

Transcript of the Testimony of

Date: July 11, 2008

Case: In Re: Scotia Pacific

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

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

* * * * *

DAILY COPY
JULY 11, 2008

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On the 11th day of July, 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
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1 THE COURT: We're going to try to do this
2 by direct call here since I don't have a secretary. I
3 don't have anybody. Perhaps it will work. Hello.

4 SPEAKER: Hi, this is Jennifer from court
5 call. Let me bring counsel live for you.

6 THE COURT: Thank you.

7 SPEAKER: Counsel are connected.

8 THE COURT: Here we go. Brian Metcalf.
9 Isaac Pachulski. Do I have anybody on the line?

10 MR. PACHULSKI: Yes, Your Honor.

11 THE COURT: Start over. Brian Metcalf,
12 is Brian Metcalf going to be on the line? Anyone here
13 from Bank of America?

14 SPEAKER: Yes, Your Honor. I do not
15 believe Brian Metcalf is going to come.

16 THE COURT: Isaac Pachulski.

17 MR. WINSTON: Your Honor, this is Eric
18 Winston from Stutman. Mr. Pachulski will be joining
19 later.

20 THE COURT: Okay. That's fine. Mike
21 Neville.

22 MR. PASCUZZI: He'll be joining later as
23 well, Your Honor.

24 THE COURT: Emily Culler.

25 MS. CULLER: Good morning, Your Honor.

1 THE COURT: Jeffrey Spiers.
2 MR. SPIERS: Good morning, Your Honor.
3 THE COURT: Eric Winston.
4 MR. WINSTON: Present, Your Honor.
5 THE COURT: Shaye Diveley.
6 MS. DIVELEY: Present, Your Honor.
7 THE COURT: Todd Hanson.
8 MR. HANSON: Present, Your Honor.
9 THE COURT: Bacik.
10 MR. BACIK: Good morning, Your Honor.
11 THE COURT: Gary Clark. Nathan Rushton.
12 Heather Muller.
13 MS. MULLER: Good morning, Your Honor.
14 THE COURT: Wendy Laubach.
15 MS. LAUBACH: Present, Your Honor.
16 THE COURT: Clara Strand. Daniel Zazove.
17 Ira Herman.
18 MR. CRANE: This is Ken Crane in his
19 place, Your Honor.
20 THE COURT: Ira Herman.
21 MR. HERMAN: Present, Your Honor.
22 THE COURT: There were two different
23 people. Ira Herman?
24 MR. HERMAN: Present, Your Honor. Good
25 morning.

1 THE COURT: Okay. You just said two
2 things. I'm sorry. Matthew Barr.

3 MR. BARR: Present, Your Honor.

4 THE COURT: Dimetra Liggins.

5 MS. LIGGINS: Present, Your Honor.

6 THE COURT: Efraim Diamond.

7 MR. DIAMOND: Good morning, Your Honor.

8 THE COURT: Wei Wang.

9 MR. WANG: Present, Your Honor.

10 THE COURT: Dan Kamensky. Francine
11 Montagna.

12 MS. MONTAGNA: Present, Your Honor.

13 THE COURT: Jacob Cherner.

14 MR. CHURNER: Present, Your Honor.

15 THE COURT: Mark Worden.

16 MR. WORDEN: Morning, Your Honor.

17 THE COURT: Melissa Kahn.

18 MS. KAHN: Present, Your Honor.

19 THE COURT: Anyone else on call?

20 MS. PECHT: Yes, Joli Pecht.

21 THE COURT: All right. Thank you.

22 SPEAKER: Alan Zandam.

23 THE COURT: Okay. Anyone else? All
24 right. In the courtroom, Mr. Greendyke.

25 MR. GREENDYKE: Bill Greendyke, Fulbright

1 & Jaworski, for the Bank of New York indenture trustee
2 for the timber noteholders. I'm joined by my partners
3 Louis Strubeck, Richard Krumholz, Toby Gerber, and Zack
4 Clement.

