All right.

MR. McDOWELL: Your Honor, just a few redirect questions.

REDIRECT EXAMINATION

BY MR. McDOWELL:

Q. Mr. Clark, you were asked a number of questions about the releases that Palco gave to the Maxxam entities. Do you recall that?

A. Yes.

Q. Did Palco give any other releases to any other parties other than the Maxxam entities?

A. They gave releases to MRC and to Marathon, I believe, did they not?

Q. And have you been -- has Palco been adverse to MRC and Marathon in this case up until the time the

settlement agreement was signed?

A. Yes.

Q. And would you characterize the portion of attorneys fees that was in your proffer, would you characterize it as a significant portion of those were incurred fighting the MRC plan?

MR. JONES: Objection, Your Honor, leading.

MR. McDOWELL: Your Honor, I'm not sure a party has standing to object if they didn't even cross on redirect.

THE COURT: So reask the question.

MR. McDOWELL: Yes, Your Honor.

Q. (By Mr. McDowell) How would you characterize the portion of fees that were spent in connection with fighting the MRC plan?

A. I would characterize the fees that were spent here to date as a lot of litigation over a lot of different issues throughout the course of this case. A substantial amount of those fees were used in objecting to the Marathon/MRC plan. I don't know how much.

Q. What happened to those fees, fees -- and by fees, I'm referring to the fees that were incurred fighting the MRC plan once a settlement agreement was signed?

A. As we can see by the courtroom presence today, the fees will go down because there are less lawyers in court for the debtors. And we're not fighting.

Q. Let me move on to a new topic. Do you recall being asked some questions about the $40 million claim that was being released by Maxxam?

A. Yes.

Q. Do you recall looking at -- on the screen the provision in the term sheet that dealt with when that release became effective?

A. Yes.

Q. Is that release -- is it your understanding here today that that release becomes effective even if the MRC plan is not confirmed?

A. Yes, it is.

Q. And my last topic. Do you consider yourself to be a fiduciary of Palco?

A. Yes.

Q. Do you consider yourself to have fiduciary duties to Maxxam?

A. Yes.

MR. McDOWELL: No follow-up questions, Your Honor.

THE COURT: All right. Yes, sir.

CROSS-EXAMINATION

BY MR. LITVAK:

Q. Good morning, Mr. Clark. Max Litvak of Pachulski Stang on behalf of the committee. You were asked a question or two about Maxxam's claims against Palco. Can you just remind me, what are Maxxam's claims against Palco?

A. The only claims that I'm aware of would be the financial claims for the loans that were made to Palco in 2005 and 2006 in the aggregate of about $40 million. There may be some other minor financial claims for monies that were due for reimbursements at the time that the plan was filed. I'm not -- I don't have that at my fingertips.

Q. But your best estimate today then is, as the CFO of the Palco debtors, that Maxxam -- that Palco owes Maxxam approximately $40 million; is that right?

A. Yes.

Q. Now, there was a question asked about whether some of those claims may be subordinated to certain of the creditors at Palco. Do you recall that?

A. Yes.

Q. Is it subordinated -- is the Palco debt to Maxxam subordinated to all unsecured creditor debt?

A. No. I think it's only subordinated to the

secured Marathon debt.

Q. Okay. So it's not subordinate, as far as you know, it's not subordinate to any other general unsecured claims of Palco, is it?

A. No.

Q. You just mentioned that you view yourself as a fiduciary of Palco, right?

A. Yes.

Q. So that means you feel like you have fiduciary duties to creditors, right?

A. Absolutely.

Q. Unsecured creditors included?

A. Absolutely.

Q. So if you were aware of any claims that Palco may have against Maxxam, you would say so, wouldn't you?

A. Yes, I would.

Q. You wouldn't sit up there under oath and say that you investigated claims and then -- and then claim that there were no claims, right?

A. That's correct, I would not.

Q. So the fact that Maxxam may ultimately have authority over you and could fire you --

MR. JONES: Your Honor, I'm going to object. This is argumentative leading of a witness who he's got on redirect and it's not even his witness. This

is the argument.

MR. LITVAK: Well, this is my cross-examination and we're not a party to the settlement.

THE COURT: I think, you know, they brought up the issue of his control by -- I mean, his control by Maxxam, and I mean, I don't think it's unfair at that point to ask him if he'd lie for Maxxam or if he would hide things from Maxxam. I think that, you know, I think we all know what the answer is going to be, but I still think it's perfectly appropriate to ask that question.

MR. JONES: Your Honor, my objection doesn't go to the substance of the question. If he want to form it in a proper manner, although I don't understand why he's doing --

THE COURT: I mean, I think you're one of the proponents here so --

MR. LITVAK: Your Honor, never mind. I'm done.

THE COURT: Okay. Anybody else? All right. You can step down.

MR. McDOWELL: We have no further witnesses, Your Honor.

THE COURT: All right. Any other

witnesses?

MR. SHIELDS: No, Your Honor.

THE COURT: All right. Now what do we plan on doing, going on to the request of the noteholders?

MR. SPIERS: Your Honor, I'm sorry, if I could ask for clarification. At one time there were subpoenas that were live with respect to potential adverse witnesses that the noteholders were going to call and --

THE COURT: Well, they just said they don't have any witnesses.

MR. SHIELDS: I'm not calling them.

MR. SPIERS: So is it fair to say that the witnesses that otherwise might have been called are released from the subpoena?

MR. SHIELDS: As it relates to 9019.

THE COURT: If there are any subpoenas under 9019, they are now released.

MR. SPIERS: Thank you.

THE COURT: All right. So are we going to go on to the motion to reopen the evidence?

MR. JORDAN: Your Honor, do you want closing arguments on the 9019 combined with the confirmation?

THE COURT: I think that would be better.
MR. JORDAN: All right.
THE COURT: I mean, I think it's all related. So I think that would be a better way to handle it. Unless we've already had -- we've had closing arguments at the opening.
MR. JORDAN: Your Honor, then the next matter on the docket -- the next matters are all the Indenture Trustee, so I'll just refer to them how they would like to take them up. But I would suggest that we deal with the issue of the emergency motion to open -- reopen the evidentiary record.
THE COURT: All right. And are you opposed to that? Are you opposed to that?
MR. JORDAN: Your Honor, I need to hear the scope of what it is. I doubt we'll have any cross, but we're opposed to it in this respect. Depending on what they say that they want to reopen to do. So far we've received a notice of interest in purchase of timberlands, which is signed by a lawyer on behalf of a client. It's nothing but a pleading, so I don't assume they're going to suggest that's evidence. But we do have two proffers by two individuals, and I assume that they're in the courtroom and are subject to cross that those would be something the Court would consider to

support the motion, and so I would defer first to what the scope is intended and then I would ask the question if that's all right.

THE COURT: Well, they're going the call those two witnesses; is that correct?

MR. CLEMENT: That is correct.

THE COURT: All right. Now do you have any objection?

MR. JORDAN: Your Honor, is that it? Well, the only objection then goes back to the first item. I'm not sure what they intend with the notice.

THE COURT: Okay. What do you think the notice is?

MR. CLEMENT: Your Honor, we would just like the Court to either admit it into evidence and take judicial notice of it. It is what it is.

THE COURT: I can take judicial notice of the fact that you filed it if that's what you've done.

MR. CLEMENT: It exists, Your Honor, it says they're willing to offer about $600 million cash and there is evidence of that, Your Honor.

MR. JORDAN: Well, of course that can --

THE COURT: I don't think it's evidence unless they're here to testify.

MR. JORDAN: Assuming it's not taken as

evidentiary --

THE COURT: But I will take judicial notice that it was filed.

MR. JORDAN: Well, other than that, the Palco debtors have no objection.

THE COURT: Okay. Scopac doesn't object.

MS. COLEMAN: No, Your Honor.

THE COURT: Okay. What about Marathon?

MR. PENN: We object, Your Honor, primarily because there is no reason to reopen the record.

THE COURT: Okay.

MR. PENN: There has been absolutely no showing and there is no evidentiary basis.

THE COURT: It was my understanding is that the new evidence is that you have someone now who is willing to buy the mill and invest money into upgrading the mill.

MR. CLEMENT: That is correct, Your Honor. Would it make more sense if I explain why we think the evidence ought to be reopened and then they responded?

THE COURT: That's a good idea. So how much are they willing to pay for the mill?

MR. CLEMENT: Your Honor, they're willing to pay approximately $45 million for the mill, the cogen

plant and the working capital related to the mill.

THE COURT: What is the working capital relating to the mill?

MR. CLEMENT: About $18 million. So the cash relating to the mill and the cogen plant is $27 million. They're prepared to do it in a 363 sale, so if somebody wants to outbid them, there will be an auction.

THE COURT: Okay. And how much is Marathon owed?

MR. CLEMENT: Now, Your Honor --

MR. NEIER: Your Honor, we're owed $160 million.

MR. CLEMENT: Divided between a term loan and a dip loan. And Marathon has essentially three forms of collateral, four. They have the town, which they would like to have survive nicely with a mill there that's functioning and hiring people. They have the town, the mill, the cogen plant and the working capital.

THE COURT: I have never heard of this cogen plant. What is that?

MR. CLEMENT: Your Honor, it sits right next to the mill. It burns wood pulp, it supplies electricity to the mill and some other people. It's hooked up to the California grid.

THE COURT: Okay.

MR. CLEMENT: To make sense, it's a married cousin, married sister, brother, whatever, or husband and wife with the mill. It goes with the mill. So we've got somebody prepared to pay money for the mill, cogen plant and to commit, Your Honor, to spend $70 million, invest in and fix up the existing mill, build an additional mill, hire a lot of new people in Scotia. It is the dream of reorganization for that town to have Sierra Pacific come put $70 million of investment into that town.

THE COURT: Okay. And you've got two people to testify to that; is that correct?

MR. CLEMENT: Your Honor, we have Mr. Emerson who is going to put the money in from Sierra Pacific, you've got Mr. Kamensky from Lehman who is going to testify that Lehman is prepared to give Scotia Pacific a $20 million dip loan to be sure it has plenty of liquidity to get from here to a sale of the Scotia Pacific assets. Now, Your Honor --

THE COURT: All right. Now, and the terms of their dip loan, what are they -- who are they going to prime?

MR. CLEMENT: They are priming, I think, the honest answer is no one. And let me just say it this way, Your Honor. They are going to be junior to Bank of

America. Nobody else who cares to object, they're going to be junior to Bank of America. They will, however, be senior to the Indenture Trustee's large $750 million claim. And it's $20 million. And Your Honor, that $20 million is about twice what Your Honor heard testimony might be the negative cash burn for Scopac between now and a six month sale.

Now, Your Honor, I may well have said most all of what's relevant here to the question of whether the evidence should be reopened. But to argue specifically the point of why the evidence should be reopened to hear those three things kind of starts with the Sunday School notion the truth will set you free, moves on to Your Honor's motion --

THE COURT: Well, I wanted to hear why they would now object to it before we argue.

MR. CLEMENT: Well, in that case, Your Honor, I'll respond to their objection. Those two things are what we are proposing.

THE COURT: It was the Bank of America, not the Bank of New York, Bank of America.

MR. JORDAN: Just for clarification, we're not objecting to that evidence. But just --

THE COURT: Okay. I understood that. But I don't think Marathon has made such a statement.

MR. JORDAN: Well, I'm not sure that's the case, if it is in evidence for the sake of -- I think it's a two-tiered step. What you asked me was I objecting to their evidence as their proof of why it should reopen. I don't know what Marathon has done in that respect. Palco doesn't object to that evidence. But now that you hear what the evidence is, we have arguments and objections to you reopening to consider that. But I think we're along the lines of what Marathon had mentioned.

THE COURT: All right. But first let me hear from the bank, this bank, about something other than auction security rate securities.

MR. JONES: Your Honor, it actually does relate to that. And I want to speak to the stuff on the offer to buy the plant. Your Honor is going to decide whether it's too late or not. I would point out in fairness, you know, two-thirds of the way into our hearing Marathon changed their plan to increase their cash by over half. So the idea that everyone had to come to the game with their best offer has already been, you know, thrown out the window and I think that may be a good thing. But the one I really want to talk about is the offer from Lehman on the dip financing. And this does go directly to the auction rate securities.

As Your Honor will recall, we only learned of that -- and I gather Mr. Clark, frankly, only learned of that essentially the last day of the testimony, or perhaps it was the evening of the ultimate day and we filed a pleading saying this is a big issue, this needs to be dealt with. And I do have a couple of questions for Mr. Kamensky about his offer. Mr. Clement indicated, and I believe it's the correct reading, that it wouldn't prime Bank of America but it's kind of drafted oddly so it's not entirely clear. We think, however, that certainly Mr. Kamensky's evidence meets all the requirements for reopening the record. This is a critical issue. It's an issue that came up on the seventh of eight days of testimony. It simply could not have been addressed at that time and we believe it would be error not to reopen the evidence to at least address that issue. Thank you, Your Honor.

THE COURT: All right. Now, Mr. Jordan, now you're ready to argue against reopening the evidence?

MR. JORDAN: Yes, Your Honor. Briefly my argument is going to be addressed to the idea that this Red Emerson, I have no cross with him of his proffer. That this proposal has something to do with relevant to an issue before the Court, and let me just suggest the following problems that I have. First of all, Your

Honor, if you were to reopen the evidence, it should be for a purpose. The burden is on the movant to show that there is something that has been left out of the record that is significant, and I want to address that.

THE COURT: Do you agree with Bank of America that the Kamensky evidence, it's probably fair that that ought to be reopened to allow them to at least do that?

MR. JORDAN: I don't take a position on that. That's on the Scopac side and I don't have a position on that, Your Honor.

THE COURT: Okay.

MR. JORDAN: My reference is going to be to the suggestion that Sierra Pacific has something to offer that the Court should reopen evidence to consider. First of all, I want to point out what it does do and what it doesn't do. It does provide for the payment of $27.5 million for purchase of the assets, $7.5 million of which goes into escrow and it further provides that that escrow, because the Court knows that we probably can't pay bills starting next week, much less in the time it would take to start the auction process which it contemplates. It apparently contemplates itself as a stalking horse and moving forward so that if there are any administrative expenses of Palco for the next two or

three months while the proposed 363 sale is to be done, that comes out of the escrow money which if the sale is not to them, they get reimbursed out of the entire package. What it really amounts to is that the purchase price is reduced by -- if they are the high bidder the purchase price is reduced by the amount of burn that goes on, which means, of course, Marathon who would otherwise be 100 percent entitled to the proceeds, Marathon pays for the auction process. That doesn't fit anywhere within the scope of reopening evidence because it is so counter to anything the Court, I think, will consider.

The second thing it does, it requires a 100 percent dedication of all of the timber of the noteholders for a 15-year contract. What is most disconcerting to me is to suggest that there is a basis to reopen evidence for that type of provision because what that does is tell every bidder this goes effective before the bidding process on the noteholder side. What that tells any competing bidder on the noteholder side is that if you want our timberland, because we know Beal has arranged a stalking horse claim, that if you want our timberland, you now have to buy it subject to a 100 percent contract for 15 years to be dedicated to Sierra Pacific. We don't know the terms of that contract, but that's what it provides.

The most disconcerting aspect of the suggestion that the record should be opened for this sort of proposal is that it provides nothing for the administration, the existing administrative claims. It provides nothing for the PBGC issues. It provides nothing to unsecured creditors, and it assures that when the auction is conducted that there will be no funds payable to any party except the Marathon claimant that has now been reduced by the cost of this sale, such that the estate will be insolvent, the estate will be administratively insolvent and there won't even be money left over to fund a Chapter 7 liquidation.

So there's nothing in the offer that furthers any aspect of any plan, either side except to further chill the bidding and except to assure that my client will be an administratively broke client with no ability to even fund a Chapter 7 trustee's view because there would be a negative balance or a zero balance and all the aspects.

So Your Honor, we argue that it should not be reopened from the Palco side to entertain what this offer suggests it is because it isn't an offer. Incidentally, it is also an offer that suggests that we expect to invest, but the fact is there is no commitment in this particular -- that doesn't have contingencies in

this particular offer that binds them to invest. It's much like, except for the live witness in the courtroom, the comments on the phone and the pleading that were filed by this other party suggesting that they would consider making a bid.

So Your Honor, I think on -- from the aspect of relevance there is nothing in this offer that is addressing an issue relevant to the Court simply because it accomplishes no purpose of either plan, by the way, except I will note that it is sponsored by the noteholders, which if it is sponsored by the noteholders, they will have to amend their plan to provide that any person bidding will be subject to a 100 percent output 15-year contract for the timber. That is not in their plan at this point. And I don't suspect that they are willing to amend their plan to provide for that contract. That's what this condition is. So we don't think there is any relevance to any issue before the Court.

THE COURT: Okay. Anybody else want to say something?

MR. PENN: Your Honor, every now and then it's kind of nice to go back and read a couple of cases. Specifically if you look at Kona Technology case which cites the Court to the elements for reopening -- or reopening the evidence and that's at 225 Fed 3rd 595, the

elements are that it has to have probative value and we have heard Mr. Jordan talk about that.

It also has to be proof of the reason why it was not introduced at trial. There's no evidence of that at all. None whatsoever. The proffers, neither of the proffers say why they weren't made sooner nor the term sheets. The term sheets are neither signed nor dated so we don't know when they came into being. And there also has to be proof of what kind of prejudice it would have on the non-moving parties. We have spent millions of dollars in the confirmation process. I've lost count of the number of depositions. Frankly, I don't remember how many depositions we had during the confirmation trial itself.

These proffers were thrown over the transom last night at 9 o'clock when there was zero ability for discovery to find out anything about them. That's important two reasons. One, if you look at the transcripts from each of the confirmation trial days, you'll find an appearance by Lehman, one of the large noteholders. They have been here. Why now? It's not in the proffer. It's not in anything that is before this Court to consider.

As far as Mr. Emerson goes, Mr. Emerson was here Thursday of the last week of trial sitting

approximately where he is today. He wasn't called to testify then, never put up on the witness stand at that point. No explanation as to why this is happening now, why it's being thrown over the transom at such a late hour other than take a step back and remember who profits from the delay. It's the noteholders.

THE COURT: Okay. But the delay is going to be in an hour of testimony. I mean, there's no big delay in terms of timing. I mean, there's no doubt that if your plan is confirmable it's going to get confirmed. I mean, it's got the massive overwhelming support of creditors. So this is -- I mean, I'm not ruling that, but I don't think anybody believes that a court would confirm some other half plan over a whole plan that deals with everything and that it's supported by all the creditors if it's confirmable. So the real issue here is is your plan confirmable.

In addition to that then, if your plan is not confirmable, then the issue perhaps is is their plan confirmable. And I don't see how finding out about what might happen to Palco under their plan has any -- I mean, how is that going to hurt anybody? Now, I agree with you that under normal circumstances you don't reopen evidence in a trial if the evidence was available beforehand and they should have been able to get it and all the parties

were here and they just didn't call them and now they have changed their mind and all that sort of stuff but this is not an ordinary trial. This is a confirmation that we have tried to, as much as possible, expedite the confirmation process because of a number of primarily financial reasons. And that is, we have run out of money. Everybody agrees to that. And even money that's in the SAR account, maybe you can't get to that, you know. We understand that now.

So I mean, I think it's not fair to -- I mean, I agree that the fact that Lehman was here and sitting here and maybe the other guy was here, too, they could have made the deal earlier. Maybe they should have made the deal earlier. I mean, I think that's stuff that can go to the weight to be given to it, etcetera. But I don't think it would be unfair. I think in fact it would be fair under the circumstances of this case to allow them to put on the evidence. I think that it also might well be fair that if you want to depose them and it turns out that they are saying something that is totally wrong, we will allow you to do that later if we ever get to that issue. And I understand you haven't deposed them.

I heard about this yesterday some time, I guess, or maybe it was the day before because yesterday I was in the Valley so I've got to believe that you-all

knew that they were going to do this two days ago. You may not have known who the witnesses were or did you know? Maybe you got the proffers last night, but was there any attempt to try to depose these witnesses before today?

MR. CLEMENT: Zero. Zero.

MR. PENN: Okay. Now, let's talk about the scenario of how it happened. The term sheets got logged in, what, on Tuesday. The proffers got thrown over the transom last night about 9 o'clock, so zero effort is kind of preposterous.

THE COURT: You want me to give you an opportunity to depose them first or do you want to go on with it right now and question them on the stand? Or do you want to have the opportunity to depose them later after they are questioned on the stand? What would you prefer to have happen? Because they are going to testify so now let's see how do you want that handle them?

MR. JORDAN: The only option you left out was to not reopen the record. So it sounds like --

THE COURT: I left that out because I just ruled. So it wasn't leaving it out, it was a ruling, perhaps it was disguised because it was so direct.

MR. JORDAN: I got there, Your Honor. I'm not suggesting that.

THE COURT: Okay. And I don't want to make light of any of these things. I know we have a tendency to do that. And it's not because -- it's probably the seriousness of the issues that lend itself more to sometimes some humor from time to time. It's not because we don't -- there's nobody in this room, and me included, that doesn't think this is very serious stuff. But it's a court of equity, it's a process that has sort of been a moving process as we have gone along. Things have changed as we have gone along. I have tried to give you-all the opportunity of those changes, etcetera. And I'll let them testify.

MR. JORDAN: Your Honor, may I --

THE COURT: What it proves, I don't know.

MR. JORDAN: May I make the suggestion in that we agree to the record being opened for the purpose of the proffer and can we have five minutes to see if we have any cross at all?

THE COURT: Okay. Yeah, we'll take a break now. This will be a good time to take a break. And the two witnesses -- perhaps you might want to do a little oral deposition. I will give you half an hour to do that.

MR. PENN: Your Honor, having heard the Court's ruling, I'm not going to argue the point anymore.

THE COURT: Okay. Thank you.
THE BAILIFF: All rise.
(A recess was taken.)
MR. CLEMENT: The Indenture Trustee calls Red Emerson to the stand.
MR. JORDAN: Your Honor, I'm not sure it's necessary since you already admitted the proffer. We have no cross.
THE COURT: Does anyone have any cross-examination?
MR. SHIELDS: I just need to prove up his declaration.
THE COURT: Okay. If you would raise your right hand to be sworn.
(Red Emerson was sworn in by the Clerk.)
THE COURT: If you'll have a seat. And we'll just do this the way I normally do it, if you don't mind. It seems to be quicker that way. Mr. Emerson, you are A.A. Red Emerson?
THE WITNESS: Yes, sir.
THE COURT: And is this your proffer, what has been handed to me?
THE WITNESS: Yes, it is.
THE COURT: Is it true and correct, to the best of your knowledge?

THE WITNESS: Yes.
THE COURT: All right. You may have a seat. Do you have anything else you want to say?
MR. SHIELDS: I just wanted to give him the opportunity to talk to the Court about the seriousness of his bid and his commitment to doing something for the Palco mill, which this Court has expressed a concern about. And I am somewhat surprised they want no cross-examination, if that's what it's to be. But --
THE COURT: Well, I don't think anybody thinks he's not serious. I mean, he's shown up in court, he has a bid and his bid is more than what the term sheet says, isn't it?
THE WITNESS: Yes, sir.
THE COURT: Is there anything different about the term sheet that you wanted to say?
THE WITNESS: I don't think so, Your Honor.
MR. JORDAN: We object to being purely duplicative.
MR. SHIELDS: If you're not going to cross-examine him, I want you to meet him and --
THE COURT: Do you have any questions for this witness?

MR. NEIER: No questions, Your Honor. We just want to make sure that we are following the same procedure we followed during the trial.

THE COURT: Anyone else have any questions?

MR. BRILLIANT: No, Your Honor.

THE COURT: All right. Thank you. You are excused. You may step down. I know you probably wanted to be asked questions, didn't you? All right. So you're free to go on back now. Thank you, Mr. Emerson.

MR. CLEMENT: Your Honor, the Indenture Trustee calls Daniel Kamensky.

(Daniel Kamensky was sworn in.)

THE COURT: All right. And Mr. Kamensky, I have what you are -- first of all, you're Daniel B. Kamensky, aren't you?

THE WITNESS: That's correct, Your Honor.

THE COURT: And is this in fact your proffer that has been given to me?

THE WITNESS: Yes, it is, Your Honor.

THE COURT: Is everything in there true and correct, to the best of your knowledge?

THE WITNESS: Yes, it is.

THE COURT: Any other questions?

MR. CLEMENT: Your Honor, I had eight

questions that were simply designed to put foundation. And I'll go through them, Your Honor, until Your Honor tells me --

THE COURT: Well, if they're what's in his proffer, I don't think you need to say them. What else do you have? Do you have something aside from this? I'm not trying to -- I mean, I think the procedure we've set up was that expert witnesses, we're going to allow them -- isn't this the case where we allow the expert witnesses to be questioned on direct and then -- but the fact witnesses we just -- their proffer is their testimony.

MR. CLEMENT: Your Honor, this does not go beyond the proffer and we're content to go forward.

THE COURT: All right. But now, they may have questions for this one. Do you have questions for this one?

MR. JORDAN: No one has questions that I polled except Bank of New York has --

THE COURT: All right. Bank of New York has some questions. I'm sorry. Bank of New York offered the witness, Bank of America has the questions.

MR. JONES: Your Honor, it's Mr. Jordan's fault now for that confusion. In fact, I got a parking ticket at his office for parking in Bank of America

space.

MR. JORDAN: And I'm charged with collecting it, Your Honor.

CROSS-EXAMINATION

BY MR. JONES:

Q. Mr. Kamensky, Evan Jones on behalf of Bank of America. I think I have just one real simple question that I mentioned to you earlier.

THE COURT: You parked in the Bank of America parking lot at Bank of America and they ticketed you?

MR. JONES: Yes, they did, Your Honor, but I think I convinced them that I was there on Bank of America business.

THE COURT: I was going to say, was it a city ticket?

MR. JONES: No, no. It's Mr. Jordan's building.

MR. JORDAN: It cost me $25 to get the guard to do that.

Q. (By Mr. Jones) Mr. Kamensky, I just want to be real clear. The language in the term sheet refers to the priority of the liens that Lehman would receive for any loans. Am I correct in understanding that Lehman would not prime the liens in favor of Bank of America and its

syndicate members if it made this dip loan?

A. That is correct. That is the intent, is that we would not prime the Bank of America.

MR. JONES: Your Honor, I have no further questions.

THE COURT: All right.

MR. JORDAN: I don't believe any parties do.

THE COURT: Does anybody have any questions?

MR. BRILLIANT: No questions, Your Honor.

THE COURT: All right. Thank you.

MR. JORDAN: I don't believe there are any other witnesses in respect to these issues, so we move to reclose the record.

THE COURT: Okay. Are there any other witnesses?

MR. CLEMENT: No, Your Honor.

THE COURT: All right. The evidence is closed. All right. Now are we ready to argue?

MR. JORDAN: Your Honor, we are. This may take sort of a joint session for a moment. I'm not certain that we have defined how the argument goes, but we may have, who gets what and how much time. I do understand, Your Honor, that we have the rest of the day.

And I think there has been an agreement reached, but there was one issue about whether or not Mr. Pachulski was going to argue or whether that would come out of the time of that side of the table. And I'm not sure we resolved that. So I just didn't want to get started if there was a rules issue. Otherwise, I think we've got all the time defined for each party and the order, but I think that is an outstanding issue.

THE COURT: Okay. So is there a play sheet? Or are you going first?

MR. NEIER: No, Your Honor. I'm assuming that Mr. Pachulski doesn't get extra time, that he's part of the Noteholders' time, given Your Honor's ruling that you're going to let him argue, that's okay with us.

MR. GREENDYKE: I think you really need -- Judge, this is Bill Greendyke for the Indenture Trustee. You really do need to look at the play sheet because the one that was e-mailed around --

THE COURT: What are we planning on doing? Okay. Who's going first and how much time?

MR. GREENDYKE: He's going to hand you one.

THE COURT: Oh, we've got a play sheet. Okay.

MR. JORDAN: I e-mailed a play sheet that

I got.

MR. GREENDYKE: This is the play sheet that was e-mailed around yesterday.

THE COURT: Okay. Marathon an hour; MRC an hour; Bank of New York an hour; Scopac an hour; Palco 30 minutes; the Committee 30 minutes; California 15; federal agencies 10; Bank of America 30.

MR. GREENDYKE: If you count up the time -- there's two plans. If you count up the time that's allocated to the MRC/Marathon plan, we've got three plus hours for them. And what they're asking us to do is to take time out of the one hour that's allocated to the Bank of New York and give it to Mr. Pachulski who represents some of the noteholders. We have another counsel who is here who represents yet another noteholder. And I think the amount of time that's allocated to the MRC plan --

THE COURT: How much time does Mr. Pachulski want?

MR. GREENDYKE: 30 minutes.

THE COURT: How much time do you want?

MS. KELLER: Your Honor, less than five minutes.

MR. GREENDYKE: We would like an hour. And I would suggest to the Court that the three plus

hours that's allocated to --

MR. NEIER: Your Honor, that's fine.

THE COURT: I mean, if Palco is taking 30 minutes, why is Scopac taking an hour?

MS. COLEMAN: Your Honor, Scopac does not intend to use anything close to an hour.

MR. JORDAN: And I talk a lot faster.

THE COURT: That's true. We'll take judicial notice of the fact that you talk fast.

MR. JORDAN: We have no objection, Your Honor.

MR. GREENDYKE: So the order is as the play sheet goes except where to place Mr. Pachulski.

MR. JORDAN: I think we should place him in order with you.

THE COURT: So can I put Scopac down for 30 minutes?

MS. COLEMAN: Certainly, Your Honor.

THE COURT: And then put Mr. Pachulski in for 30 minutes? And then -- and I have already forgotten your name.

MS. KELLER: Babson Capital, Your Honor, Robin Keller for Babson Capital.

THE COURT: Babson Capital for 5.

MR. JORDAN: Your Honor, I'm not sure

where you're putting them.

THE COURT: I'm putting them either before or after Scopac, whichever they prefer.

MR. JORDAN: That's fine.

THE COURT: All right. Are we ready? Is anyone planning on having lunch? You know, are we just going straight through or are we going to break for lunch?

MR. JORDAN: I suspect we would break for lunch because it's going to take a while, I think, to get these issues done.

THE COURT: So would you prefer to break now for lunch and then start at 1 o'clock, say?

MR. BRILLIANT: Your Honor, I guess I have the enviable task of going first. I actually think that it would be better to have lunch first.

THE COURT: Okay. Then you get it. So we'll start at 1 o'clock. You can leave everything. If you have, you know, electronic things to do, make sure they're all set up ahead of time so we know they work and everything. If you need somebody to help you, let me know and we'll get it. Thank you.

THE CSO: All rise.

(A recess was taken for lunch.)

THE CLERK: All rise.

THE COURT: Be seated. All right. Marathon.

MR. BRILLIANT: Actually, Your Honor, it's Mendocino.

THE COURT: Mendocino. So the order is not --

MR. BRILLIANT: Mr. Neier and I had agreed to swap.

THE COURT: You're swapping. Okay.

MR. BRILLIANT: We swapped, Your Honor.

THE COURT: Okay.

MR. BRILLIANT: Good afternoon, Your Honor.

THE COURT: Is there any of these people saving time for closing or are you just going to do your hour?

MR. BRILLIANT: I'm going to save ten minutes for rebuttal. Mr. Fiero is keeping time. And at the end of 50 minutes, he's going to let me know.

THE COURT: All right. Thank you.

MR. BRILLIANT: Mr. Neier and I have decided to split up the closing on behalf of Mendocino and Marathon in support of our clients' joint plan. I'm going the deal with the evaluation issues, the fact issues, the testimony and with 1129(b), the cram down

issues. Mr. Neier is going to discuss the best interest tests and some of the other legal objections that have been raised by the Indenture Trustee.

Now, Your Honor, as you know, most of the attention during the eight day trial days of testimony was focused on the value of Scopac and its assets with a lot of emphasis given on the value of the timberlands in particular. And that's appropriate for this hearing because as Your Honor pointed out this morning, you know, the vast majority of all the parties in interest support the Marathon and Mendocino plan. Pretty much all the parties in interest, you know, save the Noteholders through their Indenture Trustee, you know, support the plan.

We count among those who support the plan the general unsecured creditors of Palco, the trade creditors of Scopac, Bank of America is the revolving lender at Scopac, the Pension Benefit Guaranty Corporation, the State of California through various of its regulatory bodies, the federal regulatory agencies, Palco itself, and now Maxxam, the shareholder of Palco, and last but not least, the official creditors committee, the joint committee for both the Scopac and the Palco estates.

So the only real issue, Your Honor, that's

left for you to decide is whether or not, you know, the plan meets the requirements for cramming down, you know, the two non-consenting classes at the Scopac level, both of which, you know, are the Noteholders, both their secured claim, you know, and their unsecured claim, their deficiency claim.

Now, as Your Honor knows, under the plan, the Noteholders will get $530 million in cash, subject to certain adjustments, you know, on account of their secured claim. And we believe and I'm going to discuss over the next few minutes with Your Honor that the evidence has clearly established that the $530 million, subject to the adjustments, is significantly more than the value of all their collateral, whether it be the timberlands or to the extent they have a security interest in a Headwaters litigation, any Headwaters litigation or any other collateral.

You know, accordingly, we believe that the Noteholders are getting everything they're entitled to under the bankruptcy code because they're getting more than the value of their collateral with respect to their secured claim. And that the plan meets all the other requirements and safeguards under the bankruptcy code for secured creditor and therefore, comports with the bankruptcy code and the plan is confirmable and that it

should be confirmed.

But before we get there and start talking about the expert witnesses and the valuation, you know, testimony and really focus just on Scopac --

THE COURT: Will you provide me with a proposed findings of facts and conclusions of law?

MR. BRILLIANT: We have a joint one that, Your Honor, it's being submitted. I think it will be submitted today.

THE COURT: Okay. What about the Noteholders?

MR. GREENDYKE: We have one, Judge.

THE COURT: Okay. And do you have it also on disk in Word?

MR. NEIER: We are giving it to you on disk in Word or we're e-mailing it to you. I don't remember which.

THE COURT: Okay.

MR. BRILLIANT: We'll get it to you very quickly. We have something that's completed. In light of the testimony being reopened, we have a few minor changes. We'll get that to you very soon.

THE COURT: Thank you.

MR. BRILLIANT: But Your Honor, you know, although most of the testimony and a lot of decisions

have to be made with respect to Scopac, I think it's important that we step back for a second and, you know, look at the case in the full, you know, context that we have here, both, you know, Palco and Scopac.

Now, we all know what the corporate chart looks like here. You have Maxxam on the top, you know, it owns 100 percent of Palco. Palco owns 100 percent of Scopac. Each of Palco and Scopac are separate legal entities. I think that's undisputed and undenied. Noteholders, you know, make a big deal about it. You know, we think maybe too much of a big deal. But it doesn't matter, it's undisputed, they're separate legal entities. But together they operate an integrated lumber business.

Now, by integrated, they are separate legal entities and they have separate businesses but together they operate an integrated, you know, business. Scopac harvests logs, sells them to Palco. Palco is, you know, Scopac's only customer. Scopac cuts the timber in its mills and it sells the lumber.

Now, as I said, during the confirmation hearing, we really emphasized, you know, the trees and the value of the trees and we have seen pictures of the trees. This, Your Honor, is a picture of the mill. As you can see, it's a pretty -- you know, it's a pretty

large, you know, mill. Here's a picture of the mill, you know, in the winter. The mill, as Your Honor knows, employs 150 to 200, you know, people. And in addition to the -- in addition to the mill itself, Your Honor, as we talked about it, Palco, you know, owns the town, you know, of Scotia. Now, there's been undisputed testimony during the hearing that, you know, Palco is a driving economic force for the town of Scotia. Most of the people in the town, they owe their livelihood directly or indirectly to the operation of the mill, you know, or to the timberlands.

Now, it's a little unusual in this day and age, you know, for a company, you know, to own a town. But that being said, you know, Scotia is a pretty ordinary, you know, small town. It's similar to many small towns all across America. You know, there's nothing fancy in Scotia. You know, working men, working women, small houses. This is the school.

THE COURT: Are those houses owned by --

MR. BRILLIANT: The houses, Your Honor, are owned by Palco.

THE COURT: And they're rented by the --

MR. BRILLIANT: And they're rented to people in the town. And that's one of the pieces of collateral, you know, for Marathon. Here's a picture of

the houses with the mill in the background. You know, here's the school. The school used to be owned by Palco, it was recently sold. But it's one of the few, you know, buildings in the town that actually aren't owned, you know, by Palco. There's playgrounds, there's churches, also owned by Palco, rented, you know, to the various denominations. You know, there's senior citizens and there's children.

Now, unfortunately, Your Honor, the employees of Palco and the townspeople of Scotia, you know, they're innocent but not disinterested bystanders in this valuation dispute over the valuation of the timberlands. You know, as Gary Clark, Mr. Breckenridge, Mr. Dean all testified, if the Indenture Trustee's plan were to be confirmed, it's likely that the mill will close, jobs will be lost and the effect on the town and its townspeople will be devastating.

Now, Your Honor reopened the evidence today and let in this term sheet from Mr. Emerson and his business. And I'm sure that the Noteholders will undoubtedly tell you in their closing that this last minute offer from Mr. Emerson somehow changes the calculus here a little bit in that if the Indenture Trustee's plan were to be confirmed, that the mill doesn't necessarily, you know, have to be closed, that

somehow Mr. Emerson and his company will buy the mill.

What they don't tell you is that the $27 and a half million that he would pay for the mill and the cogen facility is only 7 and a half million dollars more than the value of the cogen facility. And the undisputed evidence in the case is from one of the witnesses who didn't testify but came in by stipulation, was from Mr. Hodge, who valued the cogen facility, the Scotia power plant at $20,500,000. That's the evidence in the record about what the power plant is worth.