5 THE COURT: All right. Certain
6 noteholders.

7 MR. DAVIDSON: Good Morning, Your Honor.
8 Jeffrey Davidson, Stutman, Triester & Glatt for certain
9 noteholders.

10 THE COURT: All right.

11 MR. GIBBS: Good morning, Your Honor,
12 Jeff Gibbs, Akin, Gump, Strauss, Hauer & Feld on behalf
13 of CSG Investments and its affiliates.

14 THE COURT: All right. Various
15 committees.

16 MR. FIERO: John Fiero and Max Litvak
17 with the committee.

18 THE COURT: All right. Marathon.

19 MR. PENN: John Penn, David Neier and
20 Steven Schwartz on behalf of Marathon.

21 THE COURT: All right. Mendocino.

22 MR. BRILLIANT: Alan Brilliant and Brian
23 Hail on behalf of Mendocino.

24 THE COURT: Okay. Scopac.

25 MS. COLEMAN: Good morning, Your Honor.

1 Kathryn Coleman, Eric Fromme, Gibson, Dunn & Crutcher
2 for Scopac.

3 THE COURT: And Palco.

4 MR. McDOWELL: Good morning, Your Honor.
5 Luckey McDowell with Baker Botts on behalf of Palco.

6 THE COURT: And for the Trustee.

7 MR. STERBACH: Charles Sterbach for the
8 United States Trustee, Your Honor.

9 THE COURT: And California.

10 MR. PASCUZZI: Good morning, Your Honor.
11 Paul Pascuzzi for the California State Agencies. And
12 Michael Neville from the Attorney General's office will
13 also be on the phone.

14 MR. McDOWELL: Your Honor, one very quick
15 announcement. At the beginning of yesterday's hearing,
16 we did submit a 9019 order. The Court did sign it. The
17 indenture trustee asked for an opportunity to review it.
18 I have confirmed that the indenture trustee had reviewed
19 the order and it's acceptable to them, subject to, of
20 course, they're not waiving any underlying objections.

21 THE COURT: All right. Thank you. All
22 right. Where are we on exhibits?

23 MR. KRUMHOLZ: Your Honor, the parties, I
24 believe -- and correct me if I'm wrong -- have agreed
25 that all exhibits are admitted other than the following.

1 And tell me where I'm wrong here. The Red Emerson and
2 the other affidavits that have been submitted from folks
3 who are not here to testify, they have objected to as to
4 hearsay. And I would like to take those up at the end
5 of the day because I think some of those issues will be
6 worked out either through testimony or agreement.

7 THE COURT: Okay. Well, you know, a stay
8 pending appeal is more like a TRO preliminary injunction
9 hearing, I think, than it is like a confirmation
10 hearing. And so I'm going to admit the documents
11 because I think I could admit affidavits without
12 hearing. So the weight to be given to them, I think
13 there's an issue there about whether or not -- you know,
14 what the impact to others are. But I think -- I haven't
15 heard your side, but go ahead, see if you can convince
16 me otherwise. But I think I will admit those.

17 MR. NEIER: Good morning, Your Honor.
18 David Neier on behalf of Marathon. I think
19 Mr. Brilliant advised yesterday that we asked for a
20 deposition of these people and they refused to be --

21 THE COURT: I know. I think that goes to
22 the weight to be given that document, I agree. But I
23 still think I should probably consider those documents.
24 In a TRO hearing, you wouldn't know at all what --
25 because it could be done on an ex parte basis. Now, I

1 don't think that -- I don't think that a stay pending
2 appeal could be done on an ex parte. That's not what
3 I'm saying. I'm just saying that even in a preliminary
4 injunction hearing, I think in a preliminary injunction
5 hearing, I'm not required to hear a single live witness.

6 MR. NEIER: Right. But as to weight, we
7 will say if they refused to appear for deposition and be
8 cross-examined means that very little weight should be
9 accorded, if any.