So the combined offer for the power plant and the mill at $27 and a half million is a bid for $20 million, effectively it's the cogen facility and only $7 and a half million for the mill. In addition to that, Your Honor, as was pointed out by Mr. Jordan, the Emerson term sheet would require that any buyer of the timberlands agree to sell 100 percent of the logs to the Scotia mill for 15 years. And as Your Honor has heard testimony throughout the last month during the eight days of testimony, the fact that the Indenture Trustee's plan and the bill bid -- the Beal bid rather, would both limit the amount of trees that would be sold to the -- to the mill to 50 percent or 40 percent respectively. And in addition to that, under the terms, it could be terminated, you know, on 18 months, you know, notice, not

anything close to the 15 year transaction that Mr. Emerson is requiring in order for him to be interested in stepping in and buying the mill. Which really confirms, Your Honor, what our witnesses have been telling you that without 100 percent dedication of the trees to the mill, that the mill is not likely to be able to operate and therefore, would likely be closed.

Now, Your Honor sat through eight days of testimony on the valuation of the various assets. And you heard two different types of testimony. You heard testimony from the expert witnesses. And we're going to go through some of them individually and talk about what they said and whether or not Your Honor should give it any weight. But you also heard a lot of testimony about other things. You heard testimony about the UBS sale process that occurred in 2004. You heard the testimony from Mr. Matthews from the Bank of New York, who, you know, is the person who, you know, is the Indenture Trustee or the representative of Bank of New York who acts as the Indenture Trustee here.

And he told you about how Houlihan, since April of 2007, you know, has been out soliciting third-party bids. His testimony was, quote "that they were beating the bushes," close quote, since August 2007 and how, you know, that beating the bushes, you know, had

led to the Nature's Conservancy expressing some interest, Harvard and other expressions of interest.

Now, the Noteholders are going to claim or claim that there's been no market test here, that we're asking Your Honor to make a decision about valuation solely on the basis of experts and somehow that subjects them to a risk of undervaluation. And we'll get into, you know, later the legal issues and 1111(b) and whether or not, you know, they waived any protections that they might have had to an undervaluation. But the reality is, Your Honor, that they're skewing the record. They're leaving out half of what Your Honor has heard here.

And what Your Honor has heard here is that there have been marketing efforts, there has been a market test. The market test has been substantial. And the fact that so many of these people have come into the courtroom or contacted, you know, counsel for the Indenture Trustee does give some sense here that there has been a market test, and the reality is the cold hard fact is that notwithstanding all of these marketing efforts, notwithstanding the publicity involving this case, notwithstanding the fact that Your Honor terminated exclusivity and Mendocino and Marathon, you know, filed a plan and that all of these other parties, whether it be Harvard, Nature's Conservancy, you know, this expression

of interest that Your Honor took judicial notice of today from Timber Star, all these parties have had an opportunity to do something, and not one third-party, other than Mendocino and Marathon, have put something that isn't contingent on the table that -- you know, here.

And in fact, the Marathon/MRC plan is the highest and best deal for the Noteholders at this point in time. After all of this market test, after all of this publicity, after all of these people coming in, it still is, you know, the highest and best proposal for the Noteholders. And that, when compiled on top of the expert, you know, testimonies, really gives Your Honor, you know, the comfort for knowing that the Noteholders are getting more than the value of their collateral, that they are getting the indubitable equivalent. They are getting everything they are entitled to get under the bankruptcy code.

Now, the Indenture Trustee, you know, puts a lot of emphasis on the Beal term sheet. And we don't believe that that's of probative value here for a whole lot of reasons. And we'll get into that in detail in a little bit. But first, I think, Your Honor, it's worthwhile to go through the expert testimony a little bit so that Your Honor can get a sense from our

perspective what it was you heard and how we summed it up. And we put this in our brief and I'm sure that Your Honor has reviewed it. So I'm not going to repeat all of our views of the experts. And you'll see it also in the proposed finding of fact but I think it is worthwhile to go through a little bit who it is that testified here.

Now, Your Honor heard from two experts on behalf of the Indenture Trustee in this hearing. And in addition, through our designation of deposition testimony and the admission of prior affidavit, you know, we gave Your Honor the testimony of Mr. Di Mauro, Mr. Christopher Di Mauro from Houlihan who had previously valued, you know, the Scopac assets. And he did that in September of 2007. Now, you have the two valuations from Houlihan Lokey, one in September of 2007 by Mr. Di Mauro, and then you have the latest one from Mr. Daniel from March of this year.

Now, one of the things that I know Your Honor, you know, has noticed is that the Indenture Trustee to some extent has been hiding the ball a little bit about what it is that Houlihan Lokey's relationship would be with the Indenture Trustee on a go-forward basis after the confirmation of the plan. Now, we know that the -- under the Indenture Trustee's plan, they would be the sale agent. And the testimony is that they are going

to get a fee. Mr. Matthews, the Indenture Trustee, testified that they would get a fee. And in the deposition designations from Mr. Di Mauro, he said they would get a fee. And Your Honor probably remembers when I cross-examined Mr. Daniel, he said that it would be customary and he would expect that his firm would get a fee.

Notwithstanding the fact that they would get a fee, the Indenture Trustee, you know, has not told Your Honor what that fee would be. Now, as Your Honor probably remembers, we sought to exclude Mr. Daniel's testimony on the basis that because he had a contingent outcome in this case, he had a contingent fee, so to speak, in this case because if the plan was confirmed, his firm would get a fee here. The Indenture Trustee -- and Your Honor overruled that and left it to weight. But notwithstanding that and notwithstanding the cross-examination on the issue, the Indenture Trustee has still never told you, their counsel have never told you what it is that the fee that Houlihan would get.

Now the evidence is closed for the second time, hopefully for the last time, you know, and it's too late. But I think it's important that Your Honor keep in mind, one, that Houlihan Lokey does have a contingent interest in the outcome here. And two, the fact that

whether that interest is exceedingly large or relatively small, Your Honor doesn't know. And they could have told you and they chose not to tell you. And I think Your Honor should make, you know, some presumptions against the Indenture Trustee with respect to their failure to come clean with you as to what that amount of their fee would be.

Now, in September 2007, Mr. Di Mauro submitted a valuation of the timberlands, and he opined that the timberlands were worth between $375 million and $500 million using a discounted cash flow analysis. And $290 million to $460 million based on a comparable company's analysis. Both of his ranges, high end, are less than the distributions that the Noteholders would get under the Mendocino/Marathon plan.

Now, their report was prepared in September of 2007. It was prepared with the assistance of Mr. Di Mauro's helpers, you know, Mr. Eric Winthrop, Mr. Brad Meyer. And in the deposition designations that we gave for Mr. Di Mauro, Mr. Di Mauro testified that since the September 2007 valuation, that the housing market has softened, the construction is down, and that, you know, the housing markets generally have deteriorated and that the debtor's business has generally suffered due to a severe liquidity crisis.

In addition to that, Your Honor, you heard numerous testimony from many of the experts in this case that the price of redwood, especially young redwood, has gone down significantly, 10 to 15 percent during the last several months since the real estate recession, you know, has taken hold in the United States.

Now, this valuation was in September of 2007, and as I said, things have only gotten worse, you know, generally from a marketplace perspective. Now, obviously the trees may have grown and other things may have occurred during that point in time, but generally, you know, things have gotten worse. Now, Your Honor knows you didn't see Mr. Di Mauro, you know, here to testify, that his -- his original valuation, you know, came in as an exhibit and that the deposition designations came in, but you didn't see Mr. Di Mauro. Instead, you saw Mr. Glenn Daniel from the valuation group at Houlihan Lokey and he came in and testified.

And I'm sure Your Honor will recall that when I cross-examined him, Mr. Daniel said that he got involved in this matter when he received a call from Mr. Di Mauro and he told Mr. Di Mauro that he was too busy to do the matter, he didn't want to do it. And then miraculously, his words, miraculously, Irwin Gold, the head of the restructuring group of Houlihan just got on

the phone, didn't know how he got on the phone, just joined the call, he asked him to do it, he told Mr. Gold he was too busy, he couldn't do it, and then again, you know, doesn't know how it happened, the co-CEO of Houlihan Lokey, which is a large organization for being a co-CEO, is a big job, the co-CEO also seemed to manage to join the call and Mr. Jeff Werbalowsky, the co-CEO of the company, you know, said to him you're going to do this, aren't you? And he said that, you know, that he would.

And then that very same day, a report, a draft valuation report showed up from Mr. Daniel, got an e-mail, he thinks it came from Mr. Meyer, and that he then spent about a week from March 4th to March 11th, you know, reviewing it, had some conversations with some people, it was sent to him in a PDF format so he wasn't even in a position to mark it up. And in fact, he testified he didn't mark it up. He gave some comments on the telephone and that became, you know, his report.

It's clear he was pressured into doing this and that the co-CEO of his firm told him to do this. He also -- Mr. Daniel testified that he was told these are important clients and this is an important matter, you know, to Houlihan Lokey, you know, and he agreed to do this. Now, what's really mystifying is that Houlihan picked somebody to do this who had no timber expertise,

had no industry expertise at all, asked him to sign off on a report in a week that he didn't draft. And when Mr. Daniel was cross-examined at his deposition, as he testified here in front of Your Honor, he didn't even know at the time of his deposition the fact what the harvest rate was at the company and he didn't even know that the harvest rate had been coming down dramatically over time. And he wasn't aware of many of the other significant issues about the company's business, its revenues, and its expenses.

So he basically, you know, was testifying to a report prepared by others in an industry he had no expertise based upon specialized knowledge that he didn't have in his report. On those reasons alone, you know, should be completely dismissed by Your Honor and found, you know, not to be credible at all.

But Your Honor, it gets even worse for the Indenture Trustee than that with respect to, you know, Mr. Daniel. When he was cross-examined, he didn't know at the time of his deposition -- he acknowledged that he didn't know at the time of his deposition that he used three methodologies, weighted them all equally and that one of the methodologies was based upon an average of three preliminary bids that the company had. He used three methods, a discounted cash flow method, a

comparable companies method and he used a preliminary bids method.

Now, at the time of his deposition, he denied that he had given a third, a third and a third weight to those and he acknowledged that here in front of Your Honor. He also acknowledged that it was inappropriate to use preliminary bids because they weren't binding on the parties and therefore, wasn't something that was a good indicator of value.

He also indicated that he had never done it before and had never seen anyone else who had used preliminary bids as an indicator of value. So but a third of his valuation was based upon these preliminary bids. And as Your Honor probably recalls from his testimony, the three preliminary bids were the Beal bid, the -- what we call bidder B. Your Honor, I take it you remember who bidder B is. We have this confidentiality protective order with them. Do you remember who they are? It was an East Coast university endowment fund.

THE COURT: I don't remember. I won't say it on the record, if that's what you're telling me.

MR. BRILLIANT: Because if you want, I could -- the last time I gave you a note. Do you want me to do it again? It doesn't matter.

THE COURT: I think everyone knows who

bidder B is.

MR. BRILLIANT: Okay. In any event, Your Honor, the second was bidder B and the third was the Nature Conservancy. And Mr. Daniel, and even though he gave one-third of his weight to these three bids, at the time that he did this, he was not told by his colleagues that bidder B, who he gave in his report a valuation of $560 million had indicated that they no longer were prepared to pay that and in doing more due diligence they had lowered their number.

And that the Nature Conservancy, when asked to sign a letter of intent, said quote "no way, no how," and that they weren't prepared, you know, to move forward. And he also wasn't told that the Nature Conservancy had not arranged for any financing and in fact didn't have any financing to finance the transaction. So he relied on information and facts that Houlihan Lokey, at the time that he relied on it, knew wasn't accurate, knew wasn't appropriate.

And more than that, more than just using a third valuation, relied on these three bids. He then used these three bids as a means to come up with his discount rate for his discounted cash flow analysis. So not only were these three bids a third of the -- of his valuation, he then also used them in a polluted -- one of

his other two methodologies, the DCF. And as Your Honor probably recalls from the testimony, Mr. Daniel calculated the DCF by using a weighted average cost of capital, which came to 11.2 and he did that by, you know, miscalculating the beta, by using a beta that was different than his mean and his median in order to come up with a lower discount rate.

And then after doing that, he decided to lower -- he said the only reason for lowering it was because he believed that the discount rates used by the three preliminary bidders was in fact less than that and so he lowered it, you know, to 10.5. And Your Honor, two of those parties were not really interested anymore at the levels that, you know, were discussed. And the -- and consequently, it made no sense.

And also, in order to back out a discount rate, one would have had to know what the financial projections were that the other parties were relying on. And when Mr. Cherner testified, Your Honor, I'm sure you recall, we asked him whether he used the same financial projections that were used by -- were prepared by Fleming and he said, no, he did not. So in order to even use the third preliminary bid, you know, the Beal bid, the $603 million which would have come up with an even lower discount rate, it was based on a premise that wasn't

true, the fact that Beal was using the same financial projections as prepared by Mr. Fleming.

So the DCF, you know, itself and the discount rate itself really have, you know, no validity as prepared by Mr. Daniel. And in addition to that, Your Honor, as you know, the discount cash flow is two things, you know, the first thing is it's a projection of future earnings and discount it back. As we talked about, the discount rate that he came up with was inappropriate. And more importantly, the financial projections themselves were given to Mr. -- given to Mr. Daniel by Mr. Fleming. He relied completely on Mr. Fleming's financial projections.

And as Your Honor probably recalls, there's two huge, you know, hockey stick jumps there. The first is from -- in 2008 they show an 80 percent increase in cash flow in the first year. And then what Mr. Fleming had done, which was different than what all the other experts in this case, whether they be our experts or Scopac's experts, instead of doing a 50 year harvest rate he did a 15 year harvest rate and then he had a second jump right before the terminal valuation where he increased the value again, and therefore, dramatically, you know, increased the -- you know, the net present value under the discount rate.

The third methodology that Mr. Daniel used, you know, was equally unreliable. He used a comparable companies analysis. And I'm sure Your Honor has heard lots of experts testify about comparable company analyses. Usually you take last 12 months EBITDA or you take, you know, a past multiple or you use a forward, you know, multiple, the next 12 months EBITDA. Mr. Daniel didn't do either of those. He didn't use either of those. Instead what he did was he took the last six years of earnings and Mr. Fleming's projections for the next three years. He took nine years of earnings, averaged them out and then applied a multiple against them. And the multiple that he used was significantly higher, you know, than the mean or the median of the comparable companies he used.

So he didn't even -- he took four comps and threw effectively three of them out, only used the high one, the Plum Creek one, which is a very large, you know, company, doesn't do business in California, isn't in redwoods, gets a lot of its revenue from manufacturing, not a particularly good comp. And he used an incredibly, you know, high EBITDA. A multiple, you know, based on that. Completely unsupportable.

And when asked about the fact that the average EBITDA that he was using for the multiple, you

know, was much greater than last years, it wouldn't be achieved, you know, for ten years, Mr. Daniel said he was trying to average something out, you know, to get a sense of what the company can do. But it's just a methodology and it wasn't appropriate. It was designed, you know, solely to increase, you know, the valuation and try to distinguish themselves from where they were with the valuation from Mr. Daniels, you know, colleague, Mr. Di Mauro. Now, you know, because the valuation was riddled with inaccuracies, you know, it really shouldn't be counted, you know, at all.

Now, the second and only other valuation expert that Your Honor received from the Indenture Trustee was Mr. Fleming. And as I said earlier, Mr. Fleming was the only expert who didn't use a 50 year, you know, harvest analysis. Now, Mr. Fleming equally was unqualified to do this work. In fact, he only once previously had done any kind of large timberland valuation, other than some work he had done but never completed with respect to Scopac. That was in 1978, it involved about 24,000 acres of real property. Something very different than valuing Scopac's assets.

Now, there's several major problems with the analysis that was done by Mr. Fleming. First, he only did an income approach. That's number one. Two, as

Your Honor probably remembers, he did his analysis using an Excel spreadsheet. You heard on the one hand, you know, Scopac's experts who used this fancy Options system, Mr. LaMont used a very complicated system. Mr. Fleming, he based his entire analysis of the harvest rate and everything else on an Excel spreadsheet without doing any kind of stand-by-stand analysis, looking at what could be harvested, anything of the sort. You know, instead, he, you know, did this with just those numbers. And again, his projections that he came up with are just ridiculous in light of what's going on at this company and what's going on in the housing market generally.

He didn't take into account his EBITDA gross 80 percent in year one, no explanation for that. And then kicks up again, as we said, right before, you know, the terminal valuation effort. Other problems with the Fleming valuation is it was done in September -- I'm sorry, October of 2007, prior to when the, you know, pricing came down, you know, in the marketplace. And Mr. Fleming, you know, chose not to take into account all the new market data about what was going on in log prices because of the industry downturn in housing. He also grouped the price of logs starting with the 2007 price at a very high, you know, level, which left -- you know, compounded his errors over time and also made his issues,

you know, just inherently unsupportable.

So from the Indenture Trustee's evidence were two expert witnesses, neither of which were credible. They weren't credible individually standing on their own, they weren't -- didn't have the sufficient expertise to give this report and they came up with very skewed analysis, and analysis which are very different than what Houlihan's own valuation was in September 2007 before the market turn down.

Now, Scopac had equally unreliable testimony, but for different reasons. I'm sure Your Honor remembers seeing Mr. Yerges, and the biggest problem in his valuation was that he has a real price increase for redwoods for 1.5 percent per year in perpetuity. He's basically saying redwood prices will go up 1.5 percent every year, compound every year, you know, forever, different than even the very aggressive presumptions and assumptions, you know, made by Mr. Fleming.

He also, you know, based his analysis on an expectation that the species mix, the mix between redwoods and Douglas Fir would change over time. And that growth rates for the trees would become much higher than they have historically because of, you know, the planting of cultivars, you know, genetically modified

redwood trees.

He didn't really value the timberlands as they exist today, he valued them as one might hope they would be, you know, 30 or 40 or 50 years from now, but that's not how anybody in the marketplace would look at it. And it's just not something that Your Honor should give, you know, any weight to that.

With respect to Mr. LaMont, Your Honor, he did his analysis the right way, used the right discount rates. And his analysis, you know, which comes up with a valuation of $430 million is consistent with Mr. Dean's testimony as to what the limitations are on the ground in terms of harvesting. You've got pricing right. And Your Honor, we believe that that's the best valuation here.

Now, with respect to the Beal term sheet, Your Honor, the Indenture Trustee would ask you to put a lot of weight into that, given the fact that the -- from an expert witness perspective, it didn't go so well for them, they would say, well, you know, everything is okay, you should still not approve this plan because Mr. Beal has agreed to pay $603 million for the timberlands and therefore, you know, that's the value. But we all know there's problems with that argument. First, Beal owns 38 percent of the notes. He's an insider. He doesn't really want to own them. All he wants to do is have an

auction. That seems to be what he wants to do.

And something I can't figure out, but the Beal term sheet is expired. Now, obviously the -- you know, here, Your Honor, is a copy of the amended April 28 term sheet. It says "the offer expires May 10, 2008 unless on or before such date the Indenture Trustee's plan is confirmed and the buyer is selected as a stalking horse bidder in accordance with the terms and conditions provided herein." Obviously, neither of those things happened and so even if you thought that this was rock solid, as the Indenture Trustee would tell you, it's not today, you know, because it's expired. Obviously they had every opportunity to extend that.

And Your Honor probably recalls, there was a mix-up the last day of testimony about the red line and there was a red line version that had May 30th dates in there for that. Mr. Neier got up and said, Judge, the red line isn't right because that's not the date that's in there, it says May 30th in the red line. And Your Honor astutely pointed out, well, obviously Beal backed off of that date. And in fact he did, he put in a date which has now expired.

But even if the expired Beal bid hadn't expired, it doesn't really reflect value for a whole lot of reasons. One, it's not really binding. The only

thing binding about it is they fact that they called it a binding amended term sheet but it's not really binding. All the binding would do is to negotiate in good faith for a massive purchase agreement.

There was testimony from Chris Matthews, the Indenture Trustee that there were drafts of a massive purchase agreement flying around, that they thought they would have something done and in fact the expectation was that there would be one signed before May 10th, but there is no asset purchase agreement.

And I think what is more important than the term sheet itself is the conduct of Mr. Beal. Your Honor, we sought to depose him so we can get an indication as to what this was all about, whether he was really serious about it, whether there were conversations that he had had with other noteholders about whether or not they would -- whether they would credit bid so we could get some sense of whether this was real or not. And as Your Honor recalls, the Indenture Trustee fought us on that.

And ultimately Your Honor said it's up to Mr. Beal as to whether or not he wants to come in and, you know, testify and sit for a deposition as to whether or not he wants you to take his bid seriously and they chose not to have him sit for a deposition and not to

come in.

I think his actions -- Your Honor, I think his actions speak much louder than words. And if he really was serious about a $603 million bid, there would be an asset purchase agreement, he would have come in and testified. And we would have had, you know, a very different analysis here with respect to the bid rather than having a nonbinding term sheet.

Now, Your Honor probably recalls one of the main issues that we had raised in cross-examination with respect to the Beal term sheet was the fact that it requires a settlement of the Headwaters litigation both for Scopac and Palco and the settlement has to be in the best interest -- I'm sorry, has to be acceptable to Mr. Beal. And we don't know what that means and we weren't able to, you know, cross-examine Mr. Beal as to what that would be. It may be that he would only go forward if it could be settled for $100 million, maybe he would go forward if it was completely dismissed. You know, we don't know but obviously it's a big contingency and basically it's an out for Mr. Beal, you know, if he doesn't --

THE COURT: Are you going to talk about the value of the Headwaters agreement?

MR. BRILLIANT: Yes, Your Honor. Do you

want me to skip to that?

THE COURT: Yeah.

MR. BRILLIANT: Yes. Okay. Let me say one more thing about Beal.

THE COURT: Okay.

MR. BRILLIANT: Your Honor, one other thing I wanted to point out is, you know, we've always thought that the Beal offer was really just something, you know, to be used in the court as evidence on value in order to, you know, skew the issues here. And that it was really, you know, just a precursor to a credit bid. Now, as Your Honor knows, under the indenture that governs the timber notes here, the Indenture Trustee would be required to credit bid unless two-thirds of the Noteholders, you know, waive the credit bid requirement.

Mr. Greendyke in his affidavit in connection with the conversation he had with the Noteholders regarding the modification of the plans, says that he communicated with 75 percent of the Noteholders. And there's testimony that the steering committee of the notes had more than two-thirds of the notes. So at any time they wanted to, the Indenture Trustee could have, if they really -- this isn't just a precursor for a credit bid, they could have asked two-thirds of the Noteholders to agree that they would waive a credit bid here and have

a direction that they would give to the Indenture Trustee that would be irrevocable so that Your Honor would know this really was a bid and that Mr. Beal was going to take economic risk and that he was interested here in closing on the transaction but they didn't do that. You know, again, they kind of hide the ball, you know, from Your Honor as to what their true intentions are but they had the opportunity, you know, to do it, you know, and they chose not to.

Let's talk about the Headwaters litigation. I think, Your Honor, you're right, I think they make a big deal about it in their brief. I don't think that, you know, it's really that hard of an issue here for Your Honor. Admitted into evidence with respect to the Headwaters litigation is a complaint, the answer to the complaint, the motion to dismiss the complaint, and you know, that one sentence, you know, preliminary order with respect to the preliminary denial of the motion to dismiss certain of the counts on the -- on the pleadings. In addition, there was some testimony by Mr. Dean about a business person's view of it. And of course, there was Mr. Lumsden's testimony, the expert put on by Scopac as to his damage calculation.

Now, Your Honor, you don't have to be a constitutional scholar when reads the complaint and the

motion to dismiss and the answer to realize that this is a really, really hard lawsuit for the Indenture Trustee -- I'm sorry, for the Plaintiffs, for Palco and Scopac to succeed. Basically what they're alleging is that when the State of California entered into the Headwaters agreement, that the legislature of the State of California agreed never to promulgate any more, you know, legislation regarding timberlands that might adversely affect the Headwaters and that the water board, which was not a signatory to the agreement, was somehow bound by, you know, implied language in the agreement to not do its job anymore and regulate, you know, the -- you know, not to regulate timber as it relates to silt going into the water lands of California.

Clearly that is a very difficult piece of litigation. Mr. Dean, you know, testified that as a business person, you know, he had, you know, problems with seeing any merit in that, acknowledged that he didn't talk to any lawyers about it, hadn't done a complete analysis, didn't see what he would do. Mr. Cherner, on behalf of Beal, had indicated it needed to be settled and it would be very problematic to own the timberlands and to simultaneously be suing your regulator. To the extent that there is any value there, you know, it may very well be that any value in pursuing

litigation also takes away value for the timberlands, based on Mr. Cherner's view. But in any event, it's pretty clear, although the possible damages, you know, might be, you know, very large, the likelihood is success. As I said, if you just read the answer, Your Honor, I'm sure you will very quickly come to a conclusion. It's, like I said, I think any first year law student would.

THE COURT: It doesn't matter that in your plan you have both Scopac and Palco unsecured creditors sharing in the results of the Headwater agreement because there's no value to it.

MR. BRILLIANT: Your Honor, I think our plan is a little bit different. We do not put it in a litigation trust. Our plan just leaves the Headwaters litigation to Newco, transfers it into Newco. Our view is that the value of that, we think, it's very small, it negligible. But if it were large, there's enough of a cushion between the value of the timberlands and what the Noteholders are getting.

You know, we believe that the timberlands are worth 430, our plan gives them 530, you know, subject to certain adjustments that should be relatively minor. And so there's, you know, 80, 90, $100 million of cushion there, you know, at best if Your Honor thought, you know,

it was a 50/50 case. Like I said, it's not a 50/50 case. Your Honor has seen enough lawsuits to know it's not anything close to that. You know, it's a five or ten percent case at the most. But in any event, we're talking about a big enough cushion that they're getting sufficient value from an indubitable equivalent, you know, perspective that Your Honor can, you know, confirm the plan.

If -- you know, we don't suggest this and I know Your Honor doesn't view that, you know, you have the right to, you know, red pencil a plan. But if Your Honor thinks that the Noteholders have to get, you know, the litigation, you know, in order to confirm the plan, you know, I guess we would like to hear that. But we don't see that, Your Honor. They would be more than adequately compensated for it. Their own testimony from Mr. Beal is that it doesn't have that much value.

THE COURT: Well, I'm just wondering why you didn't -- whatever you settle it for, I mean, I'm not so certain that you have to give them the litigation, but you at least have to give them those proceeds from the litigation that would be attributable to Scopac, wouldn't you?

MR. BRILLIANT: We don't think we need to do that as a matter of law, Your Honor, because of this

cushion that we believe --

THE COURT: Well, if there's not a cushion, if it's of value, if it's a significant value, then you would have to do that. I agree with you, if there is a sufficient cushion to pay the value of it. But how do I -- how do I value it then? I should just read the answer and I should use my practical experience to say that it's a five percent case and multiply five percent times the probable damages and then try to assess what portion of that goes to Scopac. And as long as you paid them more than that amount of value over and above the value of the timberland, then you're okay?

MR. BRILLIANT: Yes, Your Honor. Now, I think Your Honor could come up with very high percentages, you know, relatively high percentages of likely success, discount out what you think the cost of litigation would be, which would be, you know, amends and still have enough of a cushion here. Because you're talking, you know, high end $200 million, you know, of damages that Mr. Lumsden testifies to, you know, for Scopac. He actually breaks the damages down. But I don't think it's -- you know, obviously Your Honor knows that's that what the plaintiff would ask for, not necessarily what anybody would give them. And --

THE COURT: What was the amount that they

said the damages were?

MR. BRILLIANT: Roughly $200 million, I believe.

MR. PACHULSKI: Excuse me, it was over $300 million on Scopac alone. Sorry to interrupt.

THE COURT: You think three, you think two, okay. Somewhere between $200 and $300 million.

MR. BRILLIANT: Right. But Your Honor, that's what we think. Like I said, if Your Honor thinks that we need to give them the litigation, you should let us know and that's something we would consider.

THE COURT: Well, if you don't think it has any value, I don't know why you didn't just give it to them anyway.

MR. BRILLIANT: I think, Your Honor, it's the reason --

THE COURT: Unless you think that the value is that because it has no value to settle it.

MR. BRILLIANT: That's right, Your Honor.

THE COURT: But if you give them the litigation and you buy and run the operation, it's not like the estate can hold it against you. I mean, you have to do what you have to do. But go ahead.

MR. BRILLIANT: Your Honor, if you like --

THE COURT: I mean, if you added the

creditors' committee so you didn't have to worry about standing.

MR. BRILLIANT: That's right, Your Honor.

THE COURT: You came up with cash so that you didn't have to worry about the indubitable equivalent.

MR. BRILLIANT: Yes, Your Honor.

THE COURT: You just -- I mean, the issue of the -- well, go ahead.

MR. BRILLIANT: Before Mr. Neier is done, I'll get back to you on this issue.

THE COURT: Okay.

MR. BRILLIANT: I see I'm starting to use up all my time, Your Honor, so I'm going to very quickly talk about 1129(b).

THE COURT: Okay.

MR. BRILLIANT: I think, Your Honor, we have a fundamental disagreement with the Noteholders as to how 1129(b) works with respect to secure creditors and fair and equitable. There are three different buckets, as Mr. Pachulski refers to them, but they're linked by an order, you know, and they are disjunctive. And if you meet any of the three tests, including indubitable equivalent, then the plan can be confirmed over the objection of the secured creditor with respect to the

secured portion of the class. You know, we cite in our brief the May case, the broad case. We believe that those are, you know, the best cases on this particular point.

The Noteholders have a convoluted statutory argument. They argue that even though there is an order and even though in their opening brief, you know, they say that they are in the disjunctive and if you meet either of the three tests, that the plan can be as fair and equitable with respect to a secured claim. They now say that with respect to the second test if there's a sale of assets, then it has to be subject to a credit bid.

And they say that since number two is more specific, that that overrides number three, and therefore, it has to be interpreted that way. And they go further and they say that to read it any other way would give the credit bid, you know, analysis, you know, no meaning in the statute. And you know, that's wrong for a number of reasons.

First, as we say, it's clearly written in the order, acknowledged in their opening brief a number of courts, including courts of appeals, have said that it's disjunctive and you only have to meet any of the three tests. The second thing is that the issue with

respect to the sale of assets, that doesn't require that the Court make any judicial determination of value. That just says that if there is a sale and they're given a credit bid, then that's fair and equitable, period. The Court doesn't have to have a hearing and say was the sale to the highest and best bidder, was it a fair price, was there a good marketing effort, any of the other types of tests you might have to meet under 363 of the bankruptcy code.

The indubitable equivalent test is an entirely different burden. It's a burden on the movant and to show that the party is being completely compensated for the value of its lien. You know, the secured portion of its -- you know, the value of its claim is a secured portion of its claim, you know, through evidence. So it's a very -- it's a very different, you know, test. And what they're trying to do is ask Your Honor to read into the statute a right to a credit bid where none exists.

The other thing is there's a number of -- number of cases, we cite them in our brief. I think the Orfa is the best case where the courts have said in a sale process -- I'm sorry, in a plan process, even if there is a sale, there's no right necessarily to credit bid. The credit bid right is something that comes in

363.

THE COURT: The code does talk about 1129 and 363 together as a sale and a plan. I mean, isn't that the second prong? If there's a sale and a plan then --

MR. BRILLIANT: That's right.

THE COURT: -- you have to give them a right to credit bid.

MR. BRILLIANT: That's not what it says. It doesn't say if there's a sale and a plan you have to give them a credit bid. It says it's fair and equitable if there's a sale and a plan and you give them a credit bid. Like I said, it's not that if there's a sale you have to do it. That's what, you know, what Orfa and other cases say. It's not that you have to but if you do a sale and you give them the right to credit bid, regardless of whether the price is fair, that meets the fair and equitable test because the secured creditor has the right to take their collateral under the circumstances.

Here, you know, there is not -- we don't view this as a sale, there is a transfer of the assets, you know, to the Newco. It's not the type of a sale -- it's not a 363 sale, it's not the type of a sale that would give the right to a credit bid. We also cite in

our brief a number of cases in the 363 context where credit bids are not allowed.

THE COURT: I would ask that if I believe the analysis of the Noteholders to be true with respect to that provision, then there could be -- never could be a third-party plan of any sort, any plan other than a debtor's plan in which there would have to be a credit bid.

MR. BRILLIANT: I believe that's what they are telling you, Your Honor, that that's their view of the law. I don't think that's right, but I think that's their view of the law. And I think in this context here where you have multiple debtors that operate an integrated, you know, business that has -- if that were, you know, the view, you could get stuck in a situation where you would have, you know, lienholders on assets --

THE COURT: Well, if you have an integrated plan which is part of the overall process of whether you call it sale or transfer, assets are conveyed to a new corporation. The structure obviously is subject to lots of plans. If you have that situation, what would the right to credit bid then be? To take that plan exactly as somebody else has suggested it and pay off all the creditors? And only credit bid your claim? Or would it somehow have to provide -- are we suggesting if that's

the case, that you have to structure a plan even in the context of comprehensive sale of a bunch of assets with a bunch of creditors and everything or each piece is individually credit bid by each secured creditor? Or do you just simply have to give them, even if they're right, you have to give them the right -- all you have to give them is the right to credit bid, pursuant to your plan, the entire deal.

MR. BRILLIANT: Right. Your Honor --

THE COURT: Where you get credit for your lien, but you have to come up with all the rest. You have to pay off Marathon, you have to do all the rest of the things to come up with the cash to fund the unsecured creditors the way they did over the whole process, all of those things.

MR. BRILLIANT: Right. Your Honor, as I said, we believe that Your Honor makes judicial findings of indubitable equivalent, that's just the end of it. Don't go any further. Now, if you were to go further and you don't agree with that, that somehow they're not disjunctive and that they're not alternatives, that if you meet any of the three tests, you know, that's not good enough. And they cite Colliers also for the proposition of the credit bid, but if they would have gone earlier in Colliers, it talks about the section

itself, you know, it says there are three different tests, you only have to meet one. You know, they just cite the part on the credit bid, they don't cite the entire section and they get out of context. I don't think, you know, Colliers even agrees with them.

But even if Your Honor were to conclude that it's not disjunctive and you have to, in a sale context, I guess we would say this isn't a sale, it's a transfer. And then if Your Honor doesn't buy that -- which I think you should -- and if Your Honor needs us to be, you know, structured in a different way, if you want to accept form over substance, we think would not be following the law, but there would be ways that we could structure this as well, you know, to meet that requirement.

But, you know, our sense is even if you got there, this is a case where you would not allow a credit bid. And, you know, or you would modify the credit bid, as Your Honor is saying, in such a way they would have to meet an entire plan because otherwise you're giving one group of creditors that have liens on assets to be able to blow up a plan.

I mean, to put this in the context of another type of enterprise, if you had a hardware store and you had a lender who had a lien on the shelving and

you wanted to sell, you know, the enterprise, they can't take the position yet, you know, pay me in full or I'll credit bid for the shelves and destroy the value of the store. You can't let one creditor use their credit bid where they would be getting the indubitable equivalent.

THE COURT: The alternative to that argument is that they contracted the right to be a separate entity and have separate security for that one particular piece. Perhaps with the notion that if we ever go to bankruptcy, we're going to be the only creditor, nobody else -- we don't have to compete with anyone, we don't have that problem. So we're going to have a right to credit bid.

MR. BRILLIANT: Like I said, they're part of a separate entity but part of an integrated, you know, business here which involves multiple debtors. I think Your Honor should, you know, take that into account in analyzing, you know, what rights, you know, they have here.

The other thing here is, Your Honor, we spoke very briefly about 1111 --

MR. FIERO: His time is up. Obviously yours is not, Your Honor.

MR. BRILLIANT: Can I finish with this? And, you know, with respect to 1111(b), Your Honor, we

did give them the opportunity to elect 1111(b) and that would have provided them the protection of Your Honor --

THE COURT: $100 million over 30 years with what interest, none?

MR. BRILLIANT: What's that?

THE COURT: No interest, just for 30 years?

MR. BRILLIANT: It was a very low interest rate, Your Honor, but they chose not to do that. They had the right, you know, to the extent that they viewed it was a risk of Your Honor undervaluing their collateral, they had right under 1111(b) to make an election and they chose not to do that.

THE COURT: Are there cases under 1111(b) as to what constitutes a valid provision and a plan for an election under 1111(b)? I mean, can you load it up with so little interest that it's so unattractive that they can't possibly take it and so they don't really have a meaningful election.

MR. BRILLIANT: Well, that's a different issue, Your Honor, because they could have -- they could have made the election and then argued the plan wasn't confirmable for all of those reasons but that they were entitled to the full amount of their claim with the present value of their collateral and argue that the

notes didn't give them the right interest rate but they chose not to do that. And there are a number of cases, Your Honor, that say that, you know, credit bid and 1111(b) are mutually exclusive. You know, you get one right or the other because they decide to protect, you know, a similar thing. Here they had the 1111(b) right, they chose not to exercise it. That puts them in a position where, you know, they shouldn't be able to claim now that they should have a right.

THE COURT: All right.

MR. BRILLIANT: Thank you, Your Honor.

MR. NEIER: Good afternoon, Your Honor, David Neier on behalf of Marathon. What I'm going to try and do is I'm going to try and answer the Court's questions and really go through really in linear order the objections raised in the Indenture Trustee's brief. And if you have any questions on any particular subject, you know, it might be the way to ask them.

The expired Beal term sheet, according to the Noteholders, results in a $603 amount, $603 million amount. And the Noteholders compare that to a $517 million amount by the MRC/Marathon plan being distributed to them, but of course, the $603 million amount is a gross number and the $517 million was a net number. As you may recall, our plan provides for $580 million being

contributed in total to pay the administrative claims, Bank of America, one of the members of the jury who has now evacuated the box. And it's only fair to compare apples to apples. You don't compare a gross number of $603 million, assuming that there was a valid term sheet existing to that amount to $517. What you do is you try and figure out what is the distributable value to the Noteholders.

And Mr. Johnston testified that if you take out the administrative claims, you take out Bank of America's claim, you pay the priority claims, you pay the secured tax claims, what you're left with under the Noteholders plan, including their distribution to unsecured creditors under their plan, you would be left with $505 million after they have their auction period and they have their -- the time value money because the auction is going to take some time and then they're going to need regulatory approval which we assume to be 60 days but it could be longer.

In fact, you may recall that Mr. Johnston said I have no way of valuing it or determining the risk of not getting regulatory approval because I'm just not an expert in that area. And you heard from the State that they have complete and total discretion to grant or deny regulatory approval to any particular bid.

So when you compare these bids, if you consider the Beal term sheet, the expired Beal term sheet a bid, against each other, it's clear that the MRC/Marathon plan actually provides more distributable value to the Noteholders than is true under the Beal term sheet. And the reason that we all think that the Beal term sheet is really just a means to an end, the end being a credit bid, is of course, not only because of the conditions, but because the amount of distributable value from that term sheet would be less than the MRC/Marathon plan.

Now, is it surprising that the means to the end, the end being credit bid, is what is being sought here? No, it's not. The cases cited in our brief show that there are two reported decisions against Beal confirming cram down plans in Chapter 11 over the objections of Beal. And I would think it would be shocking to find two cases for indubitable equivalents in Chapter 11 crammed down with respect to any secured creditor, even one like JP Morgan or Citibank, which issues a lot more credits.

As Your Honor is competent in this case, we reserve cram down for the little cases, the Chapter 13 cases, not the big cases. In the big cases you're supposed to have settlement. For Beal Bank to have two

reported decisions, one from the district court in Massachusetts, another from Judge Saenz in Nevada against you confirming plans is either a testament to your tenacity, bad luck or just an unwillingness to resolve things as you should in Chapter 11. And that's what this case is really all about.

Now, the note -- the Indenture Trustee has said that somehow in this $580 million that we're distributing to -- or that we're paying as part of this plan of reorganization, that we're contributing to all creditors that because only $517 million of that is going to the Noteholders in distributions, that we're diverting value. We're diverting value to Palco creditors, we're diverting value to Bank of America, we're diverting value all over the place and because we're diverting value somehow our plan cannot be confirmed. Well, that's simply not true. We're not diverting anything.

We're paying more than the secured value of the collateral of the Indenture Trustee and, of course, we're paying other creditors including administrative priority creditors, including unsecured creditors, including trade creditors so we can confirm a plan because that's what you do to confirm a plan. It takes consideration not just for the secured creditor, it takes consideration to confirm the Chapter 11 plan. And

whether there's a statutory secured tax claim or administrative creditors or other secured creditors like Bank of America, that's what you have to do. That's not diverting consideration from one person to another person.

Now, it is true that trade creditors and Scopac are getting separate treatment under the MRC/Marathon plan. But it's also true that the trade creditors were getting separate treatment under the Noteholders plan. They provided for separate treatment for the trade creditors, recognizing their importance. The importance that Dr. Barrett testified to, the importance that Mr. Dean testified to. This is a small isolated community. It has a particular number of loggers, haulers, other workers, people who depend on their jobs.

THE COURT: Lots of cases in which trade creditors are separately classified and --

MR. NEIER: Absolutely, for business justifications and we think we have met that test. We have shown the business justification.

THE COURT: I mean, convenience classes cram down other classes?

MR. NEIER: Yes, Your Honor, and the Greendyke doctrine is once they reject the plan, you can

take that money away from them, which is what the Noteholders have done in their plan but we have left it in our plan not just because they have supported us, but because it's the right thing to do. That's how you confirm a plan in Chapter 11, that's how you build support consensus.

The Indenture Trustee has said, and Your Honor has already raised the issue, why is there one trust for both -- one litigation trust for both the Palco and the Scopac causes of action. And with respect to that, we think it's a benefit. We think it's a benefit to the Indenture Trustee to have that because having one litigation trustee is certainly better than having two litigation trustees fighting over who does what and duplicating efforts and expenses. Moreover, 99 percent plus of that trust was going to the benefit of the Noteholders deficiency claim. They're giving up very little for the benefit of having only one litigation trustee.

In addition, MRC and Marathon are contributing $500,000 in seed money to that trust. So when you add up having only one trustee, the MRC/Marathon plan contributing $500,000 just to the litigation trustee to get them a head start on prosecuting any causes of action that they may have, that is why we think that it

is not taking something away or detrimental when 99 plus -- 99 percent plus of the trust was going to the unsecured -- was going to the Noteholders deficiency claim to simply have one litigation trust instead of two.

But if the Noteholders really want their own litigation trust and they want to have it themselves and they want to fund it themselves, that's okay with us. It's okay if they want to have a separate Scopac litigation trust and they can prosecute all the actions to their benefit for Scopac and not have the $500,000, not have one litigation trustee as we have proposed, we think that that's actually detrimental to them, but once again, under the Greendyke doctrine, once they have rejected the plan, it's okay to be detrimental to them so they can have their own Scopac litigation trust if Your Honor thinks it's beneficial to have two litigation trusts when only -- where one creditor is going to get 99 percent of the proceeds of that trust anyway.

And at the Scopac level, of course, the only people who are sharing in the Scopac litigation trust other than the Noteholders would be the Scopac trade creditors who we think it is proper to give separate treatment to from other unsecured creditors because of their importance to the reorganized business.

The Noteholders have also stated that

somehow our plan involves substantive consolidation. It's just not true. Our plan is we are taking the assets of Palco, we are contributing the mill assets, and the mill networking capital to Newco. We are contributing $25 million on behalf of Marathon. We are contributing a much larger sum now on behalf of Mendocino. And because it's over $200 million and then additional amounts bringing the total up to $580 million to Newco to pay the creditors of Scopac. That's not substantive consolidation. Substantive consolidation is when we scrambled all the eggs prior to confirmation, prior to the effective date and we treat creditors equally who previously had separate collateral. That's not what we're doing. We are respecting everybody's collateral and then afterwards we're reintegrating the business, and that's perfectly appropriate. It does not involve substantive consolidation.

You know, the Indenture Trustee has made a big deal about how it has liens on causes of action. I would urge Your Honor to look in the record. You will not find any evidence that they have a perfected lien on causes of action. They haven't put in any UCC financing statement that says they have a perfected lien on any causes of action whatsoever. They have put in the deed of trust saying they're secured by the timberlands but

they have not put in anything that shows that they have a lien on any causes of action or any other collateral other than the timberlands themselves through the deed of trust.

The Indenture Trustee, and I think if you turn to the Chapter 7 analysis on the following page, the Indenture Trustee says that we're not meeting the best interest test because they believe that in a liquidation under Chapter 7, they would receive more than would be received under the MRC/Marathon plan.

Now, first of all, you may recall that there is a liquidation analysis in the disclosure statement and the disclosure statement was approved by the Court and that disclosure statement shows a value in the 3's, not in the 5's, not in the 6's. Okay. And then we had testimony by several of the experts who did their own liquidation analysis, including Mr. LaMont, including Mr. Yerges. There were plenty of liquidation analysis for the Court, all of them show a lower amount than is currently being offered to the Noteholders in the MRC/Marathon plan.

But we also have Mr. Johnston who did an analysis assuming -- assuming that the Beal bid did not expire, that the Beal term sheet actually stayed in existence through the conversion of this case to Chapter

7. Okay. And assume that $603 million offer was still there in Chapter 7, he determined, and the testimony was unrefuted that in fact the value would be less than is being distributed under the MRC/Marathon plan. It would be approximately $500 million would be the mean. And we're distributing more than that. And that's assuming that the Beal offer still existed in a Chapter 7 liquidation, which we have already had testimony from Mr. Johnston that that would be highly unlikely because most people who are bidding on assets in Chapter 7 liquidation simply pay less. And as we know, the offer is already expired.

Now, the Noteholders have also attempted to engage in some rewriting of the disclosure statement and the plan offered by MRC and Marathon. They have brought up testimony -- or they brought up argument by Mr. Brilliant somehow saying that MRC has considered hostile acquirer.

Now, Judge, first of all, when you start relying on various statements by witnesses in court instead of the written document that everybody is relying on, that is actually a business plan turned into a legal contract that's been approved as part of the disclosure statement that's been sent out to the solicitation that's been voted on and approved, you're already in trouble.

That's not really a valid argument and it's really unworthy, okay? But what Mr. Brilliant was actually talking about was he was talking about the 9019 and the settlement with Maxxam and why it was important to have some information on taxes and the tax indemnity from Maxxam was important to us because Maxxam was treating us as a hostile acquirer or was treating MRC as a hostile acquirer. That's what he's talking about.

The Noteholders have also claimed -- and we have Mr. Breckenridge's testimony that somehow Mr. Breckenridge -- and they have done this several times in the brief, they said, oh, Mr. Breckenridge testified that there was substantive consolidation. Of course Mr. Breckenridge is an investment banker, he's not a lawyer, he testified in laymen's terms what the effect was of the plan. You heard testimony before we all left on the last day of trial evidence that somehow Mr. Breckenridge said we're purchasing the assets.

In fact, what Mr. Breckenridge did is he explained in laymen's term the effect of our plan. That is, a foreclosure on the assets of Palco, contributing those assets to Newco and then purchasing the assets of Scopac. And that's a perfectly appropriate characterization in laymen's terms as the effect of our

plan. Is it our plan? No, of course not. Because when you look at a plan, that's how you determine what it says in the plan, the four corners of the document, not what witnesses may testify to is the effect of the plan or how they would describe a plan in their own terms in laymen's terms.

The Noteholders have also complained that somehow intercompany claims are not being respected in the MRC/Marathon plan. Of course, intercompany claims are under Section 509 of the bankruptcy code ordinarily subordinated when you're having a joint plan of reorganization. But in addition to that, there is an upward adjustment to the contribution that is being made to the Noteholders in respect of intercompany claims. In other words, the adjustment that we always talk about when we say $530 million being distributed to the Noteholders subject to adjustment, it's not just a downward adjustment, there is also an upward adjustment. That upward adjustment is for intercompany claims.

To the extent that Scopac has an intercompany claim against Palco, there is actually an upward adjustment in the contribution that will be made under the MRC/Marathon plan to the Noteholders. So we are completely respectful of the intercompany claim that Scopac may have against Palco when this plan goes

effective.

The Noteholders say that they have a super priority claim and they have made a separate motion for a super priority claim and they raise it here and there in their confirmation brief. We have already objected to that claim and we filed our objection and Your Honor can read it to see that this is really devoid of merit. In two conclusory -- without any foundation, without any evidence they have raised two basis on which they have a super priority claim. They raise the issue that, well, if the MRC/Marathon plan is confirmed, of course then the Noteholders are getting less than their -- the amount of their claim and therefore, they have a $200 million deficiency claim, and of course, that's a failure of adequate protection.

But that's ridiculous. Section 507(b) is about post petition claims based on a failure of adequate protection granted during the case. The Noteholders were granted adequate protection in this case. It was for diminution of their collateral. There has not been a $200 million diminution of their collateral during the pendency of this case and they really can't say so at this time. Their stock, if you will, since they put in a value of $420 million in mean terms in September of 2007 and then in March suddenly say their assets are worth

$600 million, it would be very hard for them to argue at this point, in fact impossible, except if you're playing fast and loose, to argue that they have somehow suffered diminution. Secondly, they have said --

THE COURT: Do we have to decide the issue of the administrative claim today?

MR. NEIER: I don't think so because under our plan we are, of course, paying all administrative claims. And if they have an administrative claim, whether it's super priority or not super priority, it doesn't matter. Under the MRC/Marathon plan, we are paying all claims. We can, of course, object to claims because we are only paying the allowed administrative claims and we have objected to that claim.

The Noteholders can't give up on an issue but they have raised the issue of antitrust once again. There has been no evidence. The MRC/Marathon plan is supported not only by the federal agencies but the U.S. Trustee has not objected to the Marathon plan. The U.S. Trustee, of course, is a program and a division of the Department of Justice. I don't know if I have described it correctly. A program at least of the Department of Justice.

If the Department of Justice wanted to come in here and say that somehow there was an antitrust

issue, they could have done so. They have not done so. And therefore -- and there is no evidence before Your Honor of any kind that somehow we have a feasibility issue due to antitrust concerns. As Your Honor may recall, there was plenty of testimony by Mr. Dean that redwood is just one of a number of products that people use for fencing and decking. They use plastic, Trex, they use cedar, they use pressure treated lumber, lots of other products.

It would be hard to say that they somehow cornered the marking on fencing and decking products. Even if you look at redwood themselves, Mr. Dean testified that there will be a competitor that is far larger, 50 percent larger than them in the marketplace after giving effect to this transaction and assuming that you consolidated, which is not the case, if you consolidated MRC and Newco together.

You know, finally, Your Honor, you know, I don't know if it's up to me to comment on the Noteholders plan. I don't think it's really relevant for this Court's consideration, but in our view, the Noteholders plan is a liquidation plan. It's Mr. Beal's own version of a Texas chainsaw massacre. The people that it massacred are the debtors, their creditors and the community where the debtors are located. We think that

based on all the evidence that you've heard, the one thing is clear is that the Noteholders plan should be rejected as most of the creditors have rejected -- in fact, all the creditors except for the Noteholders themselves have rejected the Noteholders plan. Thank you, Your Honor.

THE COURT: All right.

MR. NEIER: I guess I would add one more thing based on the new proffers that were put in today. I think Mr. Brilliant said that the offer by Mr. Emerson was $27 million, it was $47 million if the cogen plan is $20 million, and the net working capital of the mill is $20 million, which is what Mr. Breckenridge testified to, that would leave $7 and a half million for the mill. Marathon is owed $160 million. It's clearly insufficient. It's a 363 offer and the debtors are not inclined to accept it. So I don't know what it means in evidence. It's up to Lehman in offering a junior dip that is junior to Bank of America but senior to the Noteholders.

I mean, you're going to put more debt on the Scopac's assets with an administrative claim for -- a Noteholder is going to offer $20 million in financing to bridge the gap to this auction for eight to ten months. That would take the Johnston analysis and add another $20

million deduct from what the Noteholders would receive -- 20 million plus deduct from what the Noteholders would receive under the -- under the Beal term sheet, the expired Beal term sheet. So the Lehman offer of financing, the last thing that Scopac needs at this point is more debt. It needs a reorganization. Thank you.

THE COURT: All right. Is Bank of New York going next? We need to change the computer to 1.

THE CLERK: Thank you, Judge.

THE COURT: I know the hand signals. Earlier in the trial I thought he was waving.

MR. GREENDYKE: Judge, while it's sort of fresh on my mind I want to respond to some of the things that we have just heard from Mr. Brilliant and from Mr. Neier. For the record, I'm Bill Greendyke representing the Bank of New York Indenture Trustee for the timber noteholders.

Mr. Brilliant talked a couple of times about integrated lumber business and I think he said integrated business in referring to the character of the companies that are before you today in these two bankruptcy cases, the two groups of bankruptcy cases. I don't think that term integrated business or integrated lumber business shows up anywhere in the bankruptcy code. So whatever might have come out of a Harvard business

school analysis doesn't have anything to do with the legal determination you have to make here today.

I also think the slide show you saw of the town gives you some indication of their strategy with the Court and their approach to the Court in the sense their estimation of what the Court's inclinations are in this case. He also mentioned -- Mr. Brilliant talked about Houlihan Lokey's fees and it will be more clear as I talk about what I think about the values and what I think about the structure of this case is, but at some level it doesn't really make any difference what the Houlihan Lokey fee is. Our plan provides that whatever that fee is, it's going to be subject to Court approval before it's ever allowed to go forward.

And in connection with a piece of property which everybody says, except for perhaps Scotia witnesses, is upside down in terms of debt and value. It really doesn't matter. There's no equity for anybody beyond the claim of the Indenture Trustee's claims. So it doesn't matter who pays the fees. It's going to be borne by the Indenture Trustee and this group of noteholders.

With regard to the credit bid, we as a group of noteholders have not been hiding the ball from the Court about credit bid. There's just been no

agreement today to waive that credit bid. There has been no ability to reach a consensus in sufficient numbers to tell the Court we have an agreement with regard to the credit bid. Why has it been impossible to get that kind of agreement? Because they can't agree upon the value.

THE COURT: You know, this credit bid notion sound more important to me of late, not in this case but in other cases.

MR. GREENDYKE: I'm going to talk a bunch about credit bid.

THE COURT: Okay. Because the notion of credit bidding doesn't necessarily mean we separate your property and you credit bid that, does it?

MR. GREENDYKE: Well, except for the fact that our property is separate, as the Court mentioned earlier. To use the hardware store example, you know, he might have a problem and this is all sort of a fundamental disconnect between Mr. Brilliant and myself about how 1129(b)(2) ought to work. What you might do in a transfer or sale of property of the estate in a consensual matter is one thing, but if you're going to try and take something that 1123 provides for as a means of implementation of the plan and then cram it down on somebody, instantly ten choices in 1123 is still down to three.

THE COURT: Okay. Well, I mean, his hardware store example, okay, yes. Say you have one bank that's got the fixtures and one bank has the inventory, that's a more likely situation. And you want to sell the hardware store pursuant to -- and you don't even want to sell it, what you want to do is somebody is willing to take over and pay the administrative claims and take over this hardware store.

MR. GREENDYKE: Usually what happens is you have a situation where somebody comes in and says I'm going to buy the whole kit and caboodle and we're going to value the claim and we're going to let you keep the liens on your claim and we're going to pay you over time what the value of your claim is. That's the reorganization the Court asked us about at the last hearing.

THE COURT: Okay. But I mean, that's even worse than now because they're not valuing your claim. Value your claim -- and I agree with you, we do that all the time, you value the claim and let them pay it over the life -- you know, a reasonable period of time. And if their -- if their claim is -- if their secured value of their claim is less than their claim, which often happens also, they get the secured value of their claim paid over a reasonable period of time at a reasonable

interest, don't they?

MR. GREENDYKE: And they keep their liens, but that's not what's happening here.

THE COURT: On what?

MR. GREENDYKE: On the property. On the property they had a lien on. You can't strip the lien away. They either get to keep it --

THE COURT: You can pay it. I mean, I agree with you that -- but what if you pay the lien? You just pay it. Pay the value of the lien. I mean, you take a secured claim. When somebody files bankruptcy, their claim becomes the secured portions of the value of the claim. That's elementary of bankruptcy law. And they have an unsecured claim unless they're an ad valorem tax agency, they have an unsecured claim for the remainder.

MR. GREENDYKE: Right.

THE COURT: So why can't you come in and say, okay, we're going to buy all this and the shelves are worth $2,000, you have a $3,000 claim but you have a $2,000 unsecured claim so we're paying you $2,000 and giving you an unsecured claim for $1,000. And the inventory is worth $50,000, perhaps they have a claim, they have a total claim of 80 so they pay them $50,000 and give them a $30,000 unsecured claim.

MR. GREENDYKE: The simple answer is 1129(b)(2) doesn't give you that option. 1129 --

THE COURT: Well, it certainly does if the debtor does that, doesn't it?

MR. GREENDYKE: Well, I don't think it gives that option to an objecting secured creditor. I think for purposes of cramming --

THE COURT: If you do not transfer any of those assets to anyone, let's assume that we're getting rid of the debt and there's a third, you know, I don't know, that somebody else is going to have the equity, so we don't have a new value problem, we don't have any of that stuff. If you're just paying off the secured claims and giving them unsecured claims for the remainder of their claim, and you're not transferring the assets to anyone else, they're still in the corporation, that second section wouldn't apply and you just pay them off the value, isn't that true?

MR. GREENDYKE: No.

THE COURT: Why is that? Where do you have to --

MR. GREENDYKE: Well, again, I'm going to talk about this a lot and not just in response.

THE COURT: That's the part I'm having a problem with.

MR. GREENDYKE: I'm going to show you how this works. But what you're asking me is whether or not a corporate creditor or corporate debtor has the ability to redeem property like they would in Chapter 13 or a Chapter 7 case, and the answer is no. You look at 521, it's not there. It's talking about an individual case. And so what we're used to seeing in a consumer context totally inapplicable in a court context. It's just not there because what's there is an 1129(b)(2). You have three options and you have to provide for one of those three options.

THE COURT: Okay.

MR. GREENDYKE: And what you're describing, it's not in those options. I'm going to show you an outline in a couple of minutes that will go through all of that.

THE COURT: All right. I'll hold off.

MR. GREENDYKE: Okay. The reason why, going back to credit bidding, why it is that I don't have a consensus yet with regard to credit bidding is because all of the noteholders think that there's more value there and they can't reach a consensus with regard to when an appropriate limit for credit bidding is. That's the argument. It's not there because they think there's more value there. And it's that value that this plan,

the Marathon plan, wants to take away from them that they're so strongly objecting to.

THE COURT: Is the Beal bid even valid still?

MR. GREENDYKE: I will represent to the Court that the Beal bid was extended earlier this week. It expires tomorrow. From a practical standpoint, that extension which expires tomorrow is no utility 2. My argument to you is it's still there.

THE COURT: Okay.

MR. GREENDYKE: The super priority claim that Mr. Neier talked about and that's been filed and it was today objected to, which we expected to see, I'm not sure I understand where we are on that. It's there, it's been made. The Court recognizes what it's for. If we're over secured wildly, I don't know that it means anything. If we are under secured, at whatever the Court finds --

THE COURT: If the value goes down during the term of the plan, you've asked for adequate protection.

MR. GREENDYKE: Yes.

THE COURT: And if the value goes down, you're entitled to an administrative claim for the dimunition of the value.

MR. GREENDYKE: My understanding from the

reading of the plan, and this is the first time I have heard this from Mr. Neier because we haven't conversed about this, is that the plan, the way I understood it, would operate to deduct from the 530 that the plan offers any administrative claims that might have been made, including ours. My argument is going to be that's not fair. The concession in open court is it goes on top of the 530, I don't have a problem with that because it takes care of the administrative claim subject to his right to object. If that's the concession, that's fine. Otherwise, if there is a deduct from the 530, that's something that he has to take care of and handle in terms of administrative claims.

THE COURT: If you have an administrative claim for the loss of value from the day of filing or the day -- I think does the code say from the day of filing or the day requested asset protection?

MR. GREENDYKE: I think it's from the date of filing. I think it's because of the imposition of the automatic stay, any diminution value.

THE COURT: I'm not sure about that.

MR. NEIER: Your Honor, just to make it perfectly clear, there is an adjustment for administrative claims in the class 6 distribution adjustment, so --

MR. GREENDYKE: I thought it was downward and not upward. If it's upward --

MR. NEIER: There's an upward adjustment for intercompany claims. There are downward adjustments for other things, including B of A's deficiency claim and things like that.

THE COURT: What about for -- what about a downward adjustment for -- in the event that you lose on the issue of their administrative claim of asset protection.

MR. NEIER: There is a downward adjustment because, of course --

THE COURT: So it's a dollar for dollar downward --

MR. NEIER: If the noteholders, for instance, use their own collateral in paying Mr. Greendyke's fees, that is their less collateral, so of course we have an adjustment to take care of things like that.

MR. GREENDYKE: But the claim is made with regard to fees that are expended by the debtor and lost by the debtor.

THE COURT: Okay.

MR. GREENDYKE: Finally, with regard to the quality of the liens on the Headwaters litigation,

I'm going to show you the slides that if you can trust the stenographer. But I also believe the Court can take judicial notice of our proof of claim. I think the appropriate filings are attached to the proof of claim. I can't verify that and we'll try and verify that. To the extent that it's already in the Court's docket, in the Court's records, we'll ask the Court to take notice of the proof of claim. The beginning argument --

THE COURT: As to what?

MR. GREENDYKE: Pardon?

THE COURT: As to some sort of a UCC filing that you have a lien on the Headwaters litigation?

MR. GREENDYKE: You raised a question that we haven't shown the Court a UCC filing with regard to causes of action or general in tangents of some such. And I don't know how the deed of trust was recorded or in which agency it was recorded. I think that's part of the proof of claim, and I'll show you. But I will show you the lien language in a few minutes.

MR. JORDAN: Your Honor, my only concern is that that's an offer of evidence, the evidence has now been closed twice. I don't want to start reopening the evidence every time that there's something they think was a deficiency and they want to -- so I will object.

THE COURT: Let's see how this plays out.

This case isn't going to rise or fall over some, you know, either omission or whatever of one document that everybody agrees exists. I don't know.

MR. GREENDYKE: I agree.

THE COURT: I don't think it's going to rise or fall over the issue of the Headwaters litigation, quite honestly, but maybe if you convince me that there's something there.

MR. GREENDYKE: The last time I talked to the Court in argument I asked you to keep in mind three key concepts that would transcend all the legal, factual, political and emotional issues that otherwise exist in the case. Those concepts were separateness, value and the mill. I want to talk about them all three for a brief moment now.

The first is separateness. And that brings to mind the legal arguments that the Court has been concerned with today and these other lawyers have talked to you about for the moment. Substantive consolidation is a huge issue for us because we think that's what's happening here.

THE COURT: What do you think is substantive consolidation other than the Headwaters litigation?

MR. GREENDYKE: We think that the value of

our separate collateral in the Scopac case is being appropriated and combined into a joint venture that's going to be called Newco. And all the creditors --

THE COURT: Isn't that just a question of value? If I think the property -- if I think your -- if I find by a preponderance of the evidence that the value of your assets is $500,000, that's not an issue. If I find that the value is 580 and they're bringing 580 and using some of it to pay off Palco things, then I agree with you. There's no question.

MR. GREENDYKE: I don't think you can do it because, number one, we don't want you to do it because it doesn't comply with the bankruptcy code. The taking of the property from us is not in accordance with 1129(b). It can't be done. And while you look at 1123 which says what a plan can provide --

THE COURT: Taking of the property, what taking of the property are you talking about?

MR. GREENDYKE: Let me jump ahead. Show me slide 3, Simon.

THE COURT: Everybody who gets crammed down in a bankruptcy case thinks their property is being taken, but Congress has provided Chapter 11 for a way of normally, through agreements, but for a way that you can in fact cram down different contracts on people.

MR. GREENDYKE: That's right. If you look at this slide, this is a copy of the table of contents from Colliers dealing with 1129. And it shows you the three options that we have. You need to show C at the bottom. I need the whole thing. I need C. There you go. If you look at 1129(b)(2)(a)(1) and 1129(b)(2)(a)(2) and 1129(b)(2)(a)(3), these are your three choices.

And I'm not sure what it is that Mr. Brilliant was talking about and Mr. Neier was talking about with regard to our argument. But I think the law is -- we're telling you the law is to cram us down, you have to meet at least one of these minimum requirements. When the plan was first filed, we think what they were trying to do was (a)(1). Go ahead and highlight that, Simon.

THE COURT: They thought it's right, and they were -- they were going to -- they were doing --

MR. GREENDYKE: Except for the value part, that's the way they were trying to do it.

THE COURT: They were trying to file a plan in which your secured claim, which is the value of your collateral.

MR. GREENDYKE: Right.

THE COURT: Is give them some money.

MR. GREENDYKE: Right.

THE COURT: Pay it down partially and a note.

MR. GREENDYKE: This is your hardware story. Right. And that's the part that I want you to look at. See where it says retention of lien? That's got to happen.

THE COURT: Right.

MR. GREENDYKE: So this is the new loan provision. This is the provision that says --

THE COURT: If you don't pay the claim or give it the indubitable equivalent.

MR. GREENDYKE: This is the new loan.

THE COURT: If you do the lien -- in other words, you don't pay it, you've got to have a loan. You've got to -- if you keep -- retain the liens and pay them a new loan at market rate of interest, the's one way of cramming down.

MR. GREENDYKE: Right. And that new loan can be transferred to a new entity. It can be the debtor or it can be a new entity.

THE COURT: Right.

MR. GREENDYKE: Okay. That's what MRC was proposing a month ago, only the amount was way off, way out of bounds.

THE COURT: So you're suggesting then that

if I believe the value is $530,000 or whatever or 500 and whatever you're going to realize, that instead of them paying you cash for that, if they would have just given you a note secured by the -- by the property in that amount at a reasonable interest rate over a period of time, that this plan would be totally confirmable?

MR. GREENDYKE: I'm not suggesting that at all. I'm telling you --

THE COURT: I mean, I still have to find the value.

MR. GREENDYKE: I'm telling you the law is that you can't do that.

THE COURT: Wait a minute. Under number 1 you said they could convey it to anybody else, they could do all of that, but as long as they give you a note for the value of the claim at a reasonable interest rate and retain the liens.

MR. GREENDYKE: Right.

THE COURT: So all we have then is we have no legal issue as to the B, you don't get to credit bid. You get to credit bid if they ever -- if they ever default on the note but you don't get to credit bid so they just take their 500 cash and buy a -- they go buy a -- what do you call those things? I don't have that much money, so whatever you call them where you buy

something and they send out a monthly payment to you.

MR. BRILLIANT: An annuity, Your Honor.

THE COURT: Annuity, thank you very much. There you go. See, a nonbankruptcy lawyer right there ready to go. Give him credit. They buy an annuity and then provide a note and this plan would be confirmable, at least assuming that they can prove up the value.

MR. GREENDYKE: This new loan provision works if you find a value and that is something that stands the test of appeal and all that and we keep the lien. And the important part is the lien. Because the lien, once you find the judicially determined value and we keep the lien, that means we have the upside. That means we have the right to appreciation, that means if they make a default in the payment, assuming that they have been able to prove to you feasibility, that we have -- we have what we bargained for.

THE COURT: Okay. Let's take the same thing and do number three now. Except instead of retention of the lien on the property, we let you retain the lien on the cash, which is the indubitable equivalent of the property. And so now they're going to give you a note for the value and put the cash in the bank. And that way you've got the cash. You've got the indubitable equivalent.

MR. GREENDYKE: You're not going to find --

THE COURT: Isn't cash always the indubitable equivalent --

MR. GREENDYKE: You're not going to find a case that does that.

THE COURT: That's because nobody would be stupid enough to do it that way. They always just give you the cash and you take it.

MR. GREENDYKE: They would have shown you the case if there was a case that said they could do what they're saying they can do. The three provisions are 1129(a)(1), which is the new loan provision, 1129(b)(2)(a)(2), which is the sale free and clear provision that requires compliance with 363(k), and that should be highlighted, too. And then the final is the realization of the indubitable equivalent. If you look at the Fifth Circuit, an example case is the Fifth Circuit case.

THE COURT: And let me just say that my impression of what B was -- and again, hey, I don't claim to be the expert here. But my impression of what B was is if you got, you know, say, for instance, the typical situation you got four or five tracts of land and your plan is you're going to sell all four tracts of land and

perhaps they have different lienholders on each tract of land. If you're going to confirm a plan that provides that you're going to go out in the market and sell each tract of land, you've got to give them the right to credit bid to sell the -- in the sale of the land out there when you're out there doing it.

MR. GREENDYKE: Our argument -- the answer is yes. Our argument is if you're going to cram down --

THE COURT: It's not any different from what they're doing here. I mean, they're creating a new corporation, they're just putting all the assets in there. This is more of a reorganization than a sale; isn't that true?

MR. GREENDYKE: It's not a reorganization. It's not a reorganization, and the reason why it's not a reorganization is they rely upon the word transfer as opposed to sale. You know, I've got the slide from Mr. Breckenridge, I had both of them up there talking about how he's going to foreclose on his assets and then contribute the assets from the mill and the cogen plan into Newco and then they were going to buy the assets, effectually sale of the assets of Scopac into Newco. I had the same argument. He beat me to the punch, good for him. But the point is is that these are the provisions that you have to follow to cram down the secured

creditor.

And they are saying they don't have to comply with B, the sale provision, because they're not having a sale, they're going to do a transfer. They're just calling it something different. It's a matter of form over substance. They're calling it a transfer but it really is a sale because they actually are selling something somewhere. A transfer, just because 1123 allows the Court to find a transfer doesn't mean that that transfer --

THE COURT: Okay. Let me ask you this then. And you know, I'm having the biggest trouble with this and that's why I'm asking the questions.

MR. GREENDYKE: Okay.

THE COURT: Let's assume that we got four different acres, tracts -- I mean, four different tracts of land and the plan is going to be that you're going to sell tract A. But rather than sell tract A first, we're going to first in the plan give you the indubitable equivalent of your -- of your equity in tract A. Now, that could be a lien on tract B, a lien on tract B, C and D, whatever the indubitable equivalent is. I mean, indubitable equivalent has to be the indubitable equivalent admittedly but there are cases that allow someone to substitute collateral.

MR. GREENDYKE: Right.
THE COURT: As indubitable equivalent; isn't that true?
MR. GREENDYKE: Right. That's correct.
THE COURT: And if it's a good asset and it's equally, you know, and it is in fact the indubitable equivalent, then the code would allow you in the plan to substitute collateral and then sell that in a credit bit, isn't that true? That's one way you could use C to avoid B.
MR. GREENDYKE: I'm going to disagree with it as long as you use the word sell. And the two examples I'm going to give you are Sun Country Development which is an old 20-year-old Fifth Circuit case. Now, I want to say the facts are that there were 200 acres that the mortgage company had a lien on and the way they effectuated indubitable equivalent was they traded the one lien on 200 acres and one note for 200 one-acre lots with 200 potential notes for each of those separate lots and they were going to do a development; i.e., Sun Country Development.
THE COURT: Right.
MR. GREENDYKE: The thing tanked, completely crashed. The judge made a determination that the 200 little pieces were the same as 200 acres as one

big piece and one note and it ended up being a total disaster in terms of valuation and the call by the bankruptcy judge that it was going to be an indubitable equivalent. Another example is that --

THE COURT: But they didn't find it was indubitable equivalent.

MR. GREENDYKE: They did.

THE COURT: They did?

MR. GREENDYKE: They did. But it was wrong. It was appealed.

THE COURT: But nobody appealed that.

MR. GREENDYKE: No, it was appealed. The Fifth Circuit said that's fine.

THE COURT: Under the Fifth Circuit law even one that tanks is okay?

MR. GREENDYKE: No, it's not okay. In fact they saw later on, or at least in subsequent case law they saw that the decision was improper and that it had not been made correctly.

THE COURT: Okay. But it doesn't say you can't ever substitute collateral.

MR. GREENDYKE: No. That whole provision for indubitable equivalent is really the substitute collateral provision. But the way that works --

THE COURT: So you want me to read 1129

(b)(2)(a) to suggest that it's fair and equitable to cram down a secured creditor by full payments through a loan market rate of interest, retain the lien. That's one way you could do it. Or sale. I mean, if you ever use the word sale, then indubitable equivalent can't come into the picture; is that right?

MR. GREENDYKE: Yes, yes. The case I want to cite you to, and I have a slide for it later on, but I won't call for the slide now, is D&F Construction. And it's a Fifth Circuit case. I'm trying to find the cite in my notes because I'm way off track in my notes. 865 Fed 2nd 673, it was a 1989 Fifth Circuit case. It was a single asset real estate case in which there was a cram down with a negative amortization at close that was going to retain the property and was going to rework it over a period of time. And what the circuit court said was these three choices are your three choices.

These are the minimum requirements that you have to meet, you know, with an "or" at the end in order to cram down a secured creditor. It doesn't matter whether you have a consensual transfer, consensual sale some place else. This is what you have to do if you have a secured creditor that is being crammed down. And it found rhetorically that one of those sections was made in that case and denied confirmation of the plan,

notwithstanding that they had assumed one of these was being met, it was probably A. Because the plan had the negative amortization that prevented it from being fair and equitable with regard to cram down a secured creditor. But what it said was you don't have any other options. This is what you have, this is your choice on how to deal with it. So if you're going to sell the property, it's got to be sold in accordance with B.

THE COURT: Well, and I guess what I'm saying is why would there ever be a case where a Court has to say that the treatment of unsecured creditor's claims is defined as the value of their collateral is fair and equitable if it's paid in cash?

MR. GREENDYKE: There isn't -- I hear you and I understand what you're saying.

THE COURT: It all sounds like that's -- well, of course that's fair and equitable, they get cash for the value of their claim. I mean, unless you have a 90K car or something, you know.

MR. GREENDYKE: Let me answer your question a little bit more directly because I think I understand what you're asking me now. The problem is is that whatever the secured creditor has before someone tries to do this to them, it's going to be a right of return on the investment, it's going to be a value that

they think they have, it's going to be the right because they have liens on the appreciation and the value of that asset to collect their property in the future. Let's say we're in a downturn in the lumber market like we are now, you know. Somebody who has a lien on that property might not think today is the right day to cash that out so they get to keep that lien so that they can achieve that value in the future. And if you cash them out today at today's depressed prices, you've taken property, you've taken value from those folks that have already invested --

THE COURT: I agree with you, there is the possibility of hanky-panky in the event that the market is way down and the value is way low, you quickly jump into bankruptcy and strip the lien by paying cash for it. That's the only way you can strip a lien without the consent of the other side is to pay cash for the value of it in bankruptcy if their version of this section is correct.

MR. GREENDYKE: I'm telling you you don't have the power to strip the lien and pay cash. That the lien is an integral part of what the indubitable equivalent is to these investors here. And you can't take the lien and you can't cash them out. And again, I'll tell the Court once again, why haven't they showed me a case where somebody has cashed out somebody on that

basis. It's just not there. You might be able to switch collateral, you might be able to give them property of some other nature but there is no ability for you to determine what that value is that would in any way approach the value of the upside --

THE COURT: Well, of course, if the debtor somehow had the cash to cash them out --

MR. GREENDYKE: Pardon me.