10 THE COURT: And I'll decide that. You
11 can argue about that in argument.

12 MR. HAIL: Your Honor, I also had a lot
13 of dialogue with Mr. Emerson's counsel about him
14 appearing for a deposition and showing up. The reason
15 he's not showing up is his point is he has nothing to do
16 with this proceeding. His affidavits relate to an issue
17 that's the 336 sale. And in their words, they have
18 nothing to do with this proceeding. There's no
19 relevance of what they say.

20 THE COURT: I don't think that -- I mean,
21 that may be his ruling about relevance.

22 MR. KRUMHOLZ: That's not what I'm
23 saying.

24 THE COURT: I think there's some
25 relevance as to whether or not there was something else

1 out there. But if for no other reason, to cut down on
2 the amount of the bond. But I think there's some
3 relevance. I think he's wrong to not sit for his
4 deposition. I think he has -- I mean, the mere fact
5 that he thinks it doesn't have anything to do with this
6 doesn't mean that he can't -- doesn't have to sit for a
7 deposition. The normal way you don't sit for a
8 deposition is you get an order or whatever. All right.
9 Let's move on.

10 MR. KRUMHOLZ: The only other issue, Your
11 Honor, is that we have an objection to -- is it Exhibit
12 B -- is Exhibit B to Mr. Johnston's proffer. It
13 contains a report of Cushman and Wakefield that we don't
14 believe it was produced to us ever in litigation. We
15 have also a hearsay objection. We understand Your
16 Honor's issues in that regard as well. But those are
17 the issues before the Court.

18 MR. NEIER: Well, first of all, I don't
19 know how you can make a hearsay objection to an expert's
20 report. It's just baffling to me. Putting that
21 aside --

22 THE COURT: You can't introduce an
23 expert's report without the expert in a normal trial.

24 MR. NEIER: The expert is here and he's
25 ready to testify. But putting that aside, every single

1 item in the report is footed to a document that's been
2 admitted in this court. The one exception to that is
3 Cushman and Wakefield's report, which is not our report,
4 it's the debtor's report, on Palco's assets. And they
5 did submit that report, but they withdrew it because
6 Palco settled with us.

7 So the indenture trustee is incorrect.
8 They do have the report. If they don't have the report,
9 I'd ask the debtor Palco to send it to them. And all we
10 did was take the average of the two reports. They're
11 almost indistinguishable in numbers, so the difference
12 is marginal at best. So we'll make that the debtor --
13 or we'll ask the debtors to produce that report. We
14 also have a copy.

15 THE COURT: And what's the relevance of
16 that report?

17 MR. NEIER: All we're trying to do is
18 establish the going concern value of Palco and the
19 liquidation value of Palco, so we took the two experts
20 that opined -- the two real estate appraisals that
21 opined on the value of Palco and we averaged them just
22 to come up with, you know, an undisputed number. And
23 that way we can establish what we think, if Your Honor
24 is inclined to set a bond, what the amount of the bond
25 should be, going concern less liquidation value, similar

1 to the Trans Texas and other rulings that have been
2 made.

3 MR. GERBER: Let me just add, Your Honor,
4 what they're doing is it's not the expert who gave this
5 report who's in court today. It's their expert who is
6 relying on another expert report that's not in evidence.
7 That witness is not available in court today. The
8 report that they're using, they're trying to use that to
9 bootstrap a higher value.

10 MR. NEIER: No.

11 MR. GERBER: Well, you are because the --
12 well, as the evidence will come out --

13 THE COURT: Higher value for liquidation?

14 MR. GERBER: Higher value for the going
15 concern value for Palco. And what they've done is, at
16 least in the brief, they have argued it's undisputed
17 that it's \$110 million. But if you look at this report
18 that's hearsay, it's really much higher. Okay. And
19 that's -- that's their argument. So all I'm saying is
20 that portion of the expert report about to be admitted.
21 Or at the very least, you should not give it very much
22 weight.

23 THE COURT: Well, I think I can determine
24 what weight to be given.

25 MR. GERBER: And that's fine with us,

1 Your Honor.

2 THE COURT: I'll admit the document.

3 MR. NEIER: Thank you. And we're going
4 to put the witness on in any event, so that would help
5 you in determining weight.