THE COURT: If the debtor had the cash to cash them out and filed bankruptcy and somebody would steal the debtor, I mean, it's not likely that you are ever going to have a case where a debtor comes in and has the cash to cash out the lien.

MR. GREENDYKE: Well, I'm sure that my clients would take the face amount of the notes plus accrued interest. So to that extent, they will be cashed out.

THE COURT: The question is, do they have to take the amount of the claim, which is the value of the asset.

MR. GREENDYKE: A hypothetically determined -- theoretically determined judicial valuation of the property, no, they don't. They don't have to take that. It doesn't comply with these three requirements. Now, I think based on Fifth Circuit law, you either have

to have the reorganization provision in (a)(1) or you have to have the sale provision in (a)(2) or you have to have the indubitable equivalent, which is switching collateral with its appropriate value. If you look at the San Felipe Vasquez case where there was a switch of collateral for real estate for marketable securities, there was like a 30 percent buffer in value, not a deep discount, you know, in our estimation, deep discount valuation where they're trying to low-ball value in which, you know, we've been involved in kind of a mini market here.

THE COURT: Tell me specifically what the facts of that case were. They had a lien on real estate and what else?

MR. GREENDYKE: Insurance company, office building in Houston, Texas, lien on the office building, marketable securities were substituted for the collateral rights of the lender in that case. The marketable security --

THE COURT: The value of the -- the amount of the claim was how much? The full claim.

MR. GREENDYKE: $10, 12 million.

THE COURT: Okay. And how much was the value of the building?

MR. GREENDYKE: As I recall, it's been a

long time, agreed to be about $10 million.

THE COURT: And the plan was they provided them with $10 million worth of securities?

MR. GREENDYKE: No, 33 percent more, marketable securities worth 33 percent more than what the theoretical value of the building was.

THE COURT: And that plan was confirmed or was it not confirmed?

MR. GREENDYKE: It was confirmed and it was upheld on appeal by the district court.

THE COURT: And who was the judge in that case? Okay. But a respectable judge.

MR. GREENDYKE: But that case represents a substitution of collateral in the manner that's suggested there. And not a cash out because there wasn't a cash out, there was a substitution of collateral. The way those cases work --

THE COURT: Was it an agreement or was it --

MR. GREENDYKE: The value was agreed on, as I recall. It was a long time. I think the value was agreed upon on the building and it was back at the time when people didn't fight about real estate cases. They got tired of fighting about value because everybody was under water. But the value of the collateral was agreed

upon, I think, as I recall. And the substitution was made on a 33 percent buffer with regard to what was being substituted in terms of collateral, but you had like cash, marketable securities that hadn't fluctuated in five years in terms of value more than about five percent so the buffer was adequate under the circumstances. If you read the district court's opinion, the district court talks about having to really balance what the risks are and the investment and the key is the thing you're supposed to be indubitable about is not shifting the risk.

And my point to you about the cash is you are shifting the risk and you are allowing them to capture our clients' ability to realize upside, uptake in value if they were to foreclose today by cashing them out. That deprives us of a right that the lien gives us that we own already.

THE COURT: Well, except that you could argue that if you're getting $500 million, you can go buy something that's more likely to go up than a redwood forest.

MR. GREENDYKE: Well, that's not what the bankruptcy code says.

THE COURT: You can do whatever you want.

MR. GREENDYKE: To go back to your

example, which I think is a consumer case example. If Congress wanted to put something in there about a cash out provision, you would see it. It would be there. They knew what to do in Section 521 when consumers want to redeem a piece of property within 30 or 60 days after they file a case. But that's not here in Chapter 11. That's not here on how you deal with recourse, secured creditors.

THE COURT: Okay.

MR. GREENDYKE: I'm way off track and I have covered a lot.

THE COURT: Well, do you want to argue about classification?

MR. GREENDYKE: I'm sorry?

THE COURT: Do you want to argue about classification or you want to argue about --

MR. GREENDYKE: I'm going to get to classification. I'm just trying to figure out where I'm going to pick up, Judge.

THE COURT: Okay. Do you want to take a five-minute break?

MR. GREENDYKE: No, I'm fine, Judge. Let me go back to slide 7. Slide 7 is a quote from the D&F Construction case. This is page 676 of the opinion that I cited earlier and this is kind of the Court's ultimate

ruling. As I said, this is a single asset real estate case. Here in this case the Fifth Circuit says a plan that is not fair and equitable with respect to an impaired secured creditor cannot be confirmed on the basis that such inequity is necessary to protect junior creditors. In that case the argument was being paid unsecured creditors and they are going to be paid in full and yet the abuse of this creditor, secured creditor, was being taken on a cram down under (a)(1) was going to be negative amortization for 15 years.

THE COURT: I mean, that -- I have no -- I mean, I agree with you, you can't just -- no matter how good the plan is for the State of California, I can't confirm it unless it's confirmable under bankruptcy law.

MR. GREENDYKE: You've kind of anticipated my argument in a sense because while this is a much more simple case in terms of --

THE COURT: But the mere fact that it's a great thing for California and supported by the Governor doesn't mean automatically that it's not confirmable either. I mean, I'm not suggesting -- I mean, I think that the -- you only look at -- you only look at and try and decide between two confirmable plans. You have to look at the interest of the creditors. You're not bound by it but I have to look at it. But I'm not allowed to

look at the interest of creditors in the sense that there are creditors over here in Palco that are going to be harmed in the event that Scotia -- that the MRC plan isn't confirmed if there are grounds not to confirm it. You never can just simply write into the code it's a good thing so let's confirm the plan.

MR. GREENDYKE: I agree with you completely, and the Court has anticipated my argument. I mean, this case says that you can't, in effect, not fairly or equitably with regard to a cram down secured creditor with --

THE COURT: It might be a negative amortization might provide some money for a junior creditor and allow a plan to get confirmed. It's not the right thing to do so you can't confirm the plan, that's what that says.

MR. GREENDYKE: That's exactly right. And my argument to you is that's exactly what this plan is trying to do. Because they don't comply with 1129(b)(2) or any of the three components. If this happens, you know, you're going to be asked to ignore the minimum requirements and the rights of the Noteholders and secured creditors in order to take care of junior creditors to Scopac, in order to take care of junior creditors in another case.

THE COURT: But it is true somehow that they could cure the problem in your view -- first of all, you're not agreeing to the value. I think value is always the big issue in bankruptcy.

MR. GREENDYKE: We're not agreeing to value.

THE COURT: And I understand you're not agreeing to value and so we have to discuss that. But assuming -- let's just for the purpose of argument sake, if the value is correct, what they say, the only thing they have to do to change their plan is convert it. Instead of giving you cash, give you a note secured by the forest; isn't that right?

MR. GREENDYKE: Well, number one, you told us a month ago that I want these plans to come forward and I want them -- they are going to either stand or fall on their own.

THE COURT: I agree.

MR. GREENDYKE: And both plans have been modified. And if what you're suggesting now is that they go ahead and modify their plan based on the results of this hearing.

THE COURT: No, I have not said that. I have not said that at all. I'm just saying your argument depends on me believing that somehow the code would say

it's okay for them to -- instead of giving you cash for the value of your claim, give you a note for it, payable over a period of 30 years or whatever, secured by the forest.

MR. GREENDYKE: If we agreed on value and we agreed on the terms of the note and we kept our liens, that plan is cram downable. That's what I'm telling you.

THE COURT: Right.

MR. GREENDYKE: And the fact that they aren't giving us a lien like that and giving us a note for an appropriate value and they're not giving us a sale, in effect they're having a sale under the table. And the fact that they're not giving us -- offering us the indubitable equivalent, that's what prevents their plan from being confirmed over our objection.

THE COURT: Well, the only reason, if we agree on value, that it's not the indubitable equivalent because you somehow think that you never get the upside in the event you get to foreclose.

MR. GREENDYKE: Correct. The added argument that with regard to their transaction, we think, talking about the Headwaters litigation, that we're going to show you that there was a lien on the Headwaters litigation, the value was, as Mr. Pachulski said, the value for Scopac based upon the Scopac witnesses was $300

million. And I know the Court did the math, did the equation, there has not been any estimation from an expert basis on what the liability -- what the merits on the percentage might be, but let's say it's 10 percent. You're talking about $30 million. If it's 20 percent chance of success on that, you're talking about $60 million. That's a lot of money.

THE COURT: Plus the cost of litigation.

MR. GREENDYKE: That's a lot of money. It's still a lot of money and it's not there. And that's being taken from us.

THE COURT: You know, I got the idea from the Beal bid that your bidder at least really was more concerned that he could get that thing settled quickly and that not that there was a bunch of value to it, but that it was a nuisance rather than a value.

MR. GREENDYKE: You know, I don't represent Beal and I don't represent Scotia Redwood Foundation. Jacob Cherner came twice, he testified to the Court about the bid that they made in their own business judgment. And I believe he was credible and if I were you, I think you could find that he was extremely sincere. He showed you bank minutes, resolutions, they showed you loan commitments. They are ready to go, they have funded their corporation, they are ready to do their

deal with regard to any kind of 363 process through our plan that the Court would order.

But you know, I represent a group of Noteholders that has a completely different interest. As a group, a completely different interest. Let me go to slide 5 real quick and then I'm going to go to 6 right after that, Simon.

Slide 5 shows you real quickly a portion of the deed of trust. It shows you there is a lien on the intangibles. Go to slide 6, Simon. Slide 6 is also the deed of trust, the mortgage property for which they have a lien on general intangibles, it's the company on timberlands and all proceeds. You can see it includes proceeds and condemnation, takings, dimunition in value, loss of income strain, whatever. The liens have been provided for, the liens are there. We'll try and get you information with regard to where in the Court's records you can see the information with regard to the effects.

THE COURT: Okay. Well, is there a significant difference that you are participating in a -- you get the benefit of a litigation trust that you have 99 percent plus beneficiary and being primed by $500,000 worth of money.

MR. GREENDYKE: I don't think that -- I don't think that that's the right standard. If it's ours

and we have a lien on it and they are taking it from us -- I thought what they told you they were going to do is take that property, the Headwaters litigation and just sort of spear it off by itself. I didn't realize that was going to be part of the trust, I don't think it was going to be a part of the trust.

THE COURT: I thought the Headwaters litigation went into the litigation trust and that you --

MR. NEIER: It does not, Your Honor.

THE COURT: Oh, okay.

MR. NEIER: It's being retained by the company, like Mr. Cherner said, to resolve it.

MR. GREENDYKE: Precisely my point. Precisely my point.

MR. PACHULSKI: It's not being retained by the company. I'm sorry to interrupt. It's not being retained by the company, it's being transferred to Newco or sold or whatever. It's not being retained by anybody.

MR. NEIER: Mr. Pachulski is right, it's being transferred to Newco. But by retained I meant it's not going into the trust, that's all.

THE COURT: Okay.

MR. GREENDYKE: Let me jump for a second on to the second part of the cram down process. If the value is as Marathon says, it's in the 500 range, which

we disagree with, or even if it's 600 there's going to be an unsecured claim. And if the value of the total claim is somewhere from 740 to 780, I'm using the debtors' numbers, I think even one of these lawyers used the number of $800 million, you're talking about a couple hundred million dollars worth of unsecured credit. Even if they could convince the Court they're going to cram down that claim, the secured claim, they still have to cram down the unsecured claim, and it's a huge amount. They have to do it the same way under 1129(b)(2), only it's B and not A. And the same has to do with priority arguments can apply there, and that is that unless we consent, until we are paid in full, no one below us gets any claim at all. And that ties back to the standing argument that I was going to make earlier in this case.

All the value that's in Scopac belongs to the Indenture Trustee because we are under secured. At some level we are under secured. That means no one else has the ability to get any value of that, whether it's upside on liens or whether it's the right to appreciation or anything else until we're paid in full. And the effect of this plan and the reason why we liken it to a substantive consolidation is it takes it away. It doesn't comply with 1129(b), like taking it away, it calls it a transfer and it effectuates conglomeration

into a joint venture between the mill and the cogen, the timber properties into Newco. And out of that joint venture, if you will, are going to be paid the claims of Scopac creditors, Palco creditors and the Indenture Trustee. And if that doesn't look like a substantive consolidation, I don't know what it is.

THE COURT: It depends again. I mean, if in fact they are using assets of your -- you know, that you have liens on to fund the other side of it, then I agree with you, they can't do it. But again, doesn't that just go down to what's the value.

MR. GREENDYKE: Well, I don't think it does. And the case I want to cite to you is the Owens-Corning case, 419 Fed 3rd 195, the Third Circuit 2007 case. And that involves, as the Court is probably aware, a large mother company, a parent company, and then a lot of subsidiaries. The bank group loaned money to the parent company and was supported by the independent guarantees of all the subsidiaries. Corporate formalities, corporate separateness, dissolved company bid for among all these companies.

So there wasn't a problem with, you know, prepetition blurring of the assets and affairs of the companies. And there wasn't a problem with post petition commingling of the assets and the affairs of the

companies. The motion was filed to have a deem consolidation that provided for purposes of valuing and satisfying the claims, provided for voting for or against the plan, it provided for making distributions. The circuit looked at the history of substantive consolidation and traced it back to an old 1941 Supreme Court decision and then it started to decide how it was going to handle it and it came up with in page 211 of the opinion, five points, five principles that it wanted to adhere to.

And I'm going to skip over a couple of them but the first one was, and I'm going to quote with some ellipses in the middle, "limiting the cross creek of liability by respecting entity separateness is a fundamental ground rule and expectation of state law and commercial markets." That's from page 211.

The last one that they cited, and I'm going to quote again, "while substantive consolidation may be used defensively to remedy the identifiable harms caused by entangled affairs it may not be used offensively. For example, having a primary purpose to disadvantage tactically a group of creditors in a plan process or to alter creditor rights." If you allow these folks to do what they want to do and transfer this property, I think it's contravention of 1129(b). I think

it deprives us of the rights to credit bid that we would have under a sales process and it's not the indubitable equivalent of whatever they're going to give us, even if it's a cash out like you say. And again, there are no cash out provisions in 1129(b)(2).

The Court -- the Court obviously in Owens-Corning denied it and it was a landmark case. It has been cited by the Fifth Circuit. We think what's happening here is tantamount with this deed consolidation, what they discuss in the Owens-Corning case.

I'm trying to think quickly what I need to cover that we haven't talked about. The argument that we have somehow lost our right to credit bid, because of the 11(b) election not having been exercised at the end of the disclosure statement is twofold. Number one, if you look back at slide 3, the same part again, Simon. If you look at A, you see 1111(b) is mentioned under 1, (a)(1). When we're talking about the reorganization we're talking about paying somebody the allowed amount of their claim. That's where 1111(b) comes in. If you look at Colliers, that's the only place it applies. If you look at 1111(b), notwithstanding what Mr. Neier says, you know the argument, you can find a bankruptcy case somewhere in the country that says just about anything that you want

it to say, and he's found a couple of them.

THE COURT: Probably one side or the other, either side.

MR. GREENDYKE: 1111(b) is there to protect nonrecourse creditors. 1111(b) is there to protect the right and the upside for the benefit of nonrecourse creditors, those folks that don't have the ability to sue the debtor. We've got the ability to sue the debtor but for the bankruptcy case. We are a recourse creditor, no doubt about it, okay? 1111(b) doesn't show up under (b)(2) (a)(2) and it doesn't show up under indubitable equivalent. If you look at --

THE COURT: This isn't the statute, this is Colliers.

MR. GREENDYKE: I know it's Colliers, but I'm saying they don't even talk about it in Colliers. It's secondary authority, it's not the statute. We can look at the statute, it doesn't talk about any of that in the statute. If you look at 1111(b) -- really it's 1111(a), it's B -- I can't read it. Hang on. Part of being old. If you look at 1111(b)(1)(b), it says a class of claims may not elect application of paragraph 2, which is an 1111(b)(2) election if it's a holder of a claim -- if the holder of the claim has recourse against the debtor on account of such claim, such property is sold

under section 363 of this title or is to be sold under the plan. If the plan is as we say, if it's a sale plan, then we don't even have the right to make an 1111(b) election, because we have those rights there, the credit bid. We don't need that protection because we have a right to credit bid by the statute. When you read all these statutes they all make sense when you look at what each one of them is supposed to do.

THE COURT: Right. And when you have the indubitable equivalent, you don't really have an 1111(b) election either because you're getting indubitable equivalent.

MR. GREENDYKE: If that's capable of being done. And in the context of a cash out, our argument is it's not something that the Court has the ability to do.

We also think that the Marathon/MRC plan fails the Chapter 7 test. There was some mention earlier today about the testimony of Mr. Johnston about the cost of the Chapter 7, and my cross-examination of Mr. Johnston I think adequately demonstrated that if indeed the MRC/Marathon value is correct, then the property is upside down, this case were converted to a Chapter 7, the first thing you would see would be a motion to lift to allow a state court foreclosure. We would never let a Chapter 7 trustee sell this property.

We would foreclose and under our own marketing process if the Noteholders decided not to keep the property as a long-term investment in order to realize the value that we think is there in the property.

With regard to our plan, Judge, I have a few minutes left, I want to talk about our plan a little bit. If you maintain these two separate estates, there's only one plan with Scopac that can be confirmed and that is our plan. We think our plan satisfies 1129(a) requirements and it also satisfies the cram down requirements with regard to unsecured creditors and interest holders.

In response to plan amendments, the MRC/Marathon parties have said our changes required resolicitation of the unsecured creditors including our own constituencies. I don't think that's the law and I don't think notwithstanding me being made fun of as the terms of the Greendyke doctrine that resolicitation is necessary. We have already talked about the Noteholder claims. You have already admitted and looked at my declaration with regard to the consent of approximately 75 percent of the Noteholders with regard to the modification that was made the last week we were here. Second, with regard to the general unsecured, to show it's not my document, but a couple of other people think

about this, too, because we are not soliciting votes from those creditors who have already rejected our plan, we need no further disclosure, no further solicitation. Number one, American Solar Chain, 90 VR 808 Western District, guess who, Judge Le Clark said that didn't have to happen. The next case is In Re Rudy Sweetwater, 57 VR 354, District Court Utah 1985. A more recent case, In Re Simplot, S-I-M-P-L-O-T, 2007 West Law 2479664, Bankruptcy Court Idaho 2007.

Basically what this means is that if these folks have already voted to reject the plan, it doesn't matter really what happens. You're not trying to solicit their votes. You're not trying to -- it doesn't matter whether --

THE COURT: What is it that they're suggesting you have to resolicit?

MR. GREENDYKE: I think the argument is --

THE COURT: What is the change in your plan that somehow you want to be -- what -- describe for me the change that you want me to declare is not a --

MR. GREENDYKE: There were lots of changes and I don't have the motion in front of me, Judge, but there were lots of changes that were nonmaterial.

THE COURT: Like what?

MR. GREENDYKE: That didn't impact --

THE COURT: What's the one that they think is material, that they somehow --

MR. GREENDYKE: I think the argument, the first argument was that we diminished the treatment of our own constituency. And what I told you that is more than two-thirds in amount in number of our constituency has said okay.

THE COURT: Let's go on to another one.

MR. GREENDYKE: It's no big deal. The next one is that by treating all unsecured creditors equally, we have deluded the distribution that's going to be available to the general unsecured creditors out of the $1.45 million pot that was dedicated, carved out of the collection by the Indenture Trustee.

THE COURT: Did you change that from the original plan?

MR. GREENDYKE: We haven't changed it. The $1.45 million is still there but because there may be more unsecured creditors in that class now than previously.

THE COURT: Why are there more unsecured creditors?

MR. GREENDYKE: Because we have agreed to give to give Pension Benefit Guaranty Corporation unsecured --

THE COURT: I understand. Okay.

MR. GREENDYKE: So the estimation of distribution is going to be different. And my argument to you is based on these cases that that doesn't need to be resolicited.

THE COURT: Okay. So under your plan what happens to the pension guaranty board?

MR. GREENDYKE: Those claims get allowed and placed wherever they're at. If there's a priority claim, it's treated as a priority plan. If it's an admin claim, it gets paid as an admin claim. If it's an unsecured claim, it gets treated along with the rest of the unsecureds.

I want to talk about -- let me have slide A, Simon. I want to talk about one thing real quick while we're still thinking about numbers. You several times mentioned what you might do if there were two plans that were susceptible to confirmation. The co-provision that applies to that is 1129(c). In that it says you are to consider the preferences of creditors and unsecured loaners in determining which plan to confirm.

THE COURT: Right.

MR. GREENDYKE: The key is we're talking about Scopac creditors. Okay. If you look at what was filed with the Court prior to the confirmation,

commencement of the confirmation hearing by Logan that show you the value, under our plan 114 Noteholders voted $697 million worth of claims voted yes. 23 Noteholders, mostly held by the debtor, in their accounts, voted two and a half million dollars worth of claims voted no. Unsecured creditors, 2 for $90,000 voted yes to our plan and 28 voted no, totaling almost $8 million. If you look at Marathon's plan, our class, the Noteholder class, 124 voted no to their plan for $688 some-odd million. And 6 Noteholders voted yes to Marathon for $355,000.

If you look at the general trade class it was overwhelmingly 26 votes for their class for about $8 million. I think it was $240,000. And the general class, my class, in which we are unsecured claims are placed, 125 votes, $688 million voted no to Marathon and 7 voted yes for $7 million.

I don't know how anybody says that the overwhelming majority of creditors votes for the Marathon plan. If you look at number, if you look at numerosity, the number and you look at amount, overwhelmingly, all the votes, most of the votes, potentially all the votes are for our plan. Now, do we have the vote of the State of California? No, we don't. We don't have a letter from the Congress person, we don't have anybody from the county telling us or the federal regulatory agencies

saying they support our plan. The committee doesn't support our plan. But if you're counting noses and counting dollars, the preferences of creditors is going to be for our plan.

I think, Judge, I think I'm going to try and close unless the Court has more questions. I wanted to say to you that I think the whole world is watching this case. I think California is watching this case. We know that. I think New York is watching this case. I think it's well publicized and covered. When this case was filed, as in all are, Chapter 11s, the momentum was with the debtors. After the initial skirmishes in this case, the debtors were successful in convincing you to going along with them. But all the while you urged them to deal with the elephant in the room, the Noteholders. At significant cost to the estate, our collateral in this case lumbered along.

At the same time, however, the credit markets sank as did the home building business and to a certain extent the debtors' cash flow tanked as well. Now in the words of the Fifth Circuit, taken again from the D&F Construction case, market conditions are such and the exigencies of Palco and the activity by the politicians are such that immense pressure is being put on the Court from external sources. But I want you to

imagine -- and I'm thinking back to your comments this morning. I have a plan and I have a whole plan. And respectfully I think you've got it incorrectly. Let's imagine there's one case. Let's imagine there's no Palco, no California political pressure, no letters to the Judge. Let's imagine just Scopac, the Noteholders, and MRC and Scopac and the Noteholders want an auction because that's what complies with 1129(b)(2).

And then you go back and you read the words of the Fifth Circuit in the D&F Construction case and you ask yourself what does the law tell you to do? I think the law, 1129(b)(2) and I think the Fifth Circuit in D&F Construction tells you what you have to do to apply the law. And then you back off and you say, why would the answer to that question be any different because Palco is there? And if you apply the law the way it is written and not the way they argue it should be written, then you have to come out, you have to deny the confirmation of the MRC plan and you have to confirm our plan.

We have given you an alternative today in the proffers today for feasibility through the Lehman loan of $20 million to get us through any reasonable marketing period and we have also given you an opportunity to realize there might be an option for the

mill if you confirm our plan through the offer of Sierra Pacific Industries not only to acquire the mill for a price which includes buying the collateral on hand, buying the inventory on hand, buying the capital on hand, but also investing in the town and investing in the mill to increase jobs and increase the profitability.

THE COURT: Of course, that offer -- I mean, the debtor hasn't agreed to that offer. The debtor is the only one that can propose the sale at the present time. I mean, we can have a trustee appointed or we can convert it and that offer could be accepted, I guess, but it would be way down the road.

MR. GREENDYKE: Good point. They're ready to close in 30 days. They're ready to close in 30 days, but the point is that you don't have just two options. We have had a mini auction here all along, the price has gone up from the Marathon plan from 430 to 530 and you have the Beal bid out there during the course of this case for $603 million. There is more value there than what they are trying to give us. There's more interest than what the Court has seen so far and we haven't even begun a sales process, and that's the point.

If you want to maximize value, that's the only way to do it. Right now we're in the middle of a big fight and I think what the Court needs to do is stand

back and look at the separateness of these two companies and look at the law as it applies to Scopac because I think that's what your job is and decide what you can and can't do with Scopac and with the Indenture Trustee.

We're telling you there's options. If you make the right decision in Scopac that there's other ways out for Palco. Thank you, Judge.

THE COURT: All right.

MR. NEIER: Your Honor, would it be okay to have a break?

THE COURT: Sure, we can have a break. And we've got Scopac for 30 minutes next?

MS. COLEMAN: Your Honor, Mr. Pachulski is going to go for his 30 minutes and then Scopac will go.

THE COURT: Okay.

(A recess was taken.)

THE CLERK: All rise.

THE COURT: Be seated. It looks like we changed the order. Are you going next?

MR. PACHULSKI: Yes, Your Honor. Isaac Pachulski of Stutman, Treister & Glatt for certain noteholders. I'm going next, and I will be followed by counsel for Scopac.

Your Honor, in over one hour of argument, MRC and Marathon collectively have completely said not a

word about one of the basic reasons why their plan is not confirmable as a matter of law. So let me start there. And that's the violations of that case as to the priority rule. And, by the way, whether or not they've complied with the literal requirements of 1129 B(2)(a), whether they complied with i, ii, or iii doesn't matter because they haven't complied with this one.

Second, once I'm done with that discussion, I'll also address the issue of substantive consolidation, and I will show Your Honor how this case improperly disregards the integrity of the separate estates and, effectively, pays everyone but Marathon out of assets of Scopac.

Third, and I always hate to -- it's always kind of dangerous to disagree with the Court, but I'm going to have to do it. I'll demonstrate why, with all due respect, the Court's notion in this case does not rise and fall, and the Headwaters litigation is not quite correct. In order for that to be correct, the Headwaters litigation has to be left with the noteholders. Its private collateral cannot be taken.

THE COURT: That is the Scopac version.

MR. PACHULSKI: The Scopac claims, I'm sorry.

THE COURT: The Scopac claims.

MR. PACHULSKI: The Scopac claims, which the expert said could be over $300 million. And finally, time permitting, I'd like to address briefly an element to the public interest that's completely gotten no shrift, let alone short shrift in this case, which is construction in the capital markets, a long-recognized method of financing that will result if the -- if the outcome from the Scopac case is dictated by the needs of creditors or anyone else in the separate Palco case.

Let me first start with what is a real show stopper, the violation of the --

THE COURT: Okay. Well, let me put your mind at ease. I am not going to ever -- I mean, I don't think I can rule on that if your plan is not -- I mean, if the Marathon plan is not confirmable as against the noteholders, that somehow because it's so good for Palco, that somehow makes it confirmable. I mean, nobody believes that.

MR. PACHULSKI: Well, there's another point there, which is if our plan satisfies -- if the Indenture Trustee plan satisfies the requirements of 1129(a) as to Scopac, which is the only debtor that counts as far as we're concerned, 1129(a) says it shall be confirmed. And with respect, the Court cannot deny confirmation of a plan that shall be confirmed because it

complies with 1129(a) because it may not be good for Palco or the State of California or the governor or anybody else. And let me --

THE COURT: Well, when there are two competing plans, both of which are confirmable, then the Court has to decide which one to confirm.

MR. PACHULSKI: That's correct, but --

THE COURT: And I must look to the interest -- not the interest, but the opinions of the creditors and other things.

MR. PACHULSKI: Of Scopac.

THE COURT: Of Scopac, not -- as far as to your side.

MR. PACHULSKI: That's correct. And their plan -- I'd like to go on to my presentation. Their plan has to be viewed as a separate plan for Scopac and Palco, even though they called it a joint plan, because these are separate non-consolidated estates. Now let's talk about the absolute priority problem. It's very simple and straightforward.

Their plan proposes that even though Scopac's noteholders have a lien on all of Scopac's assets, junior interest, unsecured claims, these include administrative, priority, and trade claims at Scopac will be paid even though the secured claim isn't receiving 100

cents on the dollar. The second discreet violation of the absolute priority rule is --

THE COURT: Well, right, but that can't happen. I mean, I got to believe that you're getting 100 cents on the dollar for your secured claim for that plan to be confirmed.

MR. PACHULSKI: Well, no, Your Honor, that's -- that's the disconnect.

THE COURT: Okay.

MR. PACHULSKI: The strict priority rule says if we have a lien on the assets, you cannot say, well, the assets are only worth 500 and someone is giving you 530, so I can take the 30 and give you the unsecured creditors. The actual --

THE COURT: I thought that was Judge Greendyke's case. They gave him 133 percent of the value of their claim.

MR. PACHULSKI: Well, Your Honor, I can't speak to Judge Greendyke's case. I can only speak as to what the absolute priority rule requires, and I'm going to go through the law and show you how you get there.

THE COURT: Okay. So I am to believe that case was wrong?

MR. PACHULSKI: You know, I should have been paying more attention to it, but any case that says

that a secured creditor has a lien on everything, you can take -- you can take value and give it to junior interests based on a hypothetical appraisal of the collateral, that's not the absolute priority rule. The absolute priority rule is a strict priority rule.

Then the second one, which is simpler within the statute, is that under their plan, they're going to take value, that is -- and you'll see how this works, if it's attributable to the Scopac assets and they're giving it to creditors of the equity holder, Palco, to the tune of over $18 million. And that's just under the plain language of the statute since the unsecured creditors of Palco don't get paid in full, you can't do that.

Let's first set the legal table because I think this concept is real important.

THE COURT: Okay. Let's go back to that, what you just said. You just said that the Palco plan --

MR. PACHULSKI: No, no.

THE COURT: Part of the plan they're giving --

MR. PACHULSKI: In the Marathon plan if you look at how it works.

THE COURT: As to Palco, right?

MR. PACHULSKI: No. What they're doing is

they're taking value that's attribute to the Scopac assets and they're giving it to the equity holder, Palco.

THE COURT: What value is that?

MR. PACHULSKI: Your Honor, all of the value attributable to the Palco estate -- and I'll get to what I'd like, but to give you a preview, all of the value attributable to the Palco estate is going to Marathon. And I'll show you how that works. Well, if all of the value attributable to the Palco estate is going to Marathon and if you assume that Newco isn't the tooth fairy putting $18 million under Palco's pillow out of the goodness of its heart, then the only place that that value is coming from is from the Scopac assets. And I'll show Your Honor how that works, if you'll give me a few minutes.

All right. Let's first start with the first violation of the absolute priority rule. To set the legal table, the words "fair and equitable" didn't first show up in the bankruptcy laws in 1978. The same words, precise words, "fair and equitable" were included in the old bankruptcy act. And although those words were not defined, they were read to incorporate the absolute priority rule. And by the way, just for the record, given the color of my beard, Your Honor can tell I actually have the dubious distinction of having practiced

under the bankruptcy act, so I can --

THE COURT: I didn't practice under the act, but I remember the act. I was practicing at the time of the act, so go ahead.

MR. PACHULSKI: Now, when everyone thinks about the absolute priority rule, they always think in terms of the unsecured creditors versus equity. But -- and this is in the brief, so I'm just going to highlight this. As was pointed out in --

THE COURT: Did you file a separate brief?

MR. PACHULSKI: No, no, their brief. It's one brief. I thought you had enough paper.

THE COURT: I thought there was a brief that I didn't see. I got their brief.

MR. PACHULSKI: Okay. And in their brief there's a detailed discussion of this where Collier points out that it's a rule of strict priorities. It's not -- there used to be some notion of relative priority of the rule, but strict priorities, which is secured creditors and -- secured creditors and unsecured -- secured creditors have strict priority.

And to give Your Honor an example, there's a 2nd Circuit case that's cited. I would urge the Court to look at it because it's so clear how this rule works. It's Mokavo Corp versus Dolan, 147 F.2d. 340. In that

case basically the debtor was a hotel. The debtor owned and operated a hotel. Under the plan the second mortgage holder would only get part of its claim, and unsecured creditors would still get some cash.

It took the court a paragraph to hold that this ruling was clearly wrong, and the court cited two Supreme Court cases, one of which is Case versus Los Angeles Lumber, which is a Seminole fair and equitable absolute priority case. And the court didn't ask about value. It doesn't matter. They have to follow strict priority.

Now, since 1129(d) uses the same words fair and equitable and it uses the word "include," so it's not limiting, fair and equitable in 1129(b)(2) cannot mean less than it meant under old Chapter 10. And the reason we know that is because of two basic principles of statutory construction. The first is when Congress uses the same words in a new statute -- and it's the exact same words -- when Congress uses the same terms in this statute it used in the old one, it's assumed to understand the judicial laws that was included in those terms, and it's assumed to intend that those concepts to continue.

The second is that the Supreme Court in cases such as Mid-Atlantic and Davenport has said that it

will not construe the bankruptcy code to erode past bankruptcy practice absent clear indication of congressional intent. And the congressional intent is exactly to the contrary because what the Congress said in legislative history was that 1129(b) is a partial codification of the absolute priority rule, not a complete codification. So there are uncodified elements.

So for that reason, all this testimony is interesting, but we have a right to the application of strict priorities, and that alone is enough to kill this plan as to the treatment of Scopac's unsecured creditors. In addition -- and I'll get to this when I talk about substantive consolidation. There's value that's being diverted from Scopac's assets to the unsecured creditors of Palco.

Now, Your Honor, to begin with on the issue of substantive consolidation, they argue that, well, this isn't substantive consolidation; it's a post confirmation merger. And with all respect, you can call a pig a thoroughbred horse, but it's still a pig. And what the court said in Adelphia is that you can call it anything you want. But if it is, in fact, a plan that disregards the integrity of the separate estates, and it, in fact, imposes a substantive consolidation, then it's improper.

And here there are three elements. The first element has to do with the litigation trust. Now, what they're doing there is they're taking claims that belong to Scopac -- and I'm not talking about the Headwaters litigation. They take claims that belong to Scopac. They take claims that belong to Palco. And they blend them all in one litigation trust. They comingle them. And they then let all creditors of both Palco and Scopac share. Now they say they're doing us a favor. Well, you know what, Your Honor, that's absolute speculation. It's the kind of speculation that, for example, the Fifth Circuit in Waco would have no part with -- no part of, and no other court would.

And the reason it's speculation is this: They haven't described what claims of Scopac are going in there. They haven't given us any idea of the value of those claims. They haven't told us what claims of Palco are going in there except they've told us they're going to release the claims against Maxxam. So we have to sit here and speculate about what the value of what, and there's just no record that would justify it. And the fact that you need two litigation trustees instead of one --

THE COURT: They're not releasing the claims of Scopac against Maxxam, are they?

MR. PACHULSKI: No. That's correct. But, regardless, they're commingling claims in a single litigation trust without any valuation testimony that would let us figure out whether we're being benefitted or hurt.

THE COURT: So that issue then could be solved if they had decided to have two litigation trusts?

MR. PACHULSKI: Well, the other thing they've got to do as to the Scopac claims, they should just be left with us, as should the Headwaters litigation. And we'll get to that.

The second problem, Your Honor, is this: The way the plan works, all the value attributable to the Palco assets on which Marathon has a lien and on which it's undersecured is going to Marathon, which means that you have to figure out where the $18 million is coming from for Palco creditors.

Now, in Adelphia, the court had a somewhat similar problem. What the court said was one of the problems with the plan is it doesn't tell how the separate assets and liabilities of the estate are distributed.

And here, the plan obfuscates. It doesn't really tell you where the money was coming from to pay Palco creditors, except it says it's coming from Newco.

As I said, Newco is not a charitable institution. But if you look at how the plan is structured, you can quickly figure out what's really going on here. Under Sections 4.3.2 and 4.4.2 of the plan, this is how they describe it. Marathon's dip loan and its term loan get assigned to Newco. So these loans get assigned to Newco.

Then what happened is in exchange for that dip loan, Marathon -- for that dip loan and also Marathon is putting some money into Newco, Marathon gets three things. It gets 100 percent of Townco, which are the so-called town assets. And, by the way, Your Honor, the town assets, I think, are usually defined to include the cogen plan. I understand the Townco was the cogen plant and all the town assets.

Then Marathon gets 15 percent of the equity of Newco in exchange for the mill and some cash. And then Marathon gets a note. And what they do is they calculate the amount of the mill working capital, and Marathon gets a note for that. Well, and by the way, Mr. Breckenridge in his testimony, as Mr. Neier handily pointed out referred to this as a situation where Marathon is foreclosing on its assets. That was Mr. Breckenridge's terminology.

By the way, it's true he's a business person, but as a business person he was looking at the

substance of the transaction. That's what you're supposed to do. So instead of being coached by the lawyers on how to characterize it, he just told the truth, I'm foreclosing on my assets, and I'm getting the value. And let's see how that works.

There are three buckets of collateral for Marathon. Marathon has a lien on the town assets. Okay. Well, Marathon is getting all those assets because it owns 100 percent of Townco. You know, they called it a reorganization of the plan; he called it a foreclosure. Then in exchange for the mill and some cash, Marathon gets equity in Newco.

Then in exchange for the mill working capital, they get a working capital for Newco. Well, thus all the value for the Marathon assets, for the Marathon collateral, which is all of Palco assets is going to Marathon. Okay. Well, now they have a problem. The plan says there's $18 million that's going to go to the Palco unsecured credit. That's $7 million roughly in administrative claims, roughly $10 million dollars for the unsecured creditors, and $800,000 going to the priority tax claims.

All right. Well, as in Adelphia, they don't tell us where this money is coming from. But by process of elimination, this is kind of simple logic. If

all the value that's in Palco is going to Marathon, then by definition what's left is value attributable to Scopac. And, Your Honor, if they're paying $580 million for Scopac assets as Mr. Neier, I think, said, and we're only getting 517, you can't -- with all due respect, you can't take the $50 million saying, well, since your collateral is hypothetically worth 530 but an actual person is paying 580, I can't $50 million and give it to Palco because --

THE COURT: Why do you say that they're paying 580 for Scopac?

MR. PACHULSKI: Because according to them, Newco is providing $580 million of consideration, okay, and that $580 million, it can't be for the Palco assets because as we just saw when I went through the three buckets, all the consideration applicable to the Palco assets is being given to Marathon.

And, by the way, Your Honor, it's their burden. In the plan they have to identify which estates' assets are going to be used to pay Palco. And they obfuscated it, and that's the kind of pooling that Owens Corning reversed. That's the kind of shelving that Judge Sheindlin rebuked the bankruptcy court for approving. And that's exactly the problem where you take all of these assets and you pool them to a buyer, and then you

kind of play games and say, well, $18 million isn't really coming from Scopac, it's coming from -- you know, I'm sure Mr. Neier will give you a really good explanation. But there's a fundamental problem here because if you look at the way the plan is structured, Marathon forecloses on its assets, gets the value, and the Palco estate is done.

Now, there's a third element of the plan that reinforces the improper subsequent consolidation. And that's the elimination of the intercompany claims.

Now, it's clear that the intercompany claims are disappearing. And while they argue -- the argument was made that intercompany claims are subordinated -- nobody has shown the basis for subordination.

Now, Mr. Neier did point out that the Scopac administrative claim against Palco is considered in reducing the reduction, but he only told you half the story, so I have to tell you the other half. And the way the other half works is this. As Your Honor will recall, there is a reduction from the $530 million for administrative expenses to the extent they exceed 5 million, which itself violates absolute priority because they're taking money from us to pay unsecured administrative expenses.

And the second deduct is for certain amounts relating to Bank of America, which is appropriate. And then they say the reduction is reduced. The reduction is reduced by Scopac's administrative claim against Palco, except what he forgot to tell you was that there's a netting. And Scopac's administrative claim against Palco is netted down by all of Palco's intercompany claims. Not just Palco's postpetition intercompany claims, but Palco's prepetition intercompany claims. And that's in Subdivision C of the definition Class C distribution adjustment.

So what this means in plain English -- and pardon the trip -- is that prepetition claims of Palco against Scopac are going to be offset against postpetition claims of Scopac against Palco. Now, number one, that violates the required mutuality, but it's even better. Whoever came up with that concept read Adelphia and decided to make the same mistake, which Judge Sheindlin criticized in Adelphia, because what happened in Adelphia was that one of the criticisms was that the plan took postpetition intercompany claims, prepetition intercompany claims, and put them all in one class. And she said by doing that, you've deprived the postpetition intercompany claims of their right to payment and their right to priority under 1129(e)(9). And that's exactly

what they did here.

So they've eliminated all prepetition intercompany claims. They've created an improper offset of prepetition against postpetition intercompany claims, and in addition to the pooling we discussed, that's improper.

All right. Now let's go to -- now let's talk about the Headwaters litigation, Your Honor. And, first, just to deal with a preliminary issue, Your Honor suggested that maybe the problem could be solved by, you know, letting Newco take the Headwaters litigation and giving us the settlement proceeds. Your Honor, if Newco has that litigation, they advertise a good relationship with the state. If you just let them control that litigation, they're going to settle with the state for peppercorn, and we'll get nothing. That's not indubitable equivalent. That's like putting a fox in the hen house and saying that's indubitable equivalent. So that doesn't work. The only way you can solve this problem is to leave the Headwaters litigation with the Indenture Trustee to prosecute as the Indenture Trustee deems appropriate.

Now, let's talk about burden of proof on indubitable equivalence. We actually agree on something with MRC Marathon. They have the burden of showing by a

preponderance, which is indubitable equivalence. Now, there are two sides to that equation. The one is what they're giving us. Well, they simplified the task of valuing that because it's cash. But there's a left side, what we're giving up, what the noteholders are giving up. And they have to show that there's equivalence, and it's indubitable. And while they present the evidence on the value of the timberland, they presented no evidence on the value of the Headwaters litigation, and I'll get to the so-called evidence that they cite in a minute. But they presented no evidence. And it's their burden. It's not our burden to show it's a good piece of litigation. It's their burden to show it's a bad one.

Now, this whole problem becomes even more acute for this reason, Your Honor. As Your Honor will recall, after the -- after listening to the appraisal testimony of Marathon's appraisal, of the noteholders' appraisal, and I believe having evidence of the Beal bid, Your Honor gave a preliminary estimate -- and I understand it's preliminary -- that the value of the collateral is 500 to $600 million. Now, since Your Honor didn't have any evidence at that time of the value of the litigation, and since I'm pretty sure the Court was focused on the timberlands. In effect, you found that the timberlands have a value of 500 to 600 million. Now,

the only evidence after that was the debtor's evidence which argued for a higher appraisal, so I don't think there's anything the debtor did, even if you disregard all the evidence, that would lead to a lower valuation.

So we have a preliminary evaluation that says our timberland collateral alone is worth between 500 and $600 million. Great. And they're going to give us 530 minus some stuff, clearly at the low end, which means that they're getting, based upon Your Honor's preliminary valuation, they're getting the Headwaters litigation essentially for free. That's how those values work. So that compounds the problem.

Now, let's talk about their so-called evidence. Well, one of the things we've heard is that Mr. Clark testified that you couldn't put this on a financial statement under gap. Well, you never put unliquidated claims under gap. I have never heard anybody argue with a straight face that Your Honor should approve of a claim because under gap it's zero. Then they talk about Mr. Dean, a businessman who admitted that he really didn't investigate the litigation. And, in fact, when Mr. Dean was asked, would you just extinguish the litigation, what he said -- and I'm quoting here from the April 9th transcript, page 171, 6 through 10: "If we're successful here, we would review it, talk about it

with lawyers who know something about it," and then it goes to say they would talk to the state. Well, would review isn't the same as did review. And would talk to lawyers who know something about it doesn't mean did talk to lawyers who know something about it.

And just to show you how weak their case is, we had the spectacle after evidence was closed of Mr. Brilliant testifying from the podium about what a difficult lawsuit this is.

That's not evidence, Your Honor. They didn't submit a brief on the issue. They submitted no evidence. And both because testimony from the podium doesn't count and because the record was closed, that doesn't count.

Well, then we also had the Court being forced because of the poor evidentiary presentation by MRC and Marathon, they wanted to put you in a position, Your Honor, where you're going to look at the answer, and you're going to speculate whether this is a five percent chance, a ten percent chance, a 50 percent chance, with all due respect that's exactly the kind of things that has got the court in trouble in TMT Trailer Ferry where the Supreme Court criticized the law report for not having an ample record to evaluate the claim that was being giving out, and it's the same mistake that was made

in In Re Erico, another case involving a reversal. And that's what they want you to do. The fact is it was their burden.

Now, by the way, Your Honor, in the brief, the analogy of the settlement of a compromise was offered and it's appropriate -- it is and it isn't. If you have a compromise, if there's a motion to compromise the claim, you actually have an estate fiduciary who's entitled to a certain presumption. Well, here Newco is an anti-fiduciary, it's a hostile acquirer, so obviously what they say about this litigation isn't entitled to presumption of anything.

Okay. And if you look at the standards for approving the compromise, if the debtor came to Your Honor with a compromise and said this could be it, we filed a complaint, three of our claims survived a motion to dismiss on the pleadings, and the other two we got leave to amend. Here's our damages expert who has opined that our damages claim is over $300 million. This is Scopac. And he also testified -- and this is important -- the $200 million that was historical damages -- and the reason that's important is that historical damages are much more concrete, much less speculative, much less uncertain on future damages. And if the debtor came to you and said, by the way, I want to

settle this litigation for 5 million or 10 million, and I'm not going to tell you anything about the merits. And, you know, under GAP I can't -- I can't account for it, and we really have to do it. You know, Your Honor would throw that dead out of court. And that's what they're trying to do here.

Now, briefly they have the same problem with the best interest test. Under best interest, one of the things that would happen in a Chapter 7 is the noteholders would get to keep this litigation. They have the burden, they being Marathon and MRC, to demonstrate that in a Chapter 7 case the noteholders are getting at least as much -- that under the plan noteholders would get at least as much as they would get on a liquidation. Well, how can you possibly make that determination when they have given you no evidentiary basis whatsoever to determine what noteholders would get or a range of values in a Chapter 7 liquidation.

And by the way, every so often you actually find a case that deals with an odd issue, and you've got one here they ask for you to look at, and that's the Salem Sweets case. It's in 92 DR, page 935 and 936. And what's significant about that case is that in that case, the debtor proposed a plan where a judgment creditor who had a lien on the real property and who had

a claim against the insurance company would either have to give that up in exchange for a fixed cash payment for the insurance company or get some other treatment which was worse. And the court said in substance, I can't find that this plan meets any of the tests of 1129(b)(2) because the amount of any recovery under judgment -- of the judgment creditors is uncertain, and they presented no evidence. This is that case, Your Honor.

Now, finally, Your Honor, I'd refer to a public interest factor that I'd like to talk about, too, and that's this. As a personal matter, public capital markets, financing markets are pretty fragile anyway. One technique and that's exemplified by this case that enables borrowers to raise financing that they couldn't otherwise get or get it on better terms is the notion you separate off a group of assets and put lenders in a position where they can look to those assets. What you basically do, you get a single company and you split it. You have Goodco, which here is Scopac, and then you have not so Goodco, which is Palco. And the Goodco is able to get financing and it says, look, we've got these assets here, and you're not going to have to worry about the creditors at the other levels. And, in fact, Mr. Breckenridge, to his credit, who is familiar with how the financial markets worked, explained that the

lenders -- what the lenders bargained for this kind of a structure to keep other creditors from attaching to these assets, okay, to keep other creditors from attaching to these assets.

And in this case, just given what's been said, given the arguments that have been made, given the fact that it's pretty apparent that value is being moved from Scopac to Palco, word gets around quickly whether there's a reported opinion here or not. And in the event that this plan by MRC and Marathon is confirmed that lets Marathon bail itself out of a bad loan by playing around with Scopac's assets, it's going to undercut the utility system. Word will get around.

And Your Honor may be thinking, well, if that's the case, why haven't I heard from any industry groups. And I'll tell you based on my experience, and I don't know why, the industry groups always wait for something bad to happen. And then what happens, they do something --

THE COURT: They didn't when the issue was whether or not the noteholders were going to have to pony up all that information about what they bought and how much they paid.

MR. PACHULSKI: Well, that's because they had already lost it once and the -- they have to move --

let me give you an example, personal experience, and if you need to refer to the decisions.

In the Enron case Judge Gonzalez made a ruling in a very important issue dealing with equitable subordination and assignment of the claims. It was on a motion to dismiss. The industry associations didn't show up at all. As soon as he made that decision, there was a motion for an interlocutory appeal. They came in there, argued to the district court that you have to take this interlocutory appeal because what he did is going to disrupt the market. The district clerk took interlocutory appeal, and in the later opinion made -- one reason she did it was because of the disruptive impact on the markets and eventually reversed for legal reasons and in part because it would disrupt the markets.

But the point here is you haven't heard from the industry associations yet, but there should be no doubt in the Court's mind that even if there is some short-term benefit to, you know, Palco or Marathon or Palco's employees, this has the risk of really undercutting a very important financing tool. And every debtor who has a problem who might otherwise have been able to get financing or borrowing better terms by spinning off the assets and doing what was done here is now going to face, well, look what they did in the Scotia

Pacific case, look what happened to the noteholders there. And in every one of these cases, Your Honor, and I know you've mentioned in the past that, well, the operations are related and the noteholders knew there was a relationship. In every one of these cases where you spin off and create a separate entity, there is always relationship. The original entity doesn't give up its interest. There will be contractual relationships. There will be certainly a relationship of equity ownership. So you always have affiliations in this case.

So if Your Honor rests any refusal to confirm an otherwise unconfirmable plan on the notion that, well, we knew that we were -- we had some -- there were some dealings with Palco, and so if Palco is left stranded our plan can't be confirmed, that reasoning will apply to every financing like this that the court ever sees. So as the Court thinks about the public interest, and frankly, I don't think --

THE COURT: Well, I think there's -- obviously there's a public interest in financing also. I'm not suggesting that I should make a decision -- I think it's just as inappropriate as it would be for me to make a decision of bad law based on the -- whatever equitable considerations there might be. It would also be equally bad to make a decision. If the law allows a

plan proponent to rewrite the security basically for someone who has made a deal for a separate corporate security, the law allows that. The mere fact that it might -- you know, might change the deal you have, I mean, every -- I mean, almost every bankruptcy involves changing the deal with secured creditors. Isn't that true?

MR. PACHULSKI: They often do. But it is judged on the basis of the economics of the debtor, not other entities.

THE COURT: Right. I agree with you about that.

MR. PACHULSKI: And we have the other problems of absolute priority, substantive consolidation, and the flimsiest case you will ever see on their part on the Headwaters litigation. Now, I think I've probably used up most of my time. If I have any left, I want to save it. If the Court has questions, I'll be happy to answer because I went kind of fast, but --

THE COURT: So you have -- your clients have nothing to do with Beal Bank; is that correct?

MR. PACHULSKI: No, other than we own the same notes. But there's no relationship. We're not --

THE COURT: So are you somewhat concerned about the fact that if that bid were approved and then

there were a 66 and a half percent bid, that Beal gets a $27 million breakup fee --

MR. PACHULSKI: No, Your Honor. And let me --

THE COURT: -- in front of you?

MR. PACHULSKI: Let me explain why now. I don't know if there's been a formal vote. But let me tell you why I don't think we're concerned. If there's anything that should be clear to the Court it's that our clients believe there are -- there is substantial value here and that this whole structure has been set up so that Marathon and MRC can get this on the cheap, okay?

MR. PENN: Your Honor, I object. This is outside the record, what his clients would think.

THE COURT: I'm asking a question, so --

MR. PACHULSKI: I'm answering the Judge's question.

THE COURT: -- so he gets to answer it. Go ahead. I always like to know -- I don't know it has any legal import, but --

MR. PACHULSKI: The fact is the fact that they're willing to put up with a break-up fee is frankly additional evidence of how firmly they believe that these assets are worth more than what MRC and Marathon are going to take them for. It is very possible -- and I

can't discount the possibility -- that if all -- that there's the Beal bid. They would be happy to take these assets on a credit bid, even if it means paying the breakup fee because in the long run they see the value. And that's the -- you wonder why three mediations failed. It's because our view of the value of this asset, which is a somewhat unique asset, and their view is different.

And that's why we want an auction so we can test it by the market. And they want this process of hypothetical appraisals, so they can get it at a price -- a non-negotiated price that they dictate. But just to be clear, the break-up fee is the price we're willing to pay.

THE COURT: Why weren't you willing to then just simply track the Marathon plan and credit bid your lien?

MR. PACHULSKI: Okay. Let me -- I'm glad you asked that, Your Honor, because Your Honor before talked about credit bidding in terms of paying a bunch of unsecured creditors of Palco and a bunch of unsecured creditors of Scopac and taking on the PBCG, which is unsecured. With respect that's a complete inversion of decades asset priority law. We're ahead of those people, not behind them. And to say that in order to exercise our 363(k) run, we have to pay people who are junior to

us, not only people who are junior to us at Scopac because we're secure and they're not, but people who are super junior to us over at Palco because they're unsecured creditors of an equity holder.

And sometimes I get carried away by my own advocacy, but honestly, I don't know how there's any way that any court any place can support that with the absolute priority rule to say that in order to get access to your assets in the 363(k), you have to pay not only unsecured creditors of your debtor, but you have to pay unsecured creditors of the debtor for whom you bargained to be separate from. That's the answer. With all due respect, it's an inappropriate thing to ask us to do. And I probably just got myself in trouble with that answer, but I want to answer your question.

THE COURT: How would you have gotten yourself in trouble?

MR. PACHULSKI: Pardon me?

THE COURT: How would you have gotten yourself in trouble?

MR. PACHULSKI: If Your Honor has no other questions that will put me on the spot, I'm done.

THE COURT: All right. Thank you.

MR. McDONALD: Your Honor, this is McDonald from Baker Botts on behalf of the American

Securitization Forum, a trade group that's been monitoring these proceedings. May I address the Court for 30 seconds?

THE COURT: Sure.

MR. McDONALD: We are concerned about the consolidation issue presented here. I just wanted to apprise the Court of that. And would be glad to submit a letter to the Court setting forth that concern.

THE COURT: All right. Thank you.

MR. McDONALD: Thank you.

MS. COLEMAN: That was even less than 30 seconds, Your Honor. Your Honor, for the record, Kathryn Coleman for debtors Scotia Pacific. Well, Your Honor, I'm not the first to say it, and -- although I may be the last to say it today, but the driver of these cases has always been value. That's not unique. That happens in a lot of bankruptcy cases. But here it's come up in many ways. What's the value of the timberlands? That's what we've all been focused on. Will there be enough value on the Palco side to take care of all the claims there? Is there so much value on the Scopac side that after creditors are paid in full there's something left over for Palco, which is the past equity. We've been talking about this for 16 months, if my count is right. And it may be short.

But in that regard, Your Honor, Scopac has always had a singular goal, which is first realistically to assess, and then fairly to allocate the value of Scopac's estate. Now, Scopac doesn't have an allocation of its own to argue for anymore. It doesn't have its own plan anymore to promote; but it does hold a strong opinion as to the value of its estate. And that opinion, in turn, leads to its views as to the two plans which are now before the Court. So let's talk about value first.

Scopac is the only party, Your Honor, that obtained an independent expert assessment of the value of its estate. We're the only ones that went out and interviewed a bunch of experts and found these world renowned experts that Your Honor heard from for over eight days of testimony.

The first step in valuing timberlands, if you recall, is the inventory. So Scopac has a 2001 inventory that was based on a 10,000-plot sample, a large sample. And it had a margin of error of less than one percent. And no one has challenged that 2001 inventory. Everybody else who valued the timberlands under the Scopac experts used that inventory to start with. Scopac updates that inventory every year, and it certifies that update to the Indenture Trustee as part of the -- as required by the indenture.

Now, in addition, in connection with this case in doing this valuation, we got a valuation from Dr. Iles, who's a highly credential, renowned forest biometrician. Nobody -- nobody challenged Dr. Iles' credentials. Nobody challenged Dr. Iles' method, which included going out in the forest and cutting down trees to measure them. The inventory is solid, and that's important because as Mr. Dean testified you've got to know what you started with. And here, we do.

And then alone among the parties Scopac sought the opinion of an expert in harvest projections. Again, nobody else did this. Not just any expert, but Dr. Reimer. No one challenges him as the world's most preeminent harvest scheduler. Dr. Reimer's harvest planning model, as you heard, has been used in Washington and Georgia and Oregon and Canada, New Zealand, and China in hundreds and hundreds and millions of acres. No one challenged his expertise. And more importantly, no one challenged his model.

In fact, Mr. Brilliant gave Dr. Reimer's model, the Options model, a backhanded compliment when he was comparing it to the relatively unsophisticated techniques, he said, that were used by Mr. Fleming. And so accurate comments and objections are also critical to a credible valuation because if you start, as Mr. Dean

does, with a very low number of million board feet, 55 million board feet a year, you're going to end up with a depressed value. That's simply the way it works. The debtors harvested even in the press of bankruptcy and the liquidity crisis and all, Scopac harvested 74.2 million board feet last year. And this year Scopac is going to be harvesting 80 million board feet. Again, that's compared with 55 million board feet. You can see where that goes with the valuation.

Back to Dr. Reimer. No other expert or any other party in this case went on to the land both physically himself and through his model which again unique among the models that were used here actually ties GIS information to a map of the lands. So you know exactly where spatially these biological, legal, environmental factors and limitations reside. Then Dr. Reimer applies the specific growth rates by each kind of site, depending on how productive that little micro climate, that little micro piece of land is, by the species mixed on that land, by the tree type, if it's 75 percent redwood, 25 percent Douglas Fir, or the obverse. And he differentiates between the actual stands and planted stands. He accounts for many, many different growth rates that pertain after -- that pertain to the land, including those that pertain after selection

harvesting where more trees are left versus clearcutting where fewer trees are left, but the payoff is the forest grows back faster. His projections take account of what trees are already planted and growing and when they will mature and be available for harvest.

Again, just like Dr. Iles, nobody challenged Dr. Reimer's expertise or his results. They may not like his results because they lead to the conclusion that the timberlands have very significant value, but I think we've heard from the noteholders' side of the room that everybody kind of acknowledges that over there on the secured creditor's side.

Now, the State of California, without any evidence to back it up, asserts that Dr. Reimer's projections are very aggressive. Nothing could be further from the truth, Your Honor. They are the essence of conservativism. Dr. Reimer dialed back what you could harvest in a number of ways, for example, the so-called Tier 2 areas, which could be harvested legally. Dr. Reimer said -- told the model don't go there for 25 years. So it's a conservativism as opposed to being aggressive. It maximizes net cash flow. That was what Dr. Reimer testified he was about. That does not mean harvesting every tree you can as soon as you can. He doesn't do that. He cut the harvest back and let more

trees come of age. Rather than bringing up the harvest rate immediately, he increases the rate at a slow and steady rate over the 50-year projection period. That, too, is conservative because it resolves the adjacency issues where you can't harvest right next to an area that you just harvested. It resolves owl issues, which go off -- go off the land in certain numbers of years. And it allows for the economic efficient realization of values rather than simply going out and cutting everything you can.

The only criticism anyone mustered about Dr. Reimer involved cultivars or clones, what MRC calls trimmings and somehow suggests that Scopac's building some kind of Frankenforest. That criticism is simply unfounded. In fact, it's just silly. The use of cultivars is mainstream. The three biggest redwood growers in the world, which are Scopac, MRC, and Green Diamond -- it's been going on for decades. Now, speculation about Dolly the sheep and about how cloned individuals may not live as long as natural individuals have no credibility. I don't know if that means the allegation is that instead of living for 2,000 years, maybe a cloned redwood would only live for 1,000 years. I'm not really sure because it doesn't matter because it would be harvested long before that.

Now, again, Your Honor, it's important to distinguish what Dr. Reimer did for the work of the other experts here. No one else is a harvest planting expert. Mr. LaMont, MRC's expert, Mr. Fleming, the noteholder's expert, they do timber appraisal. They do not do harvest projections.

And then we get to Mr. Yerges from KPMG, who used Dr. Iles' inventory work and Dr. Reimer's harvest projection. And Mr. Yerges, who we turned to in the discount rate and the pricing assumptions. And he's the only expert who did a third discount rate analysis. And you didn't hear any criticism today of Mr. Yerges's discount rate. And he analyzed long-term pricing trends to arrive at his conclusion. You did hear criticism of his pricing, but the answer is that his review and his price increase assumption was based on a review of a 30-year historical trend.

He did not ignore the fact in evidence. In fact he used it, whereas -- whereas other expert, MRC's expert, Mr. LaMont, selectively chose information from the last two or three years and used that to predict much less aggressive -- much less aggressive redwood growth, or much less -- he was less positive when he was pricing growth.

And then you also heard criticism of

Mr. Yerges that he was valuing the forest as it will be rather than the forest as it is today. Well, I would submit to Your Honor that in an industry where your collateral grows at a 50-year cycle, you better be looking at the forest as it will be in 50 years and discounting it back in value. It would be irresponsible to do it -- to do any other way. That's what the buyer is buying. It's buying it for the next 50 years.

So, Your Honor, even if you choose to discount Mr. Yerges's view of what the market is telling him in terms of discount rate, in terms of pricing, if you think his discount rate is a little bit too low, maybe his pricing assumptions are a little bit too aggressive, you knock down the value for those reasons, the point is there's no way that you get from Mr. Yerges's value of $950 million for the commercial timberlands down to the Mendocino valuation of 430 million. It just doesn't go down that far.

So, in sum, unless you choose to simply ignore it, which no one has suggested any basis for doing, Scopac's intended valuation of the timberland has to cause some hesitation and simply accepting that MRC is paying fair value here.

The existence of these different valuations and the existence now of several different

offers and proto offers, and I might make an offer for the timberlands for more than Mr. Dean and Mr. LaMont says they're worth, compels the conclusion at the very least, the assets should be exposed to an expedited auction process. Scopac understands the need for speed better than anybody, but an auction is critical to disposing these assets to the market.

Now, that brings me to the plans that are on the table. Is either one of them confirmable? We've been struggling with this all day, or you've been struggling with all day. Which one is more likely to maximize Scopac's value for all of Scopac's constituencies?

Your Honor, for months and months now in all of our spare time we've been trying to find the perfect country song for this case. And I think I finally found it. It's a Jimmy Dale Gilmore song called Go to Sleep Alone where he talks about the need to referee the fight between the being and the scenic. Actually, he says it in a Texas accent, but I'm not from around here, so I can't say it without sounding kind of bad.

So Your Honor, what are these plans? Well, now let's start with the MRC plan. What it does is it gives MRC the exclusive right to buy the timberlands

for $530 million. That's more than $400 million less than Scopac's independent experts have testified they're worth. Now, here's where we get into the Jimmy Dale Gilmore problem. On its face this plan looks great.

When you first look at it you say, look, it's a way to transition the business, do a locally popular operator for both the mill and the timberlands, they're going to have a great relationship with the state and federal regulators, just ask them, they will keep many of the existing jobs at the mill, they will make the environmentalists happy because they're not going to cut down very many trees and, you know what, $530 million is a lot of money. As a reward for engineering that great outcome and for fixing the very serious challenges on the Palco side that result from the Marathon dip, Marathon is a $75 million dip here and they can't be compelled to accept anything but cash for it, it's okay if we have to force the timberland creditors to accept a payout of 60 or 70 cents on the dollar.

But when you look at what's really going on here, what it really is is a very smart attempt to buy assets for $400 million less than the amount of debt that encumbers them and to do so on an exclusive basis rather than having to participate in an auction. And the way they get there is they say, okay, first we're going to

get the Court to value the assets at or below the amount that we're willing to pay for them. They're willing to pay 530, they say you should value it at 430. And then you buy the assets, but you don't let the creditor credit bid because you are going to transfer some other kind of transaction after the sale. But you argue you don't have to let the creditor credit bid under B -- 1129(b) -- I knew I was going to get the numbers wrong -- (a)(2). I was short the first 20 numbers.

But Your Honor, you don't have to let them credit bid because you're going to go under (a)(3) and you're going to pay the creditor the proceeds and thereby eliminate the interest in the property. And then you're going to pay the deficiency unsecured claim a few cents on the dollar. What this really does, because of the fact that the deficiency claim isn't being paid anything, it's really reviving the pine gate result of cashing out, stripping down the lien and cashing out the secured creditor that was available to the creditors and the debtors under the act and is not available under the code.

Now, it's very smart, it's very clever, it's a very financially sound thing to do. And MRC makes a lot of sense as the party to run these timberlands going forward. There's a reason that they've been

looking at Palco for about four years, as you heard in the testimony. The problem is it's the elephant in the room, as Mr. Greendyke said. Your Honor, you've been reminding me mostly in this case for 16 months now the rights of secured creditors are not so easily disposed of. And Mr. Brilliant told you there's been a market test and that Marathon/MRC is the best deal available now. You know, that may well be the case but this happens all the time.

If the noteholders don't think it's the best deal and if the noteholders don't want to sell now and they don't want to take that amount in exchange for their claims, that's their choice. And they have the choice to get the property or to credit bid their claims up to the entire amount of their claims and you can't make them accept the lower amount if they don't want to. The very point of the code statutory scheme of fair and equitable treatment of secured claims is that the creditors can't be forced to accept the cashout at a lowball value like they could under precode law.

THE COURT: You disagree with Judge Greendyke's case also then to give them 133 percent of the value?

MS. COLEMAN: Well, he didn't give them 133 percent of the value, Your Honor, he gave them

substitute collateral with a value of 133 percent of the collateral that he was allowing the debtor to retain free of the liens. And that's an important point.

THE COURT: So that's a value -- the value, assuming -- let's assume it were, they have an $800 million claim and he valued the claim at $500 million and said I'll allow you to substitute 133 percent of that, so that would be whatever, that would be $600,000 in marketable securities for the claim.

MS. COLEMAN: Right. The critical point is that you're not cashing them out and making them go away at that amount. You're letting them keep a lien for that amount.

THE COURT: They would no longer have a lien on the building. They had a lien on marketable securities or maybe they owned it. Maybe they paid it. I don't know.

MS. COLEMAN: Actually, I agree with you.

THE COURT: I don't know if it was a lien on market securities or the actual market securities.

MS. COLEMAN: The judge who confirmed the case, I couldn't tell but I believe it was a lien in that case. But that's exactly the point, Your Honor. 1129 is not a -- is not a redemption or a cashout or a payoff section. It's a section for dealing with a secured

claim. Not paying it off, but dealing with it going forward in the future.

THE COURT: So then you would also agree if they had just simply -- assuming that the value is okay, if they had just given them a note for that value rather than actually paying them the cash it would have been okay as long as they retained the lien.

MS. COLEMAN: As long as they retained the lien, that's what the code says, Your Honor, so I agree with Mr. Greendyke.

THE COURT: So that makes no sense then that if you can -- if you can give them a note for $530,000 with a secured buy to the forest why can't you just pay them? I mean, and the next day as long the note, the provisions of the note provide for no prepayment penalty and the next day pay it off. That's okay under the code? Assuming the values are okay?

MS. COLEMAN: Well, Your Honor, as long as when you pay it off, as long as they haven't made the 1129(b)(2) election and as long as they have retained their deficiency claim, if you paid it off the next day, if you had that kind of cash, technically yes it would be okay under the code. However, I'm not sure it would be fair and equitable because remember, all of these three things are just examples of what's available under the

fair and equitable standard.

And this is an incredibly difficult issue because of what you said a couple hours ago, Your Honor. You said how can cash not be the indubitable equivalent, how can you not just pay them off. And the answer is what Mr. Greendyke said. The answer is that when the noteholder -- when the creditor retains the -- retains a lien and a note or otherwise has the indubitable equivalent, it's usually the substitution of collateral, it has the possibility of upside. It has the possibility --

THE COURT: It still has the possibility of upside, all they have to do is go buy it with their cash. They don't even have to buy a note, they can buy the upside of the property, buy $500 million in the property that's going to appreciate.

MS. COLEMAN: You're right, Your Honor, you can come up with a hypothetical they can do that. But that's not what the code provides. And that's not a very satisfactory answer. But think of it this way, Your Honor. If you could do this, first of all, it would completely eviscerate (a)(1) and (a)(2). You wouldn't need (a)(1) and (a)(2), it would always deal with (a)(3).

THE COURT: Well, how many cases are there of cash to pay off the lien?

MS. COLEMAN: Well, the lien isn't always worth very much, Your Honor. I mean, what if you had a claim that was $800 million and some disastrous thing happened to the collateral and it was only worth $50 million. If you could do this and you could just pay it off at $50 million you could go get another lender and say, hey, come on over here, I've got collateral worth 800, I've got a claim of 800 and collateral of 50, you could refinance it, get cash from the new creditor, give it to the old creditor. And that's what's happening here, Your Honor. The reason this isn't fair and equitable is that the -- remember, they're selling this stuff. Everybody kind of agrees with that. Marathon says they're not.

THE COURT: Let's take the worst situation.

MS. COLEMAN: Okay.

THE COURT: A tract of the land with environmental problems on it. You've got a lien of $4 million, you've got a tract of land that the value of which, if it were cleaned up, would be $3 million. And there's a lien on it. What's the value of the property? Minus one million.

MS. COLEMAN: Uh-huh.

THE COURT: Can you just simply wipe off

the lien and go away?

MS. COLEMAN: Well, Your Honor, that's a good question. And under 1111(b), as you will recall, there is an exception for collateral that isn't worth anything so you might be able to in that situation where the collateral is actually worth nothing, 1111(b)(2) doesn't allow you to make the election with respect to that situation.

THE COURT: How is that any different from the situation where the collateral is worth a million dollars and you've got a $900,000 -- if the collateral, because of the -- instead of being worth nothing, minus a million dollars, what if the collateral is worth 100,000, you've got a $4 million lien on it.

MS. COLEMAN: And the collateral is worth 100,000 so it wouldn't be worth absolutely nothing. Well, what the --

THE COURT: You're saying 1111(b) has some provision in there for absolutely worthless collateral?

MS. COLEMAN: It's worthless collateral so let's take it out of that.

THE COURT: Take that out.

MS. COLEMAN: Well, Your Honor, again, it's up to the creditor. The creditor can't be forced. Now, a creditor might very well make an economic decision

and say, you know what, this collateral is so depressed it's never coming back. But there might be situations --

THE COURT: Well, what about one? I mean, if you're going to give them a note secured by the collateral in the amount of the claim -- not the claim but in the value, you give them $100,000 note, as long as they don't default on it, you're eventually going to pay it off and once you do, don't you get the property free and clear of the lien at that point?

MS. COLEMAN: Sure, once you pay it off. But the point is --

THE COURT: So in the circumstance where you've got a large lien and a little bitty value, a Court would not be inclined to approve a plan because it just might not be fair and equitable that they're going to easily pay off that lien.

MS. COLEMAN: I'm not sure why the Court wouldn't be inclined to find that it was fair and equitable but the point is that the secured creditor can't be forced to accept a cashout at that low value because it shifts the risk to the creditor that the judicial valuation might be wrong.

THE COURT: Okay.

MS. COLEMAN: And the concern is, Your Honor, that again --

THE COURT: I guess why I'm asking then is why is there less concern about the judicial valuation under 1 than there is under 3?

MS. COLEMAN: Because under 1, you have -- the secured creditor has the ability to make the 1111(b)(2) election.

THE COURT: You don't think that there's an 1111(b) election under 3?

MS. COLEMAN: I don't think that -- no, I don't, Your Honor, because the way it works is, number one -- well, if you've -- you can make the 1111(b) election and 3 is kind of a catchall, so if you've made the election -- I think if you made the election, you can be treated under 1, 2 or 3 just it doesn't matter under 2 because you can credit bid your entire claim, and the law is very clear on that. But one is for when the debtor wants to retain --

THE COURT: Well, there is a specific provision about 1111(b) with respect to 2, but there is no exclusion from 3. It so happens that Colliers puts 1111(b) comments under 1, but that's Colliers that's not the statute. And so under 3, why can't you make the 1111(b) election under 3?

MS. COLEMAN: I think you could. I think you always have the --

THE COURT: So you have the same protection. If they're not offering you enough money for your lien, you make your election.

MS. COLEMAN: Well, if they're not offering you the otherwise indubitable equivalent. The problem, Your Honor, is that nobody --

THE COURT: Well, if it's not the indubitable equivalent, they can't do it.

MS. COLEMAN: Right.

THE COURT: And if it is the indubitable equivalent, you still can make the election.

MS. COLEMAN: Well, it's a very interesting question that quite frankly I haven't thought about. But the 1111(b) election entitles you to stream payments, which is what 1 talks about. 3 doesn't talk about a stream of payments. But the 3 doesn't talk about cash either. And I think as somebody else said, if you could do this, somebody would show you a case where it's been done and I've been reading cases for a long time on this point and there aren't any. So it would indicate to me that if you could do this, you would do it all the time. And particularly, Your Honor, in this case, I think there are two particular reasons why this isn't fair and equitable. The first reason has to do with the valuation. What you would be doing here, if you accepted

this treatment is you would be requiring the noteholders to take cash at the lowest value of all the values that came in. There's the lowest value plus some because it's $430 million plus the cushion. But Scopac's evidence is credible. Nobody said it isn't. And it isn't fair and equitable to reply to the noteholders and say, okay, we've got this range of value.

THE COURT: That just goes back. We can argue what the appropriate value is. At some point --

MS. COLEMAN: And we have.

THE COURT: -- I have to make a decision based on the preponderance of the evidence what the value is.

MS. COLEMAN: That's certainly correct, Your Honor, but given that --

THE COURT: We have entire seminars on valuation in bankruptcy because it's so important. I mean --

MS. COLEMAN: And this case could be one.

THE COURT: Those whole seminars are prefaced on the prospect that judges have to make value decisions.

MS. COLEMAN: That's exactly right, Your Honor. But again, in this situation where the choices are required -- and the choices before you are requiring

the noteholders to take a value in cash and go away and not have their lien anymore and that value --

THE COURT: Of course, isn't the ultimate protection the fact that there was not exclusivity? I mean, every debtor -- every debtor knows that they don't get their plan confirmed that they're liable to get the company stolen from them because under -- exclusivity is lifted, boom, anybody can come in and file a plan that's standing or whatever and there are lots of things that might happen that would be bad to the debtor. But also, lots of things can happen to the creditors, too, depending on who proposes the plan.

MS. COLEMAN: Yes, Your Honor, but the noteholders did propose their own plan and they said their choice is to have an auction.

THE COURT: And their plan -- I mean, you know, no question, this plan poses this table and this plan, if you believe what the newest offer on the table for Palco, it poses this table, Marathon. So we have two plans that are equally poseable. And that's pretty much what -- I don't know why in three mediations -- I never would have thought that the parties who actually agreed to something in this case would have been the parties that actually agree. I assumed that because we had a debtor who was a sophisticated -- basically owned

by a very sophisticated financing guy and we had bonds that were extremely sophisticated, those two would make a deal and this table would be the one that would be fighting their deal. It didn't happen that way. Crazy things happen.

MS. COLEMAN: As Your Honor said at the last hearing, that's the great thing about bankruptcy, you never know who you're going to end up with.

THE COURT: Right.

MS. COLEMAN: I was trying to avoid that phrase but it's okay if you say it. Your Honor, let me just finish with two points. So again, the reason it's not fair and equitable in this particular case to require the noteholders to accept cash is because that cash is the proceeds of the sale of their collateral that they weren't allowed to credit bid at.

If you take Marathon at its word and you say, well, okay, it's a transfer, it's not really a sale but we're not going to let them credit bid, you don't have to let them credit bid because 1, 2 and 3 are disjunctive and not conjunctive, you don't have to allow a credit bid, it's just one way of doing it. But here it's the very proceeds of this -- of the transfer, which is the sale just at the price that Mendocino is willing to pay. There is no principal valuation for 530, it's

either 430 or 605 or 950. There's no principal valuation at 530. They are saying we're just willing to pay that.

THE COURT: They're not buying the assets for 530. They're investing 530 in that whole company there. I mean, and --

MS. COLEMAN: Yes.

THE COURT: -- they're putting that much money in and they have calculated the way you get to how much the assets get by virtue of some other -- some other calculations.

MS. COLEMAN: That's correct, Your Honor.

THE COURT: And again, Judge Greendyke allowed 133 percent, we don't know whether he would have allowed -- assuming that I think it's 500 and they were getting 525, that would be, what, that would be 105 percent. We don't know whether he would have allowed 105. He did allow 133 percent.

MS. COLEMAN: He did, but he didn't cut them off. He let them keep their lien on collateral with 133 percent. Here you would be cutting them off.

THE COURT: But he transferred the collateral to the securities. I mean --

MS. COLEMAN: Yes, Your Honor, but the point is that --

THE COURT: I mean, we can transfer the

collateral to the money but they wouldn't want that.

MS. COLEMAN: The possibility of future appreciation is what they bargained for. They bargained for a forest that grows until 2028 when the notes are due.

THE COURT: Okay. Well, didn't they just bargain for a lien in a piece of a building in Houston at that time, of course, when nobody wanted to rent a building in Houston but -- and they got marketable securities. Okay. Go ahead.

MS. COLEMAN: And that was an unusual case, Your Honor. Your Honor, Scopac's point in all this is that confirming the -- confirming the MRC --

THE COURT: That building in Houston was not an unusual case.

MS. COLEMAN: I remember, Your Honor. I remember. Your Honor, I'll just wrap up with the point that confirming the MRC/Marathon plan is not easy. It requires some factual findings that are really a stretch given the evidence that's before you, and I won't repeat what Mr. Pachulski said about the evidence in the Headwaters litigation.

But on the evidence on the timberlands value alone, it's a difficult factual finding to make that the very bottom of the -- the very bottom of the

valuation scheme is where you ought to end up.

Second, a legal conclusion that this doesn't effectuate a sale because of the testimony in the record. But the biggy is is what we have been talking about all day and that is a conclusion of law which I think would be the first case ever to hold this, that the indubitable equivalent and the general requirement fair and equitable can be satisfied as to a security by paying the secured creditor the proceeds of a transfer of the collateral in which the secured creditor was not allowed its right to credit bid. That is a difficult decision to make.

THE COURT: So you see it that way. You could also say that the security -- if you're allowed to prove a plan in which a secured creditor is paid the value of their -- of their collateral, paid in cash.

MS. COLEMAN: That's not what 1129 says.

THE COURT: In the process of an overall reorganization or whatever you want to call it, transfers into a new corporation, the secured creditors' lien is wiped out by paying it in cash.

MS. COLEMAN: Yes, Your Honor. And I think you are skating dangerously close to pine gate, with all due respect, in that regard. And remember, now we've only been talking about secured claims. There's an

unsecured claim issue here, too, and I don't have time to go into it. But Mr. Pachulski pointed out effectively that Marathon is certainly receiving equity in the reorganized entity on account of its prior claims against Palco. It's an undersecured creditor, it's acted as the residual equity of Palco.

It is coming in and it has the equity -- it clearly is acting as old equity and therefore, old equity, a class junior to the Scopac timber noteholders unsecured claims is getting something under the plan on account of its old equity claim. And you can't do that either because that's the other half of the pine gate protection is you have an unsecured claim. That unsecured claim is getting pennies on the dollar or the proceeds of a litigation trust.

We don't know how much that will be, but it probably won't be very much as against $200 or $300 million coming out of a deficiency claim and old equity is getting something and that violates the absolute priority rule as I think has been pointed out to you by Mr. Greendyke and Mr. Pachulski. So that's a problem with this plan as well.

Your Honor, I would just like to conclude by saying that we do have a comment on the noteholder plan which is that there we feel that Scopac believes

that the full and fair -- the full and fair aspect of the auction is limited by the certain knowledge in the market right now that the Indenture Trustee is going to credit bid up to the full amount of its claim unless it gets a vote of two-thirds that tells it not to. So we would suggest, Your Honor, there is a way out of conundrum.

We would suggest that the Court confirm the noteholder plan but condition the confirmation and put in the confirmation order that the bidding procedures do two things. One, they require that anybody bidding for the timberlands and the mill obviously doesn't have this problem but if somebody is going to come in and bid for the timberlands alone, they have to bid it with a log supply contract of 100 percent of the logs on a long-term basis.

And I don't know the number of -- the appropriate number of years but I'm sure the financial advisors will be able to tell us. So to cure the -- to cure the mill problem. And then the other thing we would request in the confirmation order for that plan would be to condition the credit bid such that you'd pick a release price. You would pick whether it's the amount of Beal bid or the amount of some other stalking horse bid that's ultimately accepted by the noteholders, note that amount and the noteholders would not be able to credit

bid and the Court can for cause condition or limit the ability to credit bid, that way it turns it into a real auction. As Mr. Cherner testified, nobody is going to come -- not even an insider, not even Beal is going to come in here and engage in an auction in which it knows it's going to be swamped by $900 million secured claim. And I forgot something, Your Honor.

The third thing that Scopac would ask for is a provision in that order providing that even if a credit bid does win the day, there has to be enough cash in that credit bid somehow provided to pay off all administrative and priority claims and the claims of Bank of America, which have to be paid in cash.

But we believe that there is a way out of here, Your Honor, because if you provide for the sale of all the assets, including the mill, in that -- in that bid package, and I think we have some indication somebody will be bidding on the mill, then you have solved the problem of the mill and the town which is an important problem notwithstanding the legal difficulties of dealing with it. Thank you, Your Honor.

THE COURT: All right. Oh, she was going to go next. All right.

MS. KELLER: Thank you very much, Your Honor. Again, Robin Keller from Lovells. Your Honor, I

appeared before you previously in the Asarco case on behalf of Murray Capital which was a bondholder in that case. And I'm appearing today on behalf of Babson Capital which recently acquired Murray Capital. In order to express my client's very grave concerns that their interest in this case will be significantly prejudiced by confirmation of the --

THE COURT: So did Murray originally have the --

MS. KELLER: The Scotia Pacific timberland bonds, yes. They purchased --

THE COURT: They also had bonds in the Asarco case?

MS. KELLER: That's correct, and still does, Your Honor. And although I'm a bit late to this party, Murray Capital has been closely following the proceedings.

THE COURT: Somebody has been on the phone every time.

MS. KELLER: On the phone, correct, Your Honor. And we have filed a joinder in support of the trustee plan and in opposition to the MRC plan.

Your Honor, funds managed by Babson Capital own $11 million of the outstanding timber notes. And as I say, have held those notes since before the

bankruptcy case commenced. Babson's claim alone, I believe, equals or exceeds the amount of all of their unsecured creditors of these two debtors. The proceeds of our notes funded the operations of the debtors and preservation of asset values for both estates.

The outcome of the disputes before this Court has a very direct economic impact on the rights and interests of Babson. From all we've heard today, Your Honor, it seems like really the very, very key issue here is valuation of the collateral for the timber notes. Babson believes that the Indenture Trustee plan, in contrast to the MRC plan, offers an opportunity for the full value of the Scopac collateral to be tested in the marketplace through a 363 sale and believes that is the best way to value these assets.

Already we have a stalking horse bid for the Scopac collateral of $603 million from Scotia Redwood and Beal Bank. There are also expressions of interest in further bidding from other financially viable entities besides Beal, such as Timber Star. All indications are we would have a real auction for the Scotia assets, starting at the $603 million level. It's possible even Marathon and MRC would come to the auction to protect their interests.

In contrast, the MRC/Marathon plan fixes

an artificial cap on the value on the noteholders' collateral by allocating $530 million to the noteholders in satisfaction of their liens. To force noteholder acceptance of that plan has a direct adverse impact on Babson and the other noteholders because we would receive at a minimum 11 percent less than the competing value that could be paid to us today if the Beal offer was accepted and confirmed. In absolute dollars, this 11 percent --

THE COURT: You say today. By today you mean in nine months?

MS. KELLER: In less than six months, Your Honor.

THE COURT: Okay.

MS. KELLER: Whatever time period a 363 sale should take, you know, too much longer. This 11 percent represents a $73 million hit to noteholder recoveries.

THE COURT: Okay. Well, is your client going to vote to not credit bid the -- against Beal Bank, assuming that's still a valid bid?

MS. KELLER: Your Honor, I don't know the answer to that. My client is looking for a process that will bring in the best value for these assets.

THE COURT: And what are your notes

selling for now?

MS. KELLER: Your Honor, I believe that the trading values in the marketplace are in the maybe 74 to 76 cent range. And one of the things I'd like to address is a question Your Honor asked as to whether the trading value of the notes should be used as a proxy of some kind for value of these assets. The answer is absolutely not.

Among other things, the trading value of the notes reflects the market's concern that the true value of the assets will never be determined because an auction sale may not be held. The Beal bid of $603 million values the notes at 84 cents on the dollar but the notes are trading closer to what the MRC bid would pay them. So I think it's clear that the trading values of the notes is not indicative of collateral value. In fact, it's the concern that there will not --

THE COURT: What were they trading before the plan was even filed?

MS. KELLER: I'm sorry, Your Honor?

THE COURT: What were they trading before the plan was even filed?

MS. KELLER: I'm afraid I don't have that information.

THE COURT: Has there been any significant

change in the value of the bonds over the last six months to a year?

MS. KELLER: Your Honor, I don't know the answer. Perhaps others in the courtroom do. Your Honor, Babson --

THE COURT: Does your client have a problem with the fact that Beal Bank is over bid by credit bidding that they get $27 million?

MS. KELLER: No, Your Honor, because my client believes that the auction sale process will generate the best value, whether it's a credit bid or a sale to third-parties, as opposed to the artificially low value based on hypothetical and probably flawed in many ways expert testimony on valuation.

THE COURT: Okay.

MS. KELLER: And we do understand the Court's concerns about getting a global resolution of these cases and providing for fair treatment of other creditors and constituencies besides the noteholders and we think that the amended proposals that were put before you today from Sierra Pacific, which I understand is the second largest U.S. lumber producer and a sawmill operator itself, and Lehman in connection with the Indenture Trustee plan would provide funding for the continuation of these cases pending sale and the basis

for a reorganization plan for Palco through a sale of those assets. This should address the Court's concerns and allow the Court to embrace the auction sale process without harming other constituencies.

The Sierra Pacific proposal makes plain there is no reason why the auction of the noteholder collateral assets to achieve the highest value for the Scopac creditors can't be combined with a continuation of the mill and timber business and the restoration of the town of Scotia and its sawmill interests.

THE COURT: Are the noteholders willing to subordinate the notes to the administrative claims in the event there's an auction?

MS. KELLER: Your Honor, I can't speak for other noteholders but my understanding is they recognize that administrative claims would have to be paid for a liquidating plan to be confirmed.

THE COURT: But if you credit bid, credit bid the asset there won't be any money, so how will the administrative claim --

MS. KELLER: I know that my client would prefer to see cash come in through a prompt 363 sale process rather than auction bid, take over the assets and see what happens down the road. But obviously we can't speak for others.

THE COURT: If the market turns, there may be no bids. Or they may be lower than the one that we have today, and that's another possibility.

MS. KELLER: Your Honor, there is that risk. But it seems that the only way to solve the problem of valuation of indubitable equivalents is through that.

THE COURT: If that happens and the fact that we don't have a bid today is some indication of the fact that that might well happen. If that did happen, then the real thing -- the real possibility, I would suggest, is a credit bid. And if we credit bid it, isn't that just the same as foreclose it, lifting the stay and letting you-all foreclose?

MS. KELLER: Your Honor, there is -- you know, yes, the credit bid has that possibility.

THE COURT: So we then have an administratively insolvent case with no assets. Okay.

MS. KELLER: Your Honor, I don't think we have to cross that bridge right now because just in the short time that --

THE COURT: We still have to cross that bridge if you don't get a cash offer that you-all like.

MS. KELLER: That's correct, Your Honor. But I think Your Honor may have --

THE COURT: And you have not given me a cash offer that you-all are willing to suggest and say that we'll take this offer if there's no better offer and not credit bid against it.

MS. KELLER: Well, I can only speak for Babson Capital, Your Honor. They would take an offer in the $600 million range for the collateral. And that's because they would realize substantially better value than what's on the table today. Your Honor may have been somewhat misled. There were some statements made by Marathon at the April 27th hearing that the collateral has already been fully shopped. As if this had been on the front pages of the Wall Street Journal that this company was for sale. And that is just not correct. It's really only very recently in this contested plan process that the possibility of the assets being sold free and clear to a third-party unattached from bankruptcy claims became possible. And we think that La Salle requires nothing less than testing the value of the assets.

THE COURT: Well, I thought we were going to hear a lot about La Salle today, but now we finally have said something about La Salle. La Salle is a new value case, isn't it? And part of what they were suggesting was there was a case where there was not --

exclusivity had not been lifted and the debtor was attempting to cram it all down and pay the value without testing the market.

MS. KELLER: Correct.

THE COURT: You can't find a new value in the code so the justices were concerned that under those circumstances, in order to give them a new value exception -- well, I think some of them didn't even think there was a value exception. Wasn't that what the consent was?

MS. KELLER: I believe so.

THE COURT: I mean, the majority said, well, there's a new value exception but you've got to shop it before you can do it.

MS. KELLER: Correct, all correct, Your Honor. What's interesting here and other people have commented on is that the Marathon plan is essentially parties standing in the shoes of the equity holders of Scotia. Putting forward a plan which just says I'm going to pay X, I'm going to take your assets even though you are far from being paid in full, Mr. Secured creditor.

THE COURT: Okay. But there is no absolute priority rule in the sense -- I mean, there's no requirement of some new value exception for a creditor to come in and propose a plan after exclusivity has been

lifted, is there?

MS. KELLER: Your Honor, no, I don't think there is. I think it's only for the equity holder.

THE COURT: Now, I think we have a problem with when -- especially before there has been exclusivity lifted, no telling what they would have said had exclusivity been lifted and there being competing plans and the Court confirmed the plan or perhaps nobody even bothered to put -- no telling what they would have said under those circumstances.

MS. KELLER: But what you really have here is like an equity holder plan because they are combining the Scopac assets with the Palco assets, which they control, and basically impairing the secured creditors and flowing value through to junior creditors and junior junior creditors in their own estate.

And so I think the spirit of La Salle dictates here that what really has to happen is the value needs to be tested in the marketplace. You've heard so many competing views of the valuations of the experts, they ranged from $400 million to 1 billion 4. I don't see how Your Honor can reconcile those without letting the market speak to what in a fair and open auction it thinks these assets are worth.

THE COURT: So when can a court value an

asset for cramming in?

MS. KELLER: Well, I think the Court always, you know, values assets for cram down. But the question is what is the best way to value the assets. And here you have --

THE COURT: So we're using paragraph one. I mean, are you suggesting that even in that situation in order for the Court to decide what the amount of the note will be that there has to be some sort of test first?

MS. KELLER: Well, Your Honor, I think you have to have something that shows you -- I think the way you get around the market test in that situation is that the creditors retain their liens on the assets. So there's a backup if the creditor defaults and the valuation is wrong.

THE COURT: Okay.

MS. KELLER: Your Honor, please keep in mind that even if we went to an auction sale and let's say the Beal bid were accepted today, noteholders would recover no more than approximately 84 percent of their prepetition claim, not -- you know, which is a far cry from payment in full of a claim, which if you factored in make hold provisions and yield protections could be 8 or $900 million are the numbers I've heard. So it's not at all overreaching for these impaired noteholders where

their collateral is being taken away from them to demand a process that lets them achieve the highest possible value. They are the parties with the largest economic stake in these cases. You know, Your Honor has heard that both in terms of number and dollar amounts. There's just no other constituency that even comes close. And so the concerns of that class in Scotia Pacific should be given great weight by Your Honor.

There are a number of legal infirmities with the plan that as other parties have pointed out, not least of which is the substantive consolidation aspects of the plan, which violates the rules regarding the recognition of separateness of entities and creditor expectations, and that would include creditors like Babson who bought notes of an SPV type entity on which they relied.

Your Honor, it almost seems like there's been a self-serving joining together of the former shareholders and managers of these debtors with MRC/Marathon embodied in the settlement before this Court because that settlement shields those shareholders and managers for liability to Palco and its creditors, pays them money, purchases assets from them, protects their lawyers' fees in exchange for their support of the MRC plan. There has also, I think, been an undue elevation

of the interests of unsecured creditors who at least in the Scotia state total no more than $500,000 vis-a-vis the interest of a billion, nearly a billion dollars of secured claims with hundreds of millions of dollars of deficiency claims when the creditors committee joined in the MRC plan instead of advocating the trustee's plan.

MR. FIERO: Your Honor, her five minutes turned into 20.

MS. KELLER: Sorry. I was answering the Judge's questions. But I am finishing up right now, Your Honor.

THE COURT: All right.

MS. KELLER: To sum up, Your Honor, we submit that any plan that doesn't provide at least $600 million hard value to noteholders cannot pass muster for cram down in this court. Noteholders will lose $73 million or more of value, which is being gifted over to Marathon. We think there is a solution at hand which is allowing the assets of both estates to be sold in a 363 sale process that will maximize values and solve the Court's and the other party's problems. Thank you for your indulgence.

THE COURT: All right.

MR. TENEBAUM: Your Honor, this is Alan Tenebaum.

THE COURT: Are you next?
MR. TENEBAUM: I'm not next. And I apologize, but I have a scheduling conflict. I only have two or three minutes. I was wondering --
THE COURT: Okay. I think you have ten minutes. I'll let you go next.
MR. TENEBAUM: Okay. Thank you, Your Honor. Speaking on the behalf of the federal wildlife agencies, we filed at the beginning of the confirmation proceeding a limited objection and comment to, I think, all the plans. And I'm happy to report that the -- with respect to the limited objection, the legal objections, that we had an exchange of e-mails with both of the remaining plan proponents, the Marathon plan and the noteholders' plan. And both have agreed to language very similar to what we have requested in our objection, so those -- assuming confirmation, that they're in the confirmation order which I have already seen one draft in one of them, that those would go by the wayside.
The other thing that we filed was a comment on the -- well, before I get to the comment let me say I'm assuming that the Scopac alternative plan is no longer alive. If it is alive, then our objections would apply to that and we would need to deal with them.
MS. COLEMAN: It's been withdrawn, Your

Honor.

THE COURT: It's been withdrawn.

MR. TENEBAUM: It's withdrawn? Okay. Thank you. The other comment we made in our original filing, we stated there that we had reviewed the plans and had determined based on the presentations to us that the Marathon plan was the one that was most consistent with the HCP. We stated that, not as an objection to any of the -- to the other plan, but rather, to the extent it was relevant to Your Honor's valuation of either feasibility or valuation.

We or other people in my office have listened throughout the confirmation hearings and we still believe that to be the case, that the Marathon/Mendocino plan is the one most consistent with the HCP. The noteholders' plan has significant uncertainties about it with respect to that issue; and the main reason being, it has a lack of a lot of details at this time.

Again, it's not a -- we will work with them if you confirm their plan. We don't know what the outcome will be because we don't know the details. Again, we make that point not in the form of a legal objection, but only as a comment on feasibility and to the extent that it's relevant to Your Honor's valuation

determination.

Now, my last point is that when Your Honor considers valuation in the case, we would request and suggest that the Court may want to consider closely and perhaps with some skepticism the correct linear valuation testimony to the extent that such testimony relied on either, a, in one case, I believe a ten-year horizon valuation done because we would wonder whether or not the ten-year valuation perhaps would -- it has some assumptions in it that would have basically enable the enduring of the adverse effects during those ten years or the years thereafter if you're only looking at a ten-year plan.

The second thing that we would ask Your Honor to look at closely in valuation testimony and to consider throughout this skepticism and correctness thereof is the assumption of any witnesses who testified based on the valuation of the so-called MMCA lands. Those are the ones where it has the restrictions on them for 50 years. And some of the witnesses, or at least one of the witnesses assumed that development would be possible after 50 years. I would ask that the Court consider that closely to see whether that is a correct assumption, given the extraordinarily heavy regulation that is now in effect. I would question whether or not

it could be assumed in the valuation that there would be no regulations after 50 years. That's all I have and I thank you for letting me go out of order. May I be excused?

THE COURT: You may.

MR. TENEBAUM: Thank you.

THE COURT: All right. Now we have Palco. I think there are at least one and perhaps two people that may have beeped you with respect to talking fast, so your record may be sketchy. I'm not certain, but you may be losing your fast talking.

MR. FIERO: But they were from out of state, Your Honor.

THE COURT: That's true.

MR. JORDAN: Your Honor, this probably is not a case for fast talking because I think you heard a lot of that today quite frankly. Let me just say a few things. First of all, if there is any country music or song, it is who do you believe, me or your lying eyes because when you were told, in fact we put on the screen an index to Colliers. Even if you look at the text of Colliers, they do quote the statute. When you were told that 1111(b) didn't apply, when you were told that there was a right to credit bid, if you simply look at the two statutes that are referenced, the answer is simple. And

it isn't your lying eyes. Your intuition and your academic direction a minute ago is exactly on. 1111(b) is the strategic decision made by the noteholders in order to keep this case in the position that it's in. That is, to attempt to -- if you notice, they have hardly talked about their plan at all and I'm going to spend some time talking about how bad it is, but they have hardly mentioned their plan at all. What they want to have happen is to not have the Palco plan confirmed. And they have created a bunch of smoking mirrors that simply are not reflected in the terms of the statute. Let me just read the first part to you; and that is, instead of putting up an index, here's what it says.

In fact, it's -- for the purpose of this subsection, we're talking 1129(2). And I'll be reading to you A, which has the three subsections. "The purpose of this subsection are conditions that a plan be fair and equitable with respect to a class includes the following requirements."

Now, that means if we at least meet these requirements, because there could be others, it's going to be found fair and equitable. "With respect to a class of secured claims, the claim provides that the holders of such claims retain the lien securing their claims, whether the property subject to the lien is retained by

the debtor or transferred to another entity to the extent of the allowed amount of the secured claim." Now, if you go to the original plan that was filed by Mendocino/Marathon, it had that exact provision because they were retaining their liens, they were pick notes, they were being criticized for that.

They made a decision to make a single modification which now if you talk form over substance, which now the noteholders suggests takes them completely out of the purview of that section because if you read their plan, and this is why I say that it is -- this has been driven by the tactical decision to 1111(b) because, first of all, the plan says under 4.6.2.1 to the extent that class 6, the noteholders, does not make the election pursuant to an 1111(b) 1 A Roman 1. And if you go to 1111(b) -- again, trust your eyes, Judge. It says not whether they are a nonrecourse, it talks about recourse.

And that section says that they may make an 1111(b) election with two exceptions, and it's Roman F(i), "such holder does not have such recourse," which in this case they have recourse, "and such property if sold under section 363 of the title or is to be sold under the plan." And then the second little Roman F(ii), "the holder of such class has recourse against the debtor on account of such claim and such property is sold under

section 363 of this title or is to be sold under a plan." Flip back to the section that they didn't put on the screen. And it says that as a result of it being transferred, which is exactly what the statute says, would allow you to recognize what quite frankly you have done a number of times in the past.

You have crammed down creditors, secured creditors in plan arrangements under this provision as all of us lawyers have done. And we always face the issue of how are we going to deal with the 1111(b) election if they make it. Then they always get the upside. 1111(b) applies unless it says it doesn't. And what's important is credit bid is not a right. If you look at 363(k), it says they have a right to credit bid unless you limit it.

There is discretion with you deciding one way or another. There's no discretion with 1111(b). They elect it, they get it. There's nothing the Court or creditors can do about it. And then what it does is it does all the things that were alluded to that we were not allowing them to do, and that was it protects the upside in case there's appreciation, it protects the upside in case there's a subsequent sale. They get the full dollar amount of their claim.

Of course what it doesn't do is give them

more than the full dollar amount of the claim. This entire argument, again, I'm going to kind of move from this as quickly as I can, Your Honor, because I will urge the Court that you just simply have got to look at the statute. It's there. You've done it before. You've never done it to someone's suggestion. I don't want to protect my upside under 1111(b), I want to exercise under Roman F(ii) as if there's a 363 sale. I would refer one more time back to the plan because that's what you need -- that's what you need to do. You need to read what has been summarized incorrectly.

The plan says, and there's some suggestion that this plan was -- it certainly is not a 363 sale, we know that. The plan says the debtors -- "on the effective date the debtors shall be reorganized into two newly formed reorganized entities." That's where my client's is going. My debtor -- my client is being reorganized. It is being reorganized. In fact, it is being reorganized to such an extent that after confirmation my client will be dissolved.

After the transfer is made, under the provisions of the plan, my client will be dissolved. The only occasion in which there was any room for you to read the statute and say what you did earlier, could it possibly be -- you asked everyone at the podium, could it

possibly be that they could do this by giving you a note? But if they say no, you get your lien, you preserve your lien, a transfer occurs, and then on the effective date because you had a lien that has been now allowed, which by the way, a lien under Roman (i) is to allow the amount of the claim. That if they decide to pay you in cash, all of a sudden it all goes away, and it goes where?

Does it go to 363 under Roman F(ii)? It can't go there because it's not a 363 sale. Well, does it drop down to a indubitable equivalent? Well, yeah. Indubitable equivalent applies to 1 and 3, and the reason you know it does because you read the statute. And it says the only time it doesn't apply is under 363 sale or a sale under a plan.

So simply looking at the documents, Your Honor, dismantles every one of these arguments. But in some fashion, this plan is not confirmable because they have this right to credit bid. First of all, there isn't a right to credit bid. It is a discretionary decision which the courts typically allow. But in many cases, and we have cited them in the brief, it isn't something that's allowed. There's all sorts of criteria, including some plans and other reasons why you wouldn't do that. So I urge the Court simply to keep it simple, read those two statutes and follow your intuition.

THE COURT: The one I hadn't thought about it. But I've had plans in which there was an attempt to cram down a lien to a value that was attempted to be argued with the value; and yet, for instance, in one case I can recall the -- a public company was willing to lend the debtor 100 percent of the value with a no interest note for 20 years.

Now, under the circumstance of that case, it's easy to suggest that the value wasn't what they said it was because no public corporation could possibly lend that much money on those terms if they really thought that was the value. And there was a suggestion that somehow the way you've done this plan, that you, in essence, have taken money and taken it away from Scopac and given it to Palco.

MR. JORDAN: Let me address that because that is absolutely incorrect. First let me address what you just talked about, that you were cited to the D&F Constructors, S&L versus D&F Constructors. And I'll give you the cite because Counsel didn't give it to you. It's 865 Fed 2nd 673. 865 Fed 2nd 673. And it was cited several times for the proposition that the fair and equitable standard would not be met by our plan. It's a Fifth Circuit case, but here are the facts.

The facts are that they proposed a plan

that gave the notes to a secured creditor which eliminated all foreclosure rights, 12 years of negative amortization, no principal repayment for 15 years. And it was this treatment that had shifted the risk of loss to the noteholder and made the plan not fair and equitable. It has nothing do with the facts and circumstances of our case. So let me address what you just asked.

This idea, this argument that the plan takes Scopac's assets and gives them to the Palco creditors is false. That is not the way the plan works. Here is exactly what the plan does. And I want to address it in two parts. One, I do want to talk about this idea of the value of the Headwaters litigation because the Headwaters litigation is just a sub-example of what the noteholders have done to this Court in this entire case.

They came in here in September when they wanted exclusivity listed and they had an expert tell you the value was $440,000. That's what they told you. Nothing has changed since then. Nothing has changed. They market have gotten worse. They came back in, the same company hired, I will call him the seven-day wonder because he came in and in seven days he found $150 million worth of trees that they must have missed. Now,

that's the first thing they did to the Court, is that to suggest to you I want exclusivity lifted -- which, by the way, Judge, you lifted exclusivity to anybody who has asked. There's no one who has asked for exclusivity listed when you said no. So anybody in this case that wanted to do anything the market should test or otherwise, exclusivity --

THE COURT: Well, I think that it was different lawyers, but they asked in a sense for exclusivity to be lifted by this being a single asset real estate. I did not say yes to that.

MR. JORDAN: Okay. That's correct. I stand corrected back in the original part of the case. When exclusivity was the issue to be lifted, in fact, when we agreed to it, you haven't denied anyone that right.

In connection with the Headwaters, this is the same thing with Headwaters. It's not them showing up in September and then coming back six months later with the market worse with all of a sudden finding $150 million worth of timber some place in the forest, which we we don't know where they found them because they didn't find them the first time. They came in at the first series of hearings on the Headwater with a bid. And they say to you, Judge, believe this bid because it's

going to dismiss the Headwaters for nothing. Believe that this bid is a real true value. And the way we get to this value is we dismiss the Headwaters for nothing.

Now, that was their first prompt. We then come back to find -- because whatever their concerns were, that they have now decided, well, no, let's not tell the Judge that it's not worth anything to support the Beal bid, let's tell the Judge that it must be put into a trust. So that's what they did the second time. Again, neither time did they attempt to establish value. But the second time what they did is, I think, even more significant because I believe what they're attempting to do is misdirect what has actually happened in this case.

$530 million are being paid for their collateral package for everything, whatever that is. And that would include all the litigation. All the litigation would include the Headwaters litigation. Everything that the Scopac secured claim has is being purchased for 530. The evidence -- and Marathon is holding firm on this at 430 million for the actual timber and another 100 million to cover any other aspect, including what they call a cushion, just because this Court has to make a decision. You instructed the evidence is closed now. You've got to make a call on that. You have to. So what do you look to? Look to

Headwaters. And what you heard from the witness stand, and you heard this completely consistent. The first one to say it was their stalking horse. Their stalking horse said this piece of litigation is a negative to a going concern value in the future, which by the way, is the reorganized debtors. It is a negative. That's its value. Because if we keep it going, it's a negative to all kinds of issues that we have as a going concern.

That was just their opinion, but it's testimony and it's evidence. The second person gets on. Mr. Dean said what -- you have reminded me what he said earlier. He said the litigation is worthless. And he said it is a negative to a going concern. I don't want to be litigating some old lawsuit that I don't know a lot about against regulators going forward. So you have at least those two elements. It is a negative value. That is, the value of that litigation going forward is a negative.

The second issue you've got is that -- and let me suggest this also, Your Honor, besides the statement that Mr. Dean made about it being meritless. There was an opportunity on each one of those witnesses that each time they said anything about the value for the noteholders to cross on that and say, how do you know that it's not worth anything? How do you know that when

you say it's a negative to the future operations of a going enterprise, that that's the case? That wasn't done.

Quite frankly, I don't think the noteholders at that point knew which side they wanted, which case they wanted to take, which position they wanted to argue. And it isn't one that you can take either side. So to suggest to the Court you don't have a record, you do have a record. Now, it might be slim, but you have something else. And the trier of the fact in this case is an experienced, probably among all of us, you've seen more business transactions than we have because you get to come in and listen to them quickly and get rid of them. We have to actually live with these clients and try to collect our fees. You know what business lawsuits are about. You know how they're handled. You have in this record the complaint, the answer and the motion that grants to dismiss the two subject amendments and leaves three in place, which is a practice in California that we don't do here.

You have the -- you can look at that pleading, and it's a well pled. It's huge, it's thick. Look at the answer, listen to the comments of everyone. You have the ability to say, all right, here's my record, I'm going to look at it, I can make my decision as the

trier of fact. In fact, in federal court, federal judges don't even let lawyers, for instance, testify as to attorneys' fees because the judge is the lawyer and in federal court, the judge makes the call. I know whether your fees are right or not, I don't need to have you tell me. It's the same thing. You have a record, so this suggestion that you don't have a record is simply wrong. You do have a record. So let me address this absolute priority rule and substantive consolidation issues somewhat together.

THE COURT: Now, I understand the absolute priority and consolidation argument from both sides. I want you to address that. I probably didn't tell you what I wanted you to address. The argument that $8 million somehow goes to Palco has come from somewhere other than Palco's assets.

MR. JORDAN: Well, to me it's obvious in the record. Any money over $530,000 comes from the input of cash and -- the cash equivalents into the Newcos. They have more money. If you find 530 is the value of Scopac assets, the package, then that is all that Scopac is contributing to anything. And the point I want to make about absolute priority and substantive consolidation is that after we pay full value for every asset, we then fund as a gift back to Scopac the $500,000

in the trust, with leaving the litigation in the trust. And we paid -- our plan says that we will buy for 530. You have to either tell us we're right or wrong. And that's the issue that the valuation goes to.

But, Judge, that then cures any question of substantive consolidation. We have always -- we always keep the classes separate. We always have the issues of whose class is separate as to the assets and requiring all the assets there couldn't be an asset priority. And quite frankly, there couldn't be a substantive consolidation problem because we are acquiring all the assets and then putting some as a gift back into the trust so that there will be a way that that trust can operate and function. They don't like that it's a single trust, but it's a gift. It doesn't come from their assets because you are going to tell us whether 530 is sufficient to buy the package.

THE COURT: So now the 530 includes the forest, the Headwaters lawsuit and any other Chapter 5 lawsuits or anything else there might be in Scopac?

MR. JORDAN: Any of what their collateral package is. If their Chapter 5's are complaints like that, those are not, for instance, released. But whatever their collateral package is. By the way, they claim they're entitled to all the litigation and they're

entitled to all the general intangibles. We're buying that, and buying that in the context of you have to tell us how much the allowed secured claim is under Roman I. We are going to transfer the assets and pay that lien on those claims off at confirmation subject to, of course, irrelevant right to have made an 1111(b) election, if they thought that was the appropriate thing to do. And then we have a provision that took care of that in the same context it would have to under 1111(b), and that was to pay it over a time in the future. So both of those, Your Honor, issues are non-issues if you --

THE COURT: And remind me what the terms of the 1111(b) were. 580 million over how many years? 30 years?

MR. JORDAN: Yes, it's something like that. But keep in mind what it had to be.

THE COURT: 2 percent interest?

MR. JORDAN: It has to take 530 million and pay them that -- that net present value over the life of the $800 million claim they have in some fashion. Whatever we were to pay them --

THE COURT: You have to pay them a total of the 580 million with the present value of which is --

MR. JORDAN: No. We have to pay them a total of their full claim, 800 million or whatever it

might be, 825 million or whatever.

THE COURT: Is that what it is now?

MR. JORDAN: Don't hold me to that, but let me just use that as an example. If it's $800 million of their total claim, we had to then provide -- which, by the way, would be exactly what Roman F(i) says over time. We would have to pay them in a cash flow the net present value of 530. Cash flow would be equivalent to 800 million. And the reason that is important is not because they'll get more money. They don't get anymore benefits, but they get the upside. We can't sell for whatever, 30 years or whatever it is. Because if we sell, they get the full balance of their claim. And that's the beauty of 1111(b). That's why it fits.

THE COURT: They get to retain their lien?

MR. JORDAN: And they retain their lien, of course, yes. They're never sold -- under 1111(b), they are never sold free of the lien. The only time they're sold free of the lien -- which, by the way, a completely meaningless modification would be if Marathon or Mendocino stood up, and since I'm not a plan proponent, I asked to be, but I'm not, they could say, Judge, here is what we're going to do, we want to have an effective date but we want to go ahead and extend their payment out a month and we're going to pay them one

month's full of interest and then we're going to pay them because we want an installment because they seem to think that installment means something important to the statute.

Now, that to me is a silly way to accomplish the problem, but it would because it would then be the installment payments over time of the allowed, as it provides, of the allowed amount of such claim. But instead, they amended their plan to say it will be one installment of the allowed amount of your lien on the effective date. And that can't be a distinction with a difference. That is form over substance. If there's anything that's involved, that's form over substance because I think with that amendment, they decided that 1111(b) would be -- they shouldn't make the election because this would give them a chance under this argument because 1111(b) doesn't do anything to them, doesn't give anymore money, it just protects the upside. Well, what was more important to the noteholders? Was it to really protect the upside? And get the fair value of their claim? Or is it another play that it's just simply not come out in their conversations?

If I can, Your Honor, because I'm going to be out of time in just a minute. But let me address this

issue of value. And when I hear this argument that somehow a market test hasn't occurred, I have never been involved in a case that -- now, that doesn't really mean a whole lot -- that has had the kind of publicity from the governor, from senators, from the New York hedge funds all over the country. Just Google -- I think you can take judicial notice, just Google 2008 and Pacific Lumber Company and you will get thousands of hits of the kind of publicity that this case has brought on from every avenue of people.

So look what you did. First of all, what did the noteholders do for you to tell you what real value should be to justify them having this insider sale? Which by the way, that's what it is. I know Scopac is trying to talk you into starting all over. Judge, I've got $20 million now, so I can get from here to there, so let's start over. But let's not start over their 363 sale because it's all the insider stuff. It's by Houlihan, who already told you what the values are. And it's all by directors of noteholders. And it's all taken under their terms. And so that process -- clearly not even Scopac can live with that process. And I don't think we can live to start over.

So what has the noteholders done? They have given you Di Mauro who said 442. They gave you

Mr. Daniels who I call him the seven-day wonder. Then they brought a value. Now, he contradicts his own partner, his own company, and is forced into the job by the head guy. Then they bring to you, by the way, with the suggestion that the Headwaters is at zero value, the Beal bid.

The Beal bid has all sorts of contingencies, most of which they won't take out. And then they tell you you should compare the Beal bid to a cash up front $530 million offer. First of all, they're only $70 million apart. So how do you compare cash now and a contingency list that Beal has, including they still say, Judge, dismiss Headwaters for nothing.

So what are the noteholders going to do? Are they going to come to you and say, no, we're going to take that Beal bid back because the Headwaters is worth a lot of money, and our plan says it's in the trust. And that bid says it's going to be dismissed for nothing and we can't keep it in the trust if it's going to be dismissed. So I guess we have to amend our plan or we have to tell you the Beal Bank bid is not a bid. But they don't do either one of those. They just sort of dance around that conflict and leave it alone.

So what have they not brought? Now, keeping in mind, who would be better at generating an

interest to sell these timber notes than the noteholders? And don't think for a second that when they stood here and told you that we really think it's worth a whole lot more and that's why we want an auction; no, that's why they want a credit bid. It's a big play. And their belief is it's worth a lot.

So what have they not brought to you? They didn't bring in Harvard. Harvard came in and they were here and then they heard the 530 and they said, see you. And you can take notice they never came back. They're not coming back. You look at the Nature Conservancy. They always showed up like they were going to do something. They never did a thing. And Mr. Wolf on the phone, I'm not sure where he came from. But he comes in and furnishes you a pleading filed by his noteholders suggesting that if I get financing and board approval and all this stuff, I might do as much as 600. But we're still back in the same range of 530 versus a purely contingent -- there is no comparison of those two when it comes to a Court trying to put a particular value.

So I suggest this. There's only two possibilities. Either the noteholders are holding back what the real value is or they have done the best they can. And that's the important issue, Judge. These -- we

know these lawyers. I know these lawyers. I know you do. They're not holing evidence back or have people in the sidelines that are going to make a huge bid and they can reap all the profit. This is the best they can do.

You have gotten over the -- since October through May, you have gotten the best the market can do. And the market has said, because they filed it, we want an auction. Well, then get us a stalking horse. And you've been through this in a number of cases, including bigger cases for more money. Get us a good stalking horse in here, no contingencies, break-up fees, financing in place, financial statements ready to go. Beal wouldn't even appear for a deposition to say it's a real deal. He wouldn't tell you his financing is in place. Yet they tout it as a real deal.

You have gotten the best that the market is going to do. You have heard -- and so let me mention La Salle very quickly because, first of all, there are three things that you have listened to, all three the Supreme Court says you should. It does rate them in this one capacity. I have read to you before in this case the protected committee case in which it says expert testimony is important. It says, "expert testimony is -- the district court did not have before it all the evidence and testimony relating to the future problems

and prospects of the company which were necessary to assess its value as a going concerning." So those kind of things, oh, it's an expert, you have to. I mean, if the company is going to be a going concern, you have to have expert testimony because there is no market for what's going to happen next year or the year after.

But La Salle, in the context of buying equity, it has the quote that everyone talks about. And that is, and here's the quote, because by the way, La Salle didn't decide the question, it just posed the question and it gave you two choices. "Whether a market test would require an opportunity to offer competing plans or would be satisfied by a right to bid for the same interest sought by old equity is a question we don't answer today." They did say, though, one of the two worked.

And so in this case, just look at what you have had. You have had the ultimate market test. You have had two three two, three, five competing plans. You have experts, five sets of experts, professional financial experts, Houlihan, Blackstone. You've had a huge list of players in this market that know how to find and put together deals. And guess what happened? In seven months, which is how long it's been since you lifted exclusivity, deals have been put together. Only

one cash deal. The noteholders have never come to you with something that is a real bid for cash, no contingencies, except of course, the normal contingencies that would happen for like overbids. That has never happened.

How could you have better market tested that process -- and by the way, in the interim of all that, after you lift exclusivity and send all of us off to fight, you put us in rooms together for eight total days and say, you guys got to get this figured out. You better get it figured out because I have to make the decision and I'm going to make the decision based on what you bring me as to real evidence. You could not have market tested this company any better than to have done what you have done in this case because it has been a knock-down dragout for who gets your attention on value.

It's been driven from value from the very beginning. Who is it that's going to convince you what value is? And it's not going to be, well, now we're going to start a new market test with Houlihan who has been in the case for several years and who is going to be in charge of the market. Well, if they were, why didn't they come in the last six months instead of giving you six more with a real bid? Because the values are being tested like they're supposed to be. And everyone had

that opportunity. You have not cut anyone out of an opportunity to deal with the issues. I'll only say this about Scopac's posturing at this point. And I mean posturing in the context that it's -- that it is, to me, an acknowledgment that you can't -- you can't do what the bondholders or noteholders are asking you to do.

Their system is simply fraught with all kinds of problems. And I've got this long list which you've heard almost all of them. And I think the Court is aware of most of them of what their plan does. It doesn't do anything for anybody but them. That's just all there is to it. In fact, Mr. Pachulski was really blunt with you, is we really don't care what happens to Humboldt County and Palco, and Judge, you shouldn't. That's what he told you. And I'm not certain that in a certain context that's true. You really do have to keep these --

THE COURT: I have to make a legal decision. Within the context of the appropriate law, I can certainly take into consideration Humboldt County, but I cannot bend the the law because I think it might work better for Humboldt County.

MR. JORDAN: And that's what I wanted to close with. What was being suggested in some fashion was that your expression of concern, which we all asked you

to do, your expression of values between 5 and 6, you never said it would be 490 or it wouldn't be 615. You -- what you have done is certainly nothing that this -- that would suggest that you were then going to bend the rules or the law to confirm a plan that shouldn't be confirmed. Of course you're not.

And from the perspective, Judge, it is so clear that the noteholders don't care about the confirmation of the plan. They really don't. I mean, look what they have given you. To conclude the last few things, they have brought some tag-alongs for their plan that nobody would like. I mean, it's them selling for six months and then getting to credit bid. Well, nobody is going to like that, so they decide we better dress it up a little bit and have two tag-alongs.

The first tag-along was Mr. Emerson. He comes in and says, well, I'm going to buy the mill. And you hear the problems with that. He's going to buy the mill if they give him a contract that would so chill the bidding that he gets -- he gets the mill and they get to credit bid. But who's going to come in and say, you know, I want to buy the timber, but I guess I have to wait 15 years before I decide where my trees go.

So first of all, Emerson is a bring-the-value-down tag-along. And the second tag-along

was the first one they brought in, Beal Bank. If you compare what Beal Bank really is and what they were willing to do in this court, aside from sending a fellow who was an honest guy and who seemed to want to make decisions but knew he couldn't, when it was time for Beal Bank to go under oath and explain is this really a real deal, I mean, are you really going to do this deal or is this a deal set up so that we'll never tell the Judge if we're to credit bid or not. We'll always keep that open, nobody can tell you. And then when we do credit bid, there's going to be a $27 million claim against the estate and we'll let the estate figure out how to pay for it because I got a $27 million claim. That, Your Honor, is a diminution of any idea of value.

So go back to what the noteholders told you. If you stick with what they told you the first time, I think you're okay. Because it's 442 the first time and then how they found the extra lumber, you shouldn't consider that. And stick with what they told you the first time with Headwaters. Hey, give it away, I mean, it's not good for going businesses and we've got a $650 million offer, so we need to give it away.

If you stick with that as far as the positioning of the noteholders and then turn over and look at what this process does, we don't take money from

the noteholders. You gave them every chance to prove value. And they have put their case on. They did a good job. And you're going to decide. And if you end up in our range, we are buying everything and giving some back. That doesn't violate any of the rules that the bankruptcy code is intended. And quite frankly, it does accomplish a reorganization and the policies of bankruptcies as opposed to what everyone knows the noteholders plan is a liquidation. And I call it a glorified foreclosure because that's all it provides for, is the ability to liquidate. Thank you.

THE COURT: All right. We're now at the Committee.

MR. FIERO: Yes, Your Honor. John Fiero for the Committee. Give me just a second. Mr. Pachulski was so provocative that I've got my second here, Mr. Litvak. I'm also going to give five minutes of my time to Mr. Litvak to discuss the issues relating to the compromise this morning.

THE COURT: Okay.

MR. FIERO: John Fiero for the Committee, Your Honor. I'm going to discuss four things, if I can, in this brief amount of time. And I'm going to start with the notion that was suggested by Mr. Pachulski, who may or may not have read all the transcripts, but who

suggested that there was an $18 million value transfer going on here from Scopac to Palco. Well, we Californians are very concerned that New Yorkers be able to sleep at night. I was very concerned that half of the bond world may be worrying about what's happening here in this courtroom.

And the truth is there is evidence, Your Honor, to explain why it is that there is value that can go to Palco. And here it is on the screen from Mr. Dean's proffer, Your Honor. And it says, "finally, Newco will benefit under the MRC/Marathon plan from its relationship to MRC. MRC estimates that Newco will be the beneficiary of synergies that total approximately $10 million annually as a result of MRC sharing personnel and distribution infrastructure capabilities and relationships. Further, Newco will benefit from MRC's favorable relationships with the regulators and public, relationships that otherwise would take many years to establish and/or turn around, and from MRC's management experience in operating California timberlands, sawmill and lumber distribution activities."

So you can see right there, Your Honor, that there is evidence in the record which explains why a strategic buyer, a strategic plan sponsor like MRC, can come in here and offer money to Palco. It has nothing to

do with the value of Scopac, absolutely nothing.

Next, Your Honor, I would like to talk about the question of the absolute priority rule. And I will confess that when I began as a bankruptcy associate in 1988 at Stevenson & White in San Francisco, volume 14 or addition 14 of Colliers was already on the shelf and it had superseded stickers on it. I have only practiced under the code, never under the act. But I did do some digging after Mr. Pachulski spoke, and I do want to advise you that the section of the code cited -- or the section of the act cited in the noteholders' brief, which is Section 221, says in part -- and this is basically the analog of 1129.

"The judge shall confirm a plan if satisfied that, A, the provision of this Article 7 Section 199 and Article 10 of this chapter have been complied with." And then the next one is number two, "The plan is fair and equitable and feasible." And then it goes on to say that the plan was proposed in good faith and accepted in good faith and all of these other sort of things.

Your Honor, unlike under the code, under the act, fair and equitable was not a defined term. And it makes a big difference. It makes a big difference because here, once you look at the code and find that one

of those three, i, ii or iii are satisfied, you don't have to engage in a second inquiry -- and that's what Mr. Pachulski says you do have to do -- to determine whether in addition to having satisfied the code's requirement of fair and equitable, you then have to go and also satisfy the absolute priority rule which, of course, is not written down anywhere in the code except in (b)(2)(b) with regard to unsecured claims. And in (b)(2)(b), it makes very clear that equity can't take anything if unsecured claimants aren't paid in full.

So I think when you take these ideas and tie them together, what you end up with is the notion that, no, you don't get to slap the absolute priority rule back on top of 1129(b)(2)(a). And I think probably the easiest way to demonstrate that that's the case is just to take a look at the noteholders' brief. And Mr. Penn can bring it up here on the screen and I'll try to do some pointing.

Your Honor, you can see that this quote from Collier, this is the 14th Edition. This is the act obviously. And the first case cited, 1938. And the discussion says, "Arguments in favor of approving a plan of reorganization do not justify requiring the present bondholders to lose their lien to an extent of 50 percent and to give up equity in the property, secured by their

lien." No one is asking the noteholders to give up equity in the property. I agree that if they were being asked to give up equity in the property, there would be a violation of the absolute priority role. There would be a problem with 1129. You couldn't find that there was an indubitable equivalence here.

So that is not the case. So this case surely doesn't apply, even though, you know, the noteholders seem to think it was important. The next case which Mr. Pachulski discussed in detail, but honestly I'm not familiar with is this Mokava case from 1945 which says "the lower court erred in approving that part of the plan which provided for full payment of cash of the unsecured merchandise brokerage claim. Such a provision in a plan which did not provide full compensation in some form for the second mortgage bonds is clearly wrong."

Well, Your Honor, under the code, full compensation in some form means your claim gets bifurcated and your secured claim has to be dealt with under (b)(2)(a) and your unsecured claim must be dealt with under (b)(2)(b). This plan proposed by the proponents worked on for months in this very difficult environment satisfies that notion. The noteholders will receive full compensation in some form. Let's go down a

little further.

Now, here's where Mr. Pachulski was talking about the fact that, well, if fair and equitable was used before and fair and equitable is being used now, it must mean exactly the same thing. And I've already explained to you why that's not the case. Everybody knows this rule, right? "We will not read the bankruptcy code to erode past bankruptcy practices absent a clear indication that Congress intended such a departure."

Well, guess what? It's very obvious that Congress intended such a departure. It defines fair and equitable three ways for secure creditors and two ways for unsecured creditors. So this is a complete departure from the activities under the act. And the notion that somehow we still have to layer back on the absolute priority rule and can't pay junior classes anything, even if we have done everything right under (b)(2)(a), is just wrong. So that's the end of my discussion of the absolute priority rule, Your Honor.

I think now I would like to talk just for a moment about Headwaters. And in this case, I would just like the Court to consider the hypocrisy that we're hearing from the far table in the room. And the point is all of a sudden the Headwaters litigation is the most important thing in this case. All right. It wasn't that

way a week ago. And it certainly wasn't that way when Beal made their bid. But it's that way today. And we've got to ask ourselves why that is. And I would just ask the Court to compare the treatment that is being proposed by the noteholders under their plan under their sale procedures motion, under the Beal bid, with that being proposed by Marathon.

How, the Indenture Trustee asked, can the MRC/Marathon plan give MRC the right to control the Headwaters litigation? Leaving aside the obvious answer, Your Honor, which is that the $530 million in MRC more than compensates the Indenture Trustee, given Houlihan's value for these assets, let's look at what the Indenture Trustee proposes to do with the Headwaters litigation in its own plan.

The Indenture Trustee plan is built on the Beal bid. Under the Beal bid, the buyer has no obligation to close until the Headwaters litigation is settled. Moreover, the settlement of that litigation has to be acceptable to Beal Bank's front company, the Scotia Redwood Foundation. Thus, Scotia Redwood Foundation, the stalking horse, Your Honor, controls the resolution of this claim under the Indenture Trustee's plan. It is undisputed that the Scotia Redwood Foundation is not buying the Headwaters litigation from the noteholders.

Thus, it cannot be paying anything for the litigation. Even though the Indenture Trustee is receiving no consideration under the Indenture Trustee plan and the Beal bid for settlement of that litigation, the Beal bid requires the Indenture Trustee to agree to effectively surrender control of the Headwaters litigation. Compare this to the outcome under the MRC/Marathon plan where the Court can find substantial value in excess of the number put forward by Houlihan with regard to the value of the trees.

There, too, the Indenture Trustee won't control resolution of the litigation, but at least the noteholders will get paid for it. Under the Marathon construct, the evidence that we have presented to you, there is a factual basis for you to find that there is value in the MRC consideration being paid to the noteholders which can be attributed to the litigation. And it's more than a dollar, and it's certainly more than Beal was willing to pay or that the Indenture Trustee was willing to come to you and say here's how I'm going to do it, I've got my stalking horse bid.

THE COURT: But there's nothing in the Beal bid -- I mean, I have a tendency to agree with you that when the Beal representative was testifying, he never said that he thought it was worthless, but that

they thought they would settle that because they wanted that behind them to deal with -- and I got the sense that there was not a lot of value being assigned to it. But what is the evidence of that? And in addition to that, in addition to that, there is nothing in the Beal bid that requires them to settle it in a way that the bondholders not get anything out of the settlement.

MR. FIERO: I would agree with the latter point, Your Honor. But I would simply point out that Beal doesn't have to close. The $603 million that we have heard about so many times --

THE COURT: That goes back to the value.

MR. FIERO: It's meaningless.

THE COURT: Right. But there's nothing in the Beal bid that somehow transfers that out of the noteholders.

MR. FIERO: Well, there is, in a sense that they have given up control.

THE COURT: I guess Beal decides that the only agreement that they would -- the only settlement that they would agree to is that 100 percent of any of the proceeds go to Beal Bank. Under those circumstances, the rest of the noteholders wouldn't get anything.

MR. FIERO: Well, Your Honor, that's actually possible.

THE COURT: Well, I know. I mean, it's kind of -- it's not clear what happens to the asset under that -- under their plan; isn't that true?

MR. FIERO: I would agree. And that is big concern of the Committee. And I'm going to get to that in a minute because one thing that we haven't talked about in the last couple of hours is just what it would mean to everyone if we were to march down the auction road that's been laid out for us by the Indenture Trustee in the sales procedures motion and the Beal bid.

Your Honor, we think that if you were to compare the two where you've got the Indenture Trustee giving away control of the resolution of the litigation and understanding that Beal will not close unless the litigation is resolved or dismissed, is not as good an outcome for the noteholders as that proposed by the MRC/Marathon plan. The only difference there, Your Honor, is that we've got a disagreement about value. And that's another question and we've heard plenty of argument about it already.

But the idea that something bad is happening as a result of what Marathon and MRC are doing, but something wonderful will happen as a result of what the Indenture Trustee is doing is just complete bunk.

Your Honor, now I would like to talk about

what would happen if we were to have an auction here. What if we did test the market? The Committee asked me to make sure that I share with you some of the concerns that it has about the idea that we would just send these assets to auction. You may recall in our opening remarks on April 8 that the Committee mentioned there were only two things that could derail the new paradigm of alliances which have been created behind the Marathon/MRC plan, and those were Maxxam retaining control and further uncertainty in Humboldt County.

Maxxam retaining control is not going to happen. That's been taken care of. The only risk that remains is the question of uncertainty. And that's what the Indenture Trustee's plan still offers creditors in the community because it's not a plan. And if you go through the terms, it's very easy to figure out. First, the proposed buyer is the Scotia Redwood Foundation, a renamed affiliate of Beal Bank. And all of this, Your Honor, are in the findings and conclusions that we'll be submitting.

THE COURT: Does the noteholders plan intend on the Beal Bank bid?

MR. FIERO: Your Honor, without it, their auction will go more slowly.

THE COURT: It doesn't require it, does

it? Because we don't have a bid right now.

MR. FIERO: No, they never accepted the Beal bid.

THE COURT: I have representations by Counsel that the bid lasts until tomorrow.

MR. FIERO: Yes, Your Honor.

THE COURT: The likelihood that I'm going to rule by tomorrow is pretty slim. It's possible, but it's very unlikely.

MR. FIERO: My guess is we're going to see a midnight pleading, Your Honor. The Scotia --

THE COURT: But there's nothing in their plan that requires that bid.

MR. FIERO: No, Your Honor. But without it, their plan is even worse. Their plan is even less feasible without the bid than it is with the bid. And that's the Committee's position. And I don't think any of the moving parties will disagree with that. Scotia Redwood Foundation, Your Honor, has just two employees, Jacob Cherner and Andy Beal. Mr. Cherner is a lawyer who works for Mr. Beal. Mr. Beal is the founder of a successful bank and a well-known poker player, one who once won $10 million from some of the greatest professional poker players in the world, only to continue to play them in a long running game and lose $16 million,

such that he was down $6 million. Beal Bank has never owned a redwood forest. Beal Bank has no foresters employees. Indeed, the only prior timber experience possessed by Beal Bank is that it owns a forest in Astonia.

Mr. Matthews testified that the Indenture Trustee had not seen any specific information that would allow the Indenture Trustee to conclude that Scotia Redwood Foundation could operate the timberlands in a way that would allow it to service the debt that it anticipated putting on the property. Mr. Matthews also testified in direct response to a question by you, Your Honor, that the Indenture Trustee has not gotten specific advice from its consultants concerning -- confirming that even the Indenture Trustee would have the ability to operate the Scopac timberlands while waiting for the auction contemplated by the Indenture Trustee plan.

Indeed, Your Honor, Scotia Redwood Foundation provided the Court with no evidence regarding its operational ability or its competency. But that's not all. The Scotia Redwood Foundation has conditioned its obligation to close upon the receipt of all required governmental consents and approvals to the conveyance and assignment of the Scotia assets to the buyer. Despite repeated questions from the witness stand, Mr. Matthews

could not identify the period of time that would be required for regulatory approval to be obtained.

Scotia Redwood Foundation has also conditioned its obligation to close upon the execution of an acceptable acquisition agreement. Your Honor, I will confess to you that I was stunned that we never saw a signed APA in this courtroom. And my guess is that you share that surprise. No such agreement was presented to the Court during the confirmation hearing. And Mr. Matthews, the Indenture Trustee himself, testified that he had never seen a draft.

Finally, pursuant to the Scotia Redwood Foundation term sheet, which is Exhibit 207, Your Honor, it is a condition to closing that the Headwaters litigation be dismissed with prejudice or settled in a manner acceptable to the Scotia Redwood Foundation. Clearly all of these conditions remain unsatisfied. As of the time of Mr. Matthews' testimony, the Indenture Trustee had not agreed to accept the Scotia Redwood Foundation term sheet. Indeed, Mr. Matthews testified that the Indenture Trustee could not accept it unless it obtained a two-thirds vote from the noteholders instructing it to do so.

What does all this uncertainty mean? It means there is not enough evidence put forward by the

Indenture Trustee to justify a finding by the Court that the Indenture Trustee's plan is feasible. The Committee is not the only voice that has recognized the inherent risk in an auction set so far in the future where anyone or no one could show up to bid to become the new asset of the -- owner of the Scopac timberlands.

On April 8th the Eureka Reporter published an opinion piece by a 28-year resident of Humboldt County named Sal Steinberg that said, "Forget the auction idea of giving the forest to the highest bidder. Who might these bidders be? This concept is flawed because we've already had one horrific owner. And we need dependable stewards for our forest and streams." The Committee asked the Court to ask what will happen to the employees of Palco and the residents of Scotia while the noteholders and Beal Bank slowly turn over their cards in their game of Texas Hold 'Em during the five to seven month marketing period and subsequent auction.

Is it reasonable to expect that Marathon will blindly fund the losses of the mill and the town to preserve their livelihoods and way of life? And what if the worse happens, Your Honor? What if five to seven months pass, the cards are all turned over and it turns out Beal Bank was bluffing because the Indenture Trustee was forced to credit bid and Beal Bank chose not to bid

again and instead, simply collect its $21 million break-up fee. Then the Indenture Trustee sale process would have become nothing more than a foreclosure sale. This would be the worse possible outcome because it would just compound the uncertainty for the county and its inhabitants.

The Indenture Trustee knows even less about running a redwood forest than Beal Bank does. It would not be a long term holder of the forest. While the Indenture Trustee figured out what to do next, no one who works in the redwood business in Humboldt County would have any way of predicting their future or reasonably investing in their business or figuring out whether or not they should buy their home in Scotia.

Finally, Your Honor, this sort of uncertainty would not be good for Scopac either. As CFO Gary Clark testified: "Now, if you take the sawmill out of the equation and the Palco sawmill is not bidding in the marketplace for those logs, there's not a place for 75 million board feet of logs to go. There are three sawmills that cut redwood. They all have an adequate supply of redwood. They don't need more. That's going to put a plethora of redwood logs on the marketplace and drive down the price of redwood logs, in my opinion."

This is not what reorganization is

supposed to accomplish. And this is a primary reason why the unsecured creditors of Scopac voted 28 to 2 to reject the noteholders' plan, even though at that time, Your Honor, it purported to pay them 100 cents on a dollar, which is a far cry from their current proposal.

Finally, Your Honor, this court has often reminded the parties that one of the best services a bankruptcy court can provide to parties in interest is to seven as a forum for bargaining and settlement. The Committee agrees. This confirmation proceeding accomplished something that the 20 years prior to bankruptcy and the six days of mediation in the bankruptcy could not do. Specifically, two additional timber work partisans, namely Palco and Maxxam, agreed to join the new alliance and support the MRC/Marathon plan, leaving only Scopac and the Indenture Trustee to fight.

This aligning of interest, the state, the environmentalists, the loggers, Maxxam and Palco, is something that has surprised even the partisans themselves. But the outcome is the right one for the Committee, and its constituent members thank you for providing this forum for the exchange of ideas and the formation of a consensus on how to lead the companies and community forward. For all these reasons, Your Honor, the Committee is proud to be a co-proponent of the

MRC/Marathon plan. The Committee hopes you agree it meets all legal and common sense requirements for a way forward and that the Court confirm the plan as soon as possible so that the new beginning can actually begin. Thank you.

THE COURT: I think we're down to California.

MR. FIERO: We're down to Mr. Litvak.

THE COURT: Okay. Mr. Litvak.

MR. LITVAK: Just very briefly, Your Honor. Max Litvak on behalf of the creditors committee. I feel compelled to respond to some of the arguments that were made by Mr. Pachulski near the close of the presentation on the 9019 motion, the settlement between the Palco debtors, Maxxam, as well as Mendocino and Marathon.

The first point that I would make is really that from everything that I've heard -- and I think you were asking some of the key questions, is what specific issue is it that the noteholders, which have claims against Scopac, have with the settlement that does only one thing from the perspective of the debtor estates, and that is to release claims of Palco which we have heard a lot of argument today about that's a separate entity, that's not Scopac. Palco releasing

claims against Maxxam. And the only thing that they came up with, I think, and this was Mr. Pachulski's argument, was essentially that we have a right because we have a right to object even though it's a Palco release of Maxxam, not a Scopac release of Maxxam because under the Marathon plan, those claims, the Palco claims against Maxxam, would be put into a litigation trust, and we're the biggest constituency in the litigation trust, and that combines the claims of Palco against Maxxam, as well as Scopac against Maxxam. That's true. I can't dispute that.

But the point that I want to make is today they have no standing to object based on that argument because you haven't confirmed the Marathon plan. The only thing that they -- they have no right as to Palco's claims against Maxxam right now. And when and if you do confirm the Mendocino plan -- and I don't mean to jump forward like that. But if you do that, then only then would they have some say about Palco's claims. And they only can get what's in there.

THE COURT: It would be too late then unless I somehow held off approving the settlement.

MR. LITVAK: Well, that's my point, is they will only get under the Marathon plan what we give them with respect to Palco's rights against Maxxam.

THE COURT: Why should I wait? Let's assume that I confirm your plan. Then I'm supposed to hold off on the settlement and give them the opportunity to come in and object at that time?

MR. LITVAK: No, Your Honor. My point is they don't have any right. We can cram them down, in other words, without giving them anything with respect to Palco's claims against Maxxam.

THE COURT: I mean, I think the point -- I think your point is that whatever they have is a right -- not a right, but their only -- they get in that trust because you're putting them back in that trust. You bought all the assets of Scopac and then you voluntarily put them in a trust to give them some downside to their unsecured claims.

MR. LITVAK: Well, that's right. And it's a gift. They're not entitled to have the value of Palco's existing claims against Maxxam, if there are any, okay. So we can cram them down. And I'll refer to this Greendyke rule again. We can change the treatment so that their only rights under a litigation trust, whether it's a new trust or the current trust, are with respect to Scopac's potential claims against Maxxam. And those aren't being released. Those are their only rights right now. So the fact that they could even participate in any

claims that Palco could ever have, that's a gift. They're not entitled to that today. They're only getting that under the Marathon plan. The second point that I want to make -- and this is really a clarification. I hedged a little bit when you asked me before about about whether or not we have done any diligence on the claims, whether there is any claims here that Palco, the Palco estate has against Maxxam.

It's not that our investigation was cut short. It's that we did an investigation and we're satisfied with our due diligence, but can we do more? Absolutely. We're lawyers, we can always look at it some more. And Maxxam is here in the courtroom. And you haven't approved the settlement yet. So I don't want to be in a position where I'm committing and guaranteeing to you that Palco has no claims. That's why I have to hedge. And I just wanted to clarify that.

Based on what we know, the length of time we've been involved in this case, the conversations we've had with the debtors, the conversations we've had with Marathon, we see no valuable claims against Maxxam that are being given away. But having said that, Maxxam, as Mr. Clark testified, has valid claims, according to the Palco debtors, against Palco in the amount of about $40 million. And those claims are not subordinated as to

other unsecured creditor claims. They may be subordinated as to Marathon, but not as to unsecured creditors. So there could be a fight there about whether or not those claims are subject to subordination. But as far as Palco is concerned, those are valid claims and those will be valid offsets against anything that we would have.

So you combine that and put it all together, Your Honor, given the support that we're getting, the Marathon plan is getting from Palco and Maxxam and the length of time and the costs associated with all of the objections and fights that we have had, from our Committee's perspective, we think this is a good deal. We urge the Court to approve it.

THE COURT: Now California. Is the court call on the line? We're having some people dialing. Court call, can you take care of that?

OPERATOR: Yes. I will find out, out of the many people we have here, who are doing that. I'm so sorry.

MR. PASCUZZI: Thank you, Your Honor. Paul Pascuzzi for the California State Agencies. As the Court is aware, and I won't belabor it a lot, now the MRC/Marathon plan does have the strong support of the California State Agencies, the strong support from the

agencies that work every day with the ultimate owner and operator of the timberlands. You also know that Governor Schwarzenegger strongly supports the MRC/Marathon plan because it best meets the five principles outlined by the Governor, which this Court has stated coincide with the goals of a Chapter 11 case.

And, Your Honor, our closing brief at docket number 2881 goes through the evidence that was admitted at trial on each of the five principals in much detail with specific citations to the record, so I won't go over it again now. If the Court believes it has a choice between two plans before it, we believe that the MRC/Marathon plan wins hands down under 1129(c), and we urge the Court to confirm that plan.

And to be clear, as Mr. Jordan said, we're not asking you to confirm a plan that doesn't meet the requirements of 1129 just because we like it. We think the MRC/Marathon plan is confirmable, and we join in the other party's arguments on those points.

I do want to make a couple of other points based on what I have heard today and what I saw in the closing briefs. The Indenture Trustee argues that it has brought a much better solution for the entire case to the Court, now that there's an offer for the Palco mill. First of all, we disagree. Palco disagree, the creditors

committee disagrees, and all the people who have told you they support the MRC/Marathon plan also disagree. You heard about the problems with the offer, it was way low. It will bind Scopac to sell 100 percent of its timber to Palco, which will devalue Scopac. I won't get into that.

Second, as the Court recognized, the Indenture Trustee plan doesn't cover Palco, so there's no mechanism for a forced sale of Palco under the Indenture Trustee plan. And there's no evidence of financing in the meantime when that would happen. They could have included Palco in their plan, they could have teamed up with the creditor of Palco or the Committee, but they didn't. The Indenture Trustee plan is a liquidation plan, plain and simple, and it should be the plan of last resort.

We made some points on valuation in our brief also, Your Honor, that I won't repeat. I do want to, since the Headwaters litigation has all of a sudden become an issue, I do want to make a couple of brief points about the value of the Headwaters litigation.

Your Honor, the Court should have a hard time attributing any value at all to that litigation, and not because of a failure of proof, but because of the status of the litigation. You've got the evidence in the record in addition to what has already been said today,

that shows there are preliminary dispositive motions have been filed, that's the motion for judgment on the pleadings, and that's California State Agency Exhibit No. 8. It's the equivalent of a motion to dismiss. It assumes that all the facts are true in the complaint and it tests the validity of the cause of action.

That has tentatively been granted as to the tort claims in the complaint. It could be granted as to all of the causes of action. We don't know yet. And the tentative ruling is California State Agency Exhibit 9. The litigation is in its infancy. Discovery has just started. You heard the testimony of Mr. Lumsden, which I forget what day it was, I think it might have been April 30th at page 419 to 420 of the transcript. Paper discovery to the debtors has not even been responded to. There's been two depositions. There's -- the litigation is subject to further dispositive motions such as motions for summary judgment, for example. And, of course, the California defendants vigorous dispute the allegations, which would lead the Court to the reasonable conclusion that it will be a hard fought case at substantial cost.

Your Honor, in our brief, we cited a case called Maxwell versus KPMG. It's a brand-new case out of the Seventh Circuit Court of Appeals. It was March 21st. The cite is 520 F 3rd 713. And we urge the Court to take

a look at the closing comments of Judge Posner in that case about intimidating allegations of damages and how they are absolutely no proof of value.

We submit, Your Honor, that it will be very hard to say that this litigation is worth anything at all or worth anything that would tip the scales enough to impede the confirmation of the MRC/Marathon plan, given the evidence before the Court. And it's not a failure of proof; it's a function of the status of the litigation.

Your Honor, we agree with the creditors committee that the Indenture Trustee plan has a feasibility problem. We also address that in our brief. You heard the testimony of Mr. Cherner on behalf of the Beal entity that they have no experience operating a timber company in the United States, or more relevantly, California. They're going to hire the people they need. Well, of course, I'm sure their intentions are good, but it's just not that simple to set up a timber harvesting business for 200,000 acres of timberland in 30 to 60 days and be able to hit the ground running.

So on the bare record, the Indenture Trustee doesn't show that its plan is feasible. There's no evidence to show that they have a reasonable likelihood of obtaining state and federal approvals

needed to transfer the land to Beal or any other inexperienced buyer. Compare that with MRC's substantial experience operating a timber company in northern California and a stellar reputation it enjoys, based on a proven track record. And I want to be clear, we're not prejudging anybody. We're not saying Scotia Redwood Foundation would not be approved or anyone else would not be approved. I'm just talking about what evidence is in the record for the Court to make its confirmation decision.

Your Honor, Mr. Tenebaum mentioned some requests that both the state and federal agencies had for the confirmation order. I believe those have been agreed to by both of the plan proponents. They were outlined in our brief. I just want to make sure they're not forgotten.

And in conclusion, Your Honor, the California State Agencies urge the Court to confirm the MRC/Marathon plan. That plan assigns the most realistic value to the timberlands, in addition to meeting the goals of Chapter 11, protecting the environment and showing compliance with both the requirements of 1129 and non-bankruptcy state and federal law. Thank you, Your Honor.

THE COURT: Thank you. Are we down to

Bank of America?

MR. NEIER: And rebuttal.

THE COURT: I think somebody reserved.

MR. NEIER: Yes, we reserved rebuttal.

THE COURT: You-all reserved rebuttal.

MR. PACHULSKI: Your Honor, at some point I would like to have like five minutes rebuttal.

THE COURT: Okay. Go ahead, Bank of New York.

MR. JONES: Bank of America, Your Honor.

THE COURT: I'm sorry. Bank of America.

MR. JONES: Your Honor, you can just call me Switzerland. You can just call me Switzerland. People have observed that we're sort of in the position of Switzerland, and it's true. We don't take any position on which plan the Court ought to confirm, which ones are confirmable, which one is preferable if the two are confirmable. But Your Honor, we are like Switzerland, or at least Swiss lenders, in that we really want to get paid. We'd like to get paid now. And we've been here for 18 months. It has become clear we're not going to get paid unless there is a confirmed plan.

Every time I come there, someone -- there's been been people on all different sides tell me, we'll just take you out. I'm still here. My success of

getting taking out is about as good as it was in high school. I didn't get taken out. Your Honor, not only do we need a confirmed plan --

THE COURT: You never asked.

MR. JONES: I got to take people out once in a while. Your Honor, we not only need a confirmed plan, though, we need a confirmed plan that actually goes effective, it doesn't get stayed. Because I think there's at least some possibility that someone in this room might seek a stay if they weren't happy. And that leads me to my next set of comments, which to a certain extent are kibitzing, but I'd like to make some observations and suggestions if the Court is inclined to confirm one of the plans, suggestions that I think they are actually some -- some pitfalls that have been suggested to the Court that I think certainly Judge Jones, who seems to know a lot about bankruptcy. By the way, Your Honor, no relation that I'm aware of. And seems to get an awful lot of the Fifth Circuit appeals in bankruptcy, although I wouldn't want to suggest that there's a thumb on the wheel. But just some observations in order to bulletproof the order.

I'm sorry, Your Honor, the other thing, I have a note here to myself that I want to make very clear. We had suggested before to the Court that it

might be appropriate for the Court to use its bully pulpit to try and get these people together on a consensual plan so that we can get paid. And I very much appreciate the Court's efforts to do that. They can't always succeed, but Your Honor has gotten things a long way.

THE COURT: I was afraid you were about to say that you wish I had done that. And I thought, what else could I have done?

MR. JONES: No, Your Honor. Even I noticed the subtle suggestions. Your Honor, the first comment I have on the MRC plan, the Court has asked and some of the litigants have suggested, well, isn't this just like when you value a secure claim and pay it over time. And Your Honor, with the greatest respect, I would suggest that that's a rabbit hole the Court shouldn't go down. I think if you look at the cases and the history on 1129(b)(2)(a)(1), what it's designed to address is a situation where the debtor keeps property and pays people over time.

And the simple fact is Congress gives debtors certain options and certain rights that it doesn't afford to other people. And whether we call this plan a sale or not, I don't -- I think it's clear that this is a plan that ends up with the property in hands

other than the debtor. And so I'd suggest respectfully that you need to look at this a little more than you do as just a valuation question under 1129(b)(2)(a)(1).

By the way, Your Honor, it was also suggested, well, you can just give them a note for one month and then pay them off and wouldn't that be the same? And if that's okay, then surely I can just say it's the same because I'm giving them the cash now instead of in a month.

Your Honor, that's actually where 1111(b) comes into play. And I think in most respects, frankly 1111(b) has been a red herring today because it doesn't apply where property is transferred. Now, again, perhaps the Court -- the literal language is it's sold. Perhaps the Court is going to conclude that there is not a sale here. And I'll speak to that a little later.

THE COURT: Well, they paid them. Whether it applies or not in this plan, they had the 1111(b) election and didn't take it.

MR. JONES: Absolutely, Your Honor. But here's the point I wanted to make. If they had written a plan that said we're going to give you a note for one month and then we're going to pay it off, they would have made that election then. They aren't stupid.

THE COURT: They had worse than that.

They had 135 million or whatever, 175 million, and then -- I don't want to say goofy notes, but for 325 million. And they didn't like that. They screamed about the value of those notes and was it the indubitable equivalent, so they changed it to just cash.

MR. JONES: But Your Honor, that's precisely my point. If they had given them a one month note, as Mr. Jordan points out, if they got a one month note, 1111(b) says you have to do two things. You have to give present value of whatever the secured claim is, if the Court finds that, you have to give face value of the full secured claim. So if it were a one month note, in one month they had to be paid the face value of 800 million dollars or whatever their debt is.

THE COURT: No, no, they had to be --

MR. JORDAN: That wasn't my suggestion at all.

THE COURT: The plan has always been -- you see more of these maybe than I do. And right off the bat, you know, it's too late. But I thought you could have this treatment or you elect 1111(b) treatment. Now, that treatment is not -- it has to provide the full stream of payments and it has to be -- the present value has to be the value of your collateral, and it has to pay off the full amount of a claim over the stream of

payments. But the time of the payments is not geared by the other treatment that you're not electing, is it?

MR. JONES: Your Honor, 1111(b) doesn't --

THE COURT: I mean, if there are 1111(b) elections were we'll pay you 530 million dollars in cash or we'll pay you in one month your 1111(b) election, which is in one month we'll pay you 800, obviously they'll take the 800.

MR. JONES: And, Your Honor, that's simply my point, that the Court -- maybe I misunderstood what the Court was asking. I thought Mr. Jordan was suggesting -- I think the Court said, well, if I can term them out over time, you're telling me I can't cash them out, but suppose I just gave them a note for a month. And my point there is then they would have made their 1111 deal actually with a one month note. Perhaps --

THE COURT: They wouldn't have made it either way because, I mean, if they would have made it their 1111(b) election, the 1111(b) election does not require that the treatment that you give them in the plan in terms of the length of the payments period be identical to the treatment that you give them in 1111(b). It only requires that the present value of the stream payments be the value of the collateral, that you have the lien, and that the payments over that period of time

add up to the full amount of the claim; isn't that correct?

MR. JONES: Absolutely, Your Honor. And I'll just move on from this because perhaps I misunderstood the questions. I thought Your Honor was saying they could have given --

THE COURT: Forget 1111(b). They're arguing that it was okay under paragraph i to write the claim down to the value of the collateral and pay it off pursuant to a note if you maintain a lien on the assets. Now, the normal lien might be ten years, 15 years. I don't know. But if you're going to -- if you've got the cash money and you can't do that under iii as of the indubitable equivalent, then all you do is you give them a lien, secured by the lien on the assets for the amount of the claim, 530 or whatever it is, and the term of the note is one month. Or forget it, let it be ten months but have no prepayment penalty and you pay it off the next day and you have no lien then.

MR. JONES: Again, if they give them a one month note --

THE COURT: Forget the one month. Make it 15 years with no prepayment penalty. There's nothing wrong with that, is there?

MR. JONES: No, Your Honor, there's not.

But again, I thought Your Honor was saying, well, if I can pay them on a one month basis, I must be able to pay them in cash. The only point I'm making is if they tried to do a one month note, then these guys would have made their 1111(b) election because they would get effectively the full amount of their claim a month late. But it wouldn't be a --

THE COURT: You're missing --

MR. FIERO: Mr. Jones' clients voted for every plan, so I'm not sure where this is going, but I know it's going to go later. And I wish he would restrict himself to matters which are actually relevant to confirmation of the plans that he voted for.

THE COURT: I am getting confused perhaps by what your argument is because I think you're missing 1111(b).

MR. JONES: Your Honor, I'll be real simple. If the Court is going to --

THE COURT: I'll tell this one story, and you've given me the opportunity. Elizabeth Warren challenged me to write a song about 1111(b), and I did that to the tune of La Bamba. And the words were "nobody knows what it's meaning." That fits the blah, blah, blah, blah, whatever it is. And anyway, maybe that's true. I don't know. But her students had a hard time

with what it meant. So go ahead.

MR. JONES: Your Honor, I'll get to the bottom line on this. I think if Your Honor is inclined to confirm the MRC/Marathon plan, the Court should do it, I would respectfully submit, under the indubitable equivalent test. I don't think you can get there under (b)(2)(a)(1). And I worry --

THE COURT: I agree. I agree with you. I think it's either indubitable equivalent or it's not. I'm just arguing if the way they argue that -- well, it just doesn't -- you know, if your argument leads to an absurd conclusion, it can't be right. And the absurd conclusion is that they can pay it off the day after they did the note if they -- as long as they were not foolish enough to have a prepayment penalty.

MR. JONES: I agree, Your Honor. The only point -- and apparently you've reached the conclusion long before I suggested it to you. My concern is simply is there is a finding simply that on normal valuation standards, the value is such-and-such. I don't think that meets the little iii test. I think Your Honor has got to find that its indubitable that their value is such-and-such. And by the way, Your Honor, I think you can do that, but I just want to make sure that if we get a confirmed plan --

THE COURT: I think that the substitution of collateral has to be indubitable, the indubitable equivalent. The value has to be by a preponderance of the evidence; isn't that true? Or is that wrong? Or does it matter? I think the indubitable --

MR. JONES: I don't think we need to parse it.

THE COURT: Doesn't it mean it's got to really be the same, whereas the value has to be a preponderance of the evidence, there's value.

MR. JONES: Your Honor, I don't want to -- I actually -- I think you do have to find that the value is the indubitable equivalent. I don't think you can simply say I find value on preponderance, and since I found value, that cash is the indubitable equivalent of that value. I think that iii requires more. But I'll leave that aside for people --

THE COURT: That's an issue that we can discuss. And I understand that there have been different positions on that issue.

MR. JONES: Yes, Your Honor. By the way, I think we all do agree that it's a preponderance of the evidence as to indubitable equivalent, but I think that is a substantive standard that implies things just as, for example, Your Honor irreparable harm. You can't

satisfy that just by saying there's a preponderance of the evidence of harm. You have to get to the substantive requirement.

THE COURT: That's irreparable. And the equivalent is the indubitable.

MR. JONES: Yes, Your Honor. Your Honor, I don't want to belabor it. I do want to turn to the noteholder plan, though, because we would like to see that one confirmed also, if that's the one the Court finds is appropriate. Your Honor, it's been suggested somehow that --

THE COURT: When do you think you'll get paid if that one is confirmed?

MR. JONES: Your Honor, I don't know, but I think the six to nine month guesstimate that we have heard in court is probably a good one.

THE COURT: Okay.

MR. JONES: Your Honor, the first thing with that is we have raised a question on financing. We are concerned about the auction rate notes but, Your Honor, I think the Lehman offer satisfies that sufficiently. There's not certainty, but we think it's enough for the Court to find that you will get to effectiveness, which is obviously required for feasibility. Your Honor, it's been suggested that

somehow it's not feasible because we don't know if the winning bid -- and the Court has correctly noted we don't need to know if the winning bidder will be Beal. We don't need to know who that would be. It's been suggested somehow that they won't be able to operate. That's just not required. What's required is that we get to an auction sale that closes. And Your Honor, I think there's ample evidence for the Court to find that that will occur. It's been suggested somehow --

THE COURT: Wait a minute. You think that a plan would be confirmable, say, an airline plan that provided for somebody to buy the airline that had no pilots and no prospect of getting any pilots could be confirmed? Why wouldn't be that -- likely to be followed by another reorganization?

MR. JONES: Well, Your Honor, I think there's a difference there. That if they were buying it for cash, actually, I think that probably could be confirmed. I don't think -- there are two elements there, Your Honor. The first one is, as I read, the feasibility test doesn't go to the buyer, it goes to the debtor or its successor under the plan.

THE COURT: That's true, if somebody was buying all these assets for cash, since they can just sit there and grow --

MR. JONES: We wish them well.

THE COURT: They can probably confirm that plan.

MR. JONES: That's my point, Your Honor. The last one is that I think it's been suggested somehow it's in bad faith because it's the equivalent of a foreclosure. It's a liquidation, there's no question about that. But Your Honor, there simply are not cases out there that say Chapter 11 can't be properly used for liquidation. The Court has made absolutely clear -- and I'm not going to quibble -- that if you can conclude you can confirm both plans, which one you're going to confirm. I'm not going to quibble with that. But I do want to make sure that we don't lose the baby in the bath water here.

The Committee apparently has decided that it's their duty to ensure the future of Mendocino County. I don't think it is. I think it's this Court's duty to confirm a plan if it's the only one confirmable, and get as many people as can be paid paid. If you're choosing between the two, again, I don't quibble, but I want to make sure that if there is a confirmable plan out there, we get one confirmed so my client can get paid. Your Honor, with that, I have no further.

THE COURT: What were you going to say

about Judge Jones? And how she would couch the order in order to avoid --

MR. JONES: How I would suggest the Court couch it. Your Honor, for example -- I actually skipped over this. On the argument under 1129(b)(2)(a)(2), it's been suggested we had a market test with the equivalent of the ability to credit bid. I would be troubled trying to defend that to an appellate court. We haven't had --

THE COURT: However, even if we were in fact -- maybe we haven't had a market test in the sense of an auction, but even La Salle partners talks about the lack of exclusivity being a possibility of a market test for new value.

MR. JONES: Absolutely. Absolutely.

THE COURT: And we did eliminate exclusivity.

MR. JONES: Yes, Your Honor.

THE COURT: So everybody had a shot at these plans. And even after we had the plans, we tried to get everybody together on the ones that we had.

MR. JONES: I agree, Your Honor. But I would note that (b)(2)(a)(2) talks about the 363(k) rights, not just the equivalent of a market test, which La Salle talks about.

THE COURT: Sure.

MR. JONES: And the last thing, Your Honor, I would just note again it's been --

THE COURT: And you think this case requires a credit bid sale?

MR. JONES: No. Your Honor, again, I think you go to iii and you rule it is the indubitable equivalent, but I don't think you can rule that you've conducted a credit bid sale. I don't think you can rule that you've tested the market because I just don't think we can sustain that.

THE COURT: Okay. I guess the point I was making is that this is not a creditor cram. This is not a debtor -- you say that there are provisions in the code that give the debtor a leg up. It is true, they get exclusivity. But absent exclusivity, I'm not aware of any provisions in the code that would favor a debtor over another plan proponent in terms of what they can do. Now, I have never seen a case that suggests that. In fact, I would think La Salle Partners would be a case where they suggest just the opposite. If a debtor is going to cram down, they've got to do a market test. They've got to do -- or at least get rid of exclusivity. Although it didn't decide --

MR. JONES: That's certainly the case. But a number of the provisions tie into whether the

debtor retains property. For example, the 1111(b) election we talked about doesn't apply if the property is disposed of. Your Honor, I don't want to belabor point. I hope I have convinced the Court that it ought to be thinking about this as an indubitable equivalent case. And I want to see a confirmed plan, Your Honor. And with that, I'll sit.

THE COURT: Thank you. All right. Go ahead.

MR. NEIER: Briefly, Your Honor, I just want to clear up some of the confusion that may have started with respect to 1129. First of all, Mr. Greendyke agreed that 1129(b)(2) is in the disjunctive. It's got an or in there. And everybody seems to agree with that. It's not you have to meet all three, you have to meet one of the three.

But it's not one of the three. It's -- 1129 includes, includes either the note at market rates and interest to the indubitable -- to the value of the secured claim, a sale, number two, and the little iii, the indubitable equivalent. Are those all of them? No, they're not. As the case that Mr. Greendyke relied on, the D&F Construction case in the Fifth Circuit, plainly says Section 1129(b)(2) merely states that "the condition of the plan be fair and equitable with respect to a class

includes the following requirements," emphasis added, "Section 102(3) of the bankruptcy code states the word includes is not limiting. In other words, you're not limited to the three tests that we have to fit in a bucket that includes a one month note or some other kind of note. We're not limited to a sale, we're not limited to indubitable equivalent. We have to prove fair and equitable by one of these methods or some other method. It's up to Your Honor.

There were several other methods that were suggested that if we were going in one of these tests, i, ii or iii, we could nevertheless qualify under fair and equitable for the MRC/Marathon plan. One was the one month note. And you don't have to give the same length of term under 1111(b). Your Honor is exactly right.

But with respect to number iii, that is, indubitable equivalent, Mr. Greendyke suggested that indubitable equivalent only means that you can make people eat dirt. They have to take property in lieu of the property they have. You get the indubitable equivalent only in property; cash cannot serve as the indubitable equivalent of collateral. And that's plainly not true. He said there are no cases that say that. That's also not true.

If you go to our brief, on page 19 of our

brief we cite multiple cases where courts routinely find that cash or cash equivalents that amounted equal to the value of the secured creditors collateral are completely compensatory and constitute the indubitable equivalent. And we cite the Wiersma -- the Wiersma case, which said that cash can be the indubitable equivalent because cash is king. The court doesn't have to decide whether the property is truly indubitable in the sense whether the note is going to be paid off. You used the term goofy notes.

This gets rid of the interest rate problems, it gets rid of any problems you may have with the note, and it gets rid of the problem as to whether the dirt that you're getting is truly the indubitable equivalent of the dirt that you're giving up. Cash is king. We cite the San Felipe Voss case, which I believe Mr. Greendyke was the judge in that case, which plainly says that 1129(b)(2)(a)(3) does not contain a requirement of strict cash equivalents, but it implies by saying so that strict cash equivalent would satisfy number three.

In re Keller is Mr. Shields case. That's where an annuity, which was a cash equivalent, was the indubitable equivalent of a partial release of secured creditors' liens on real estate. So Your Honor, it's quite clear there are multiple cases which say that cash

can be the indubitable equivalent. And I don't know why anybody says there aren't cases that say that because there plainly are. And I have only cited some of them.

We've had some talk about how -- and I think this has already been answered by some of the other people, so I'm only going to briefly touch on it -- that Mr. Pachulski says there's a shell game and we have missing 18 million dollars; and therefore, there must be some, you know, Palco value coming over or Scopac value coming over the transom to Palco. That's plainly not true. It's not only in Mr. Dean's affidavit that there are synergies that equal the $18 million, it was in our disclosure statement on page 67 where we talked about the enabling of Newco to achieve synergies with MRC and MFP. And also, we had projections in our disclosure statement.

And you may recall the testimony of Mr. Johnston, his first time on the stand where he testified that the reorganized value, the value of the reorganized entity and the financial projections of the reorganized entity was $540 million. When you added up all the value because of the contributions of cash, because of the contributions of experienced personnel, because of the contributions and access of an experienced distribution business, the reorganized value was $540 million.

What we did is we went to the absolute maximum that we could possibly do. We gave reorganized value. After we put in all sorts of assets into the Newco, we gave that to the noteholders to show the Court that we are doing everything we can to reach the ultimate limit of what is fair value in this case.

Can you put up Indenture Trustee Exhibit 113. Mr. Greendyke said that this document showed that they had a lien on causes of action. This is a deed of trust filed at Humboldt County. You know, I don't want to go into an exercise in UCC, but the only way you can perfect a lien in causes of action is by filing a UCC statement where the company is incorporated, which is Delaware, not in Humboldt County. This is simply recording a deed of trust in a security agreement, but it does not get you causes of action. That has to be gotten in Delaware. That's the only place you can properly record it. The Indenture Trustee did not put in its UCC financing statements, to the extent they exist, from Delaware.

And they do not have a lien on tort claims. I think that's well established. I don't think that really matters because as the state has pointed out, the Court has already issued a tentative ruling that the commercial tort claims are going to get dismissed from

the Headwaters litigation in any event.

Mr. Pachulski also said, you know, let's imagine there's no Palco and there's no town and no mill, that's how you should decide this case. Well, we plainly disagree with that. I'm not going to go into the argument. We just think that that's not the proper way that you do reorganizations for a bunch of debtors that have always worked together in an integrated business.

Mr. Pachulski also said that there's no evidence of -- with respect to the Headwaters agreement. I think it's plain from his own statements that there is evidence, he just doesn't like the evidence. The evidence came from Mr. Dean, Mr. Cherner, Mr. Lumsden, Gary Clark, the pleadings, what the state has put in as exhibits. Clearly there's plenty of evidence as to the value or the lack thereof with respect to the Headwaters agreement and the Headwaters litigating stemming from the Headwaters agreement.

The fact of the matter is that if you prosecute that litigation, it's plain from Mr. Cherner's testimony and Mr. Dean's testimony that the value of the forest then goes down because you're in trouble with your regulators. So it's sort of like one goes up, the other goes down. You're not really creating any additional value. It really has no additional value to the

timberlands is really the point that Mr. Dean and Mr. Cherner both made.

Mr. Pachulski made this point about the capital markets and somehow there's going to be this great uproar if Your Honor confirms the MRC/Marathon plan. We think he is -- in Mr. Fiero's word, that's a bunch of bunk. Special purpose entities, you know, are not perfect. The ones that have employees, the ones that operate in an integrated business are not perfect. Every court recognizes that. Every court has dealt with that situation.

But we're not going under any of the caveats that exist with respect to special purpose entities. We are simply paying the indubitable equivalent of what the noteholders collateral is worth. That is not invading a special purpose entity. That's not creating a new law, that's not creating a big trouble. Your Honor may recall that the same argument about capital markets uproar was made when the Indenture Trustee said this was a single asset real asset business, Your Honor disagreed, wrote an opinion, and it was quickly affirmed by the Fifth Circuit without any of this capital markets uproar. So this is not the first time we have heard this, you know, sky is falling argument.

And you know, as to why we all can't get

along, you know, part of the problem is when we -- when we provide value, we -- and we tried everything in this case, cash, debt and equity, to satisfy the noteholders claim. All we do is we establish a floor for the noteholders. They can't do worse than us.

Okay. So they figure they'll take the shot and if they can appeal and they can do whatever they want, they can try and convince Your Honor to do something different, so they can only get better than what we have offered, in their thinking, and that's why we can't have a settlement here. They keep on asking for more more than their value because they already have their value from our offer. That's why there won't be a settlement here. And I think that concludes my remarks, Your Honor.

THE COURT: All right. Mr. Greendyke.

MR. GREENDYKE: Thank you, Judge. I am out of time, but I probably have a little bit of time probably just on the fact that I'm standing here and will talk a little bit. Really it's remarkable to hear how personal a lot of this has become. And the thought that I would mislead the Court in any way because I responded to the Court's questions about the statutes in the best way I could is kind of startling. But that aside, the court addressed a lot of the questions to the many folks

who spoke to you between the last time I spoke.

THE COURT: I don't think you deceived me in any way.

MR. GREENDYKE: Thank you.

THE COURT: So I don't think anybody -- I mean, we have -- you know, there's a way of arguing in Texas and a way of arguing in New York and a way of arguing in California, and they're not always the same. But none of them are personal, not in big cases. I mean, and no lawyer in this case, I think, has stepped over the line in terms of personal arguments. I think there have been certainly arguments, but I don't think that you should take any of the arguments in this case as being personal.

MR. GREENDYKE: I've said what I wanted to say. I've said what I wanted to say about that, Judge. You asked a lot of questions, particularly to Ms. Keller about her claims and what she would do. And she doesn't respect the noteholder group. She represents one noteholder, just as Mr. Pachulski represents a handful of noteholders. And you asked her some questions what the noteholders would do that she was unable to answer.

THE COURT: And maybe I was not fair to her. But after my beard comment, I wanted to let her know that I, you know, figured she could answer

questions, too.

MR. GREENDYKE: In particular I just want to make myself available as one of the lawyers for all of the noteholders, or at least most substantially all of them here, to answer any questions you might have, one of which was about the plan. You asked her whether or not the noteholder plan would provide for the payment of administrative claims in the event of a credit bid. And I think the general terms of the plan provide that anybody who makes a bid has to bid sufficient amount to pay off any administrative expenses.

THE COURT: How do you credit bid -- I mean, are you going to credit bid $800 million plus the administrative expenses?

MR. GREENDYKE: They have to pay the money. They have to pay the money to make that happen.

THE COURT: So you're saying if I confirm your plan, the order is going to require that the bids on the sale include either that whatever bid, cash money pays the administrative claims, and then the rest perhaps goes the bondholder if it's cash?

MR. GREENDYKE: Right.

THE COURT: If it's credit --

MR. GREENDYKE: If it's credit bid, they have to come out of the pocket to fund that. I think the

plan has --

THE COURT: Have they shown any indications that they'll come out? Okay. We've got pay them, too.

MR. GREENDYKE: There is a provision for that as well.

MR. JONES: Yes, Your Honor. I was surprised this wasn't addressed because we had insisted upon that, and I understood, as Mr. Greendyke says, that it requires that there be cash to pay me and administrative claims.

MR. GREENDYKE: That was one of the questions you posed to her, and I can't really remember what the others were. You might have asked about whether or not something would be done with credit bidding. I don't have authority to make a deal with the Court or offer anything to the Court, if you will.

THE COURT: And I think that the time for that has passed anyway, I mean, if you were going to make one. I know it's been clear that I have asked about that that for the last two months.

MR. GREENDYKE: But you've asked her questions and she didn't have the ability to answer. There were further questions about what the noteholders as a group would do. I wanted to make myself available

for that.

Again, there were many, many arguments. Actually, I think with regards to the D&F Construction case, I think the language of that case directly contradicts some of the things that Mr. Fiero was proposing in his argument. I think the court specifically says, even if you do -- and I assume that they did -- meet one of the requirements of cram down of 1129(b), that there were other considerations that still would be applied. I think he thought that Mr. Pachulski made an argument; I made that argument. I used absolute priority rule as an example. I'm the one who said that. The point is you can go beyond what 1129(b) says because that's what the Fifth Circuit says. It may not be that way in California, but in Texas that's the way it is.

Second, we talked about the 1111(b) election with regards to the plan. And we had an opportunity to make an 1111(b) election with regard to the plan that was filed way back in March. We haven't had an opportunity to make an 1111(b) election with regard to this plan. And if that's the suggestion that they're asking, I would ask the Court now on the record to give us a week to make that election because we haven't been afforded that opportunity with this new plan. And if that's the argument that's made, that we

forfeit all of our rights because we didn't make it months ago, then we need to be granted another opportunity based on the amendment that they have made. And to the extent an oral motion is required, I don't know what we'll do, but I need an opportunity to visit with my client if that's the challenge that is being made. With that, I'll sit down and yield to Mr. Pachulski.

THE COURT: All right. Mr. Pachulski, who I think, has the fastest talking.

MR. FIERO: He's also out of time, Your Honor.

MR. PACHULSKI: I apologize, Your Honor. I know other people have gone over and you're construing a statute and there have been a couple of arguments made that would lead you to misconstrue the statutes, so I'd like to start there. With respect to fair and equitable and Mr. Fiero's argument that the old absent priority rule bit the dust when the bankruptcy code was enacted. 1129(b)(2) says -- and actually, Mr. Neier put this on the screen for you -- the requirement that a plan be fair and equitable includes, and includes is not limited. Now, from that point --

THE COURT: Everybody has argued that.

MR. PACHULSKI: Well, no, but Your Honor,

but Mr. Neier reads it backwards. What Mr. Neier was saying is that it means even if you can't satisfy one of those three, you can be fair and equitable anyway. That's wrong. What it means is that these were minimum requirements. These are minimum requirements. And on top of these, there are others.

Now, how do we know that? Okay. We know that first -- and I'd like to go through the parts of our brief that Mr. Fiero did not put up on the board in his show and tell. The first part is that there's legislative history -- and I'm not going to give you the cite. It's at page, I believe, 50 of the Indenture Trustee's brief. And the legislative history refers to this as a partial codification of the absolute priority rule. That's a quote. It's a partial codification. In other words, they partially codified it, but there are uncodified elements.

Second, we cite an article from now Professor Ken Klee, who happens to be a former partner of mine. But both of those are less relevant to the fact that he was counsel to one of the congressional committees at the time the bankruptcy code was enacted. And he wrote an article where he talks about uncodified elements. And the point in that article -- and this was picked up by the court in D&F Construction -- is that

there are codified elements of fair and equitable and there are uncodified elements. Okay.

So when Mr. Fiero says that when Congress used the same words fair and equitable in a new statute they use in the code, it meant to aggregate precode law, that's just wrong. And it's wrong for two reasons. First, if Congress had intended to limit the application to the statutory factors, it wouldn't have said fair and equitable includes, it would have said a plan is fair and equitable if. And this sounds like parsing words, but if you look at the way this code was drafted, that's what they do. They say if when they want to limit it; includes when they want to expand it.

Second, Congress made clear its intent not to aggregate the old fair and equitable principles when it said these are a partial codification. Okay. And third, if you didn't intend the words to mean the same thing, you wouldn't have used the same words. If Congress didn't want to take with it all the baggage of the old fair and equitable requirement, it wouldn't have used fair and equitable. It would have just said here's the code requirements, you have to do one of these things, and it wouldn't have used those words. This was a term of art developed over decades. You don't put in a term of art into a statute and say, no, we didn't mean

it.

So where all of this leads you, Your Honor, is that because of the use of the word includes, because it's a partial codification, because they used the same words, the statutory requirements are minimum. And then you have to go beyond that to the absolute priority rule. And in addition, at page 53 of our brief, which is also not part of Mr. Fiero's show and tell, we cited a case, it's In Re Kennedy 158 Fed 589. And where the court states that -- the critical words are Congress did what it did quote "to preserve judicial application of certain fundamental precode factors to ensure fair and equitable treatment of the second class." In other words, the court recognizes there the truism that results from being in the legislative history.

THE COURT: Isn't it not true that under the act and under the code that a secured claim is defined as a claim for the value of its security? And the remainder is an unsecured claim, if you just take a claim?

MR. PACHULSKI: Your Honor, I can't speak -- it's clearly defined that way under the code. I can't speak to the way it was defined under the act. But under the act, and they use the same term equitable, the idea is not to -- is that junior classes can't get paid

where somebody has a secured interest in everything because there's strict priorities. And by the way, in the Mokava case we cited --

THE COURT: Let's go back to just -- forget the act then. I don't remember the act. Forget the act. If you split the came into the secured value of the claim -- just to make it simple for Corpus Christi, you've got this secured claim and you've got the unsecured claim. Now, absent priority or fair and equitable or all of those things don't count if you just pay the claim.

MR. PACHULSKI: That's not correct, Your Honor. I beg to differ.

THE COURT: So you think you can't just pay the claim?

MR. PACHULSKI: Your Honor, it depends. If I have a lien on everything, okay, by definition I have a mortgage on all the assets.

THE COURT: Okay.

MR. PACHULSKI: You can't say, okay, well, I find that the assets are worth $50 and so I'm going to give you $50. Even though you're owed $100, and I'm going to give $10 to the others. That's exactly what's prohibited by the absent priority rule.

THE COURT: Wait a minute. It depends

where the ten comes from. If it's really worth $50 -- if it's really worth $50, can't you pay the $50 claim and then everybody else is unsecured? And if your unsecured is treated like everybody else and somebody wants to contribute because they somehow want to reorganize this debtor and the money that can come from the value, can't you do that?

MR. PACHULSKI: Your Honor, you're presupposing there's a gift. And there's no way to find a gift here. So even if you accept that approach --

THE COURT: I'm just talking about my hypothetical.

MR. PACHULSKI: In your hypothetical, if for example, you had someone who just made a donation, maybe if somebody made an absolute donation. But to describe what happened here as a donation reminds me of the Eighth Circuit's warning many years ago that bankruptcy need not be divorced from common sense. There are no gifts here. But when counsel for Palco said it was a gift, it's not a gift, and we'll get to that.

THE COURT: I agree with you that bankruptcy should not be -- and that's why the example I was giving of the case of a large land and cattle and oil and gas company, there's a giant lien and wanting to pay off the lien at the value of the lien. And yet the money

they were getting to pay off the lien was coming from 100 percent loan with no interest for 20 years by a -- by a -- I mean, it was by a public company. Now, common sense tells you it's not worth that. It's got to be worth more than that if they're willing to lend that much money.

MR. PACHULSKI: Right. And there's a similar point here that we'll get to.

THE COURT: So where is that in this case that common sense tells you that your claim is worth more?

MR. PACHULSKI: Okay. Let me tell you how common sense gets you there. And it's not -- the question isn't what it's worth hypothetically; it's how do you allocate the value from these assets. It's been described as a purchase. Repeatedly it's been described as a purchase by Newco. Okay. Now, let's start with basics. Nobody got up and disagreed with my characterization that Marathon is getting all the value of the Palco assets. People said I was wrong on a whole bunch of things. Nobody disagrees with that.

So you start with the proposition that all the value in Palco's estate has gone to Marathon, which is very important. Okay. Now we're back to Scopac. And it's clear that 18 and a half million dollars is going to

Palco unsecured creditors. And one thing we know is it's not coming from the Palco estate because all the Palco value already is going to Marathon.

So you've been given two theories. Theory number one by counsel for Palco is that it was a gift. In other words, Newco just decided to be the tooth fairy. I mean, it's preposterous. Okay. So I'm not going to spend a lot of time on that. It's just ridiculous. Okay. Newco isn't making a gift. Now, the second theory is more interesting. What the second theory says is, well, there are these synergies, and we're giving you the benefit of the synergies.

But here's what's wrong in the argument. They only get the synergies if they buy the assets of Scopac. So what they're saying is we can get the benefit of these synergies by buying your collateral, but we're not going to give you the benefit. We're going to give it to the junior classes. We're going to give it to the Scopac unsecured creditors, Scopac administrative claims and we're going to the give it to the folks at Palco. And that's where you violate the absent priority rule because it's not a gift.

It's not something that's coming from outside the system. They don't get these synergies without getting these assets. And that's what's wrong in

the argument. And if they were to say that the synergies would --

THE COURT: But wouldn't that fly against the notion that you are a single purpose entity? I mean, if it were true that you have two corporations and the value of corporation A is $100, the value of corporation B is $100, the valuation of corporation of A and B $300.

MR. PACHULSKI: No. With respect, you're mixing apples and oranges. This is not a synergy by keeping Palco and Scopac together. The principals of MRC already operate timber for us, okay. Now, it's not clear where the synergies comes from.

THE COURT: I understand the synergy. I'm just trying to figure out where it is you're coming from. I mean, if Mendocino wants to give 18 extra million dollars to Palco, what difference does it make?

MR. PACHULSKI: But Your Honor, why are they getting it? They're getting it in order to buy the Scopac assets. That's the problem. To say, well, they can make a gift, they're buying something. Okay. And what their argument is --

THE COURT: So you think the allocation is off?

MR. PACHULSKI: The allocation is off.

THE COURT: Because Marathon gets all the

assets and then contributes them back?

MR. PACHULSKI: Marathon gets all the Palco value. That's the point. So if Marathon gets all the Palco value, whatever value is coming in here is a function of the Scopac assets. And whether it's because the Scopac assets have stand-alone value as timber or whether it's because some buyer says --

THE COURT: Why couldn't it be as a result of the Scotia and assets?

MR. PACHULSKI: That's easy. Marathon is getting those. Those go into Townco.

THE COURT: So that doesn't -- what about the --

MR. PACHULSKI: All the -- let me -- I'm sorry if I'm talking too fast.

THE COURT: It's okay.

MR. PACHULSKI: The town assets go to Townco to Marathon --

THE COURT: That's true.

MR. PACHULSKI: -- out of the system. Okay. There are only two assets that go to Newco from Palco. Asset number one is the mill working capital. That's lumber and some receivables. Marathon gets a working capital note from Newco for that precise amount. So it's clear Marathon is capturing that value. The

second thing that happens is Marathon is putting cash into Newco. And after foreclosing on the mill, to use Mr. Breckenridge's characterization, in exchange for the mill and the cash, Marathon gets equity in Newco. So at this --

THE COURT: Now, the words might mean something, and he said he foreclosed. There's no foreclosure going to go on. I mean, there's not actually going to be a sheriff's sale. They're not going to be out there on the sheriff's steps. It's going to be a transfer of all of these assets pursuant to the plan.

MR. PACHULSKI: Let me tell you one thing that's confusing, Your Honor, and I don't know why they did it this way, but it's bizarre. What the plan says is that the debtor in possession -- the debtor in possession loan and the term loan that are owned by Marathon will be transferred to Newco. I previously cited you the plan provision.

So now Newco owns the debtor in possession loan and the term loan. And then in consideration for that, they let Marathon take the Townco assets, they give Marathon some equity for the mill and some cash and they give Marathon the working capital note. And so the reason I'm a little hesitant is there's this bizarre structure where Marathon -- where Newco buys the dip

loan. And I have to assume there's a tax motive because whenever something seems stupid and I don't understand it, it's a tax motive. I don't know why. So that's the structure.

THE COURT: I'm going to assume that's true, too.

MR. PACHULSKI: But the important point that has to be taken away from this is all the value at Palco's estate is captured by Marathon. They don't make any gift to the unsecured creditors. They don't say, for example, okay, for the mill working capital we'll take a note for half the value and we'll give the other half to the Palco unsecured. They didn't do that. They took it all for themselves. And, again, Newco, a new company, not part of the system, can't get these synergies they're bragging about without getting the Scopac assets. So that's why the 18 and a half million dollars just doesn't fly. And the other reason it doesn't fly --

MR. JORDAN: May I make a request, just because we're so far off topic.

MR. PACHULSKI: I'm sorry, I'm trying to be responsive.

MR. JORDAN: I don't mean to interrupt. I just would like to know how much time so we can get an idea.

MR. PACHULSKI: About five minutes. I promise five minutes. I was trying to answer the question. I'm sorry. I'll be brief. There are only two other points, Your Honor, because I've addressed the substantive consolidation point, I've addressed the absolute priority point.

The first point is with respect to indubitable equivalent, I think it's important to note that elsewhere in the statute, they use terms like reasonably equivalent. So obviously indubitable equivalent means something more. For example, 548 as reasonably equivalent. The point I wanted to make is that indubitable means without a doubt. And whether it's dirt for debt, whether it's cash, while the standard is a preponderance of evidence, you have to find that by a preponderance of the evidence there is no doubt that fair value is -- that full value has been given that's completely compensatory. Congress could have used words like equal, they could have said reasonably equivalent; they used indubitable equivalent.

The last point with respect to the Headwaters litigation, the point was made by the state that the commercial tort claims on a preliminary judgment on the pleadings is going to be granted. The thing that also has to be recalled is that that same tentative

ruling denied the motion for judgment on the pleadings in the contract claim. The state of the record was based on the allegations, based on the tentative. This gets past motion practice. And the only other point is that it was clear from the expert's testimony that the breach of contract claim alone, the claim which survived the motion for judgment on the pleadings, itself would provide an ample predicate for the full amount of the damages.

And by the way, with respect to the quote from Judge Posner about scary allegations, this isn't just scary allegations in a complaint, this was expert testimony that was uncontradicted. They had a chance to cross-examine him. So this isn't just I know my tort lawyers put these numbers in a complaint that they just make up. This was an expert who looked at the damages and computed historical and future damages.

THE COURT: What about the -- I mean, I get the sense that this whole Headwaters lawsuit has sort of been an afterthought that here is a thing that we can hang our hat on that is not confirmable.

MR. PACHULSKI: It's more than that.

THE COURT: Perhaps that's why the trial went the way it did. But if that's the case, what about their issue that you didn't show that there was a Delaware --

MR. PACHULSKI: Okay. As far as the UCC filing, I think Mr. Greendyke mentioned -- I don't know if it's in the record or not. But either there is a UCC filing or not. Either if it was attached to the proof of claim, that's simple. If not, it's a piece of paper, it's uncontradicted. If it's not there already, we should have an opportunity to contest it. I think it may well be attached to the proof of claim.

THE COURT: What if it's not even filed?

MR. PACHULSKI: If there wasn't a filed UCC-1 in Delaware, then you will still have -- let me break it up. You won't have a -- if it's not perfected, you'll still have a best interest of creditors issue, and let me explain why. Because we still have a huge deficiency claim. And you're going to have to find that under the plan --

THE COURT: Okay. I got you.

MR. PACHULSKI: And, in fact, that argument just got better. And so for our deficiency, Your Honor, we have a lawsuit in a Chapter 7 instead of it having taken away by Newco, so we still win. I have nothing else. I'm sorry I went too long, Your Honor, but I wanted to make sure we get the statute right.

THE COURT: That's all right. Is there anybody else that wanted to -- okay. So we don't have

anything tomorrow, right? This is it. Done. The evidence is over.

MR. FIERO: Unless you want to have something.

THE COURT: No. Do we have both -- we have both the findings of facts and the conclusions of law, don't we?

MR. NEIER: Yes, Your Honor. I believe we filed them and we submitted them this afternoon on a Word disk.

THE COURT: That's fine. I think it's actually -- somebody submitted it on a little stick, and that's fine.

MR. NEIER: We haven't filed it yet, I'm told, but we --

THE COURT: When is it going to get filed?

MR. NEIER: It will be filed tonight, Your Honor. It's already been submitted to you.

THE COURT: It hasn't been filed, but it's --

MR. SCHWARTZ: It's part of the documents.

MR. HOLZER: Your Honor, this is Pete Holzer. You have it by e-mail, as does Ms. Walker.

THE COURT: Okay. I've got it right now. No problem. Anything else?

MR. JORDAN: I believe that's all on the docket today.

THE COURT: Okay. Well, thank you very much. I hope I can give justice to the hard work that you-all have done. You-all are excused.

THE CSO: All rise.

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THE STATE OF TEXAS:
COUNTY OF NUECES:

I, SYLVIA KERR, Certified Court Reporter in and for the State of Texas, do hereby certify that the above foregoing contains a true and correct transcription, to the best of my ability, of all portions of evidence and other proceedings requested in writing by counsel for the parties to be included in this volume of the Reporter's Record in the above-styled and numbered cause, all of which occurred in open court and were reported by me.

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