6 THE COURT: What is Mr. Holzer standing
7 for?

8 MR. PENN: Because he hasn't had a chance
9 to sit down. John Penn on behalf of Marathon. Just to
10 also clean up, our exhibits for this hearing are the
11 continuation from last week's hearing. And so we're not
12 adding anything except what Mr. Holzer is going to do.
13 So whatever was admitted last week.

14 THE COURT: Last week of what hearing?
15 At the administration claim hearing?

16 MR. PENN: Yeah, at the administrative
17 claim hearing.

18 THE COURT: So you want to admit the
19 documents that were admitted in the administrative claim
20 hearing in this hearing?

21 MR. PENN: Right. Correct.

22 THE COURT: Any objections to that?

23 MR. PENN: Based on the same reservation
24 that we'll read into the record in a minute.

25 THE COURT: And that's what you agreed

1 to?

2 MR. PENN: From the last hearing carrying
3 them forward.

4 MR. KRUMHOLZ: Well, you've already said
5 that the record from the previous hearing is part of
6 this hearing.

7 THE COURT: I think that on a stay
8 pending appeal, I can consider the entire record of
9 bankruptcy. In fact, I think I'm supposed to consider
10 the entire record. But we can argue about that. And I
11 know that's not a thing that litigators are used to, but
12 in bankruptcy that's sort of one of those things.

13 MR. KRUMHOLZ: I'm getting used to it.

14 THE COURT: We'll look at anything that
15 has happened if I'm wrong. So go ahead.

16 MR. KRUMHOLZ: Your Honor, Mr. Penn is
17 about to -- all of what I just indicated was subject to
18 a statement.

19 THE COURT: Okay. Let's hear it.

20 MR. PENN: And that is that by so
21 stipulating, the parties do not concede the truth,
22 reliability or relevance of the information contained in
23 every admitted exhibit and reserve the right to argue
24 the truth, reliability and relevance of any exhibit, as
25 well as the weight the Court should afford any exhibit.

1 This reservation of rights includes a reservation of
2 argument that an exhibit should be given no weight
3 because it is hearsay in whole or in part.

4 THE COURT: Okay. Thank you.

5 MR. PENN: Which is the continuation of
6 the same stipulation from back in May 1 as well.

7 THE COURT: All right. Mr. Holzer.

8 MR. HOLZER: Your Honor, there's the
9 multi-party exhibit list that I've handed up, Exhibits 1
10 through 12. I think we've agreed that 5 and 6, which
11 are cases, are not being offered for anything but
12 judicial notice. And then there was an objection. I'm
13 not sure if it is worked out yet from the indenture
14 trustee to the -- I believe Exhibit A to the Johnston
15 proffer. I don't know if that's been resolved. I think
16 it's a hearsay objection.

17 MR. KRUMHOLZ: Exhibit B. And we just
18 resolved it. Your Honor, just for the record, Exhibits
19 1 through 200 on the IT list for this hearing are
20 admitted, and I just want to make that clear.

21 THE COURT: Right.

22 MR. HOLZER: And I have copies to
23 supplement, hard copies to supplement.

24 THE COURT: I think I've admitted all the
25 documents that have been submitted, plus the documents

1 from the previous hearings, subject to the stipulation
2 that was read into the record. All right.

3 MR. HOLZER: And, Your Honor, from
4 yesterday, the order approving the Maxxam-Palco
5 settlement, Mr. Greendyke informed me that he has no
6 objection to the form.

7 THE COURT: I heard that. And I signed
8 it yesterday, and I don't even see it on my guess. So
9 my guess is --

10 MR. HOLZER: I have a fresh copy. We
11 have a fresh copy.

12 THE COURT: We don't ever lose things. I
13 know that she has it. So you may now enter it.

14 MR. HOLZER: Thank you, Your Honor.

15 MR. PENN: Your Honor, that would be
16 Exhibits MMX 89 through MMX 212 for ours.

17 THE COURT: Okay.

18 MR. PENN: Those are from the 507(b)
19 forward exhibits.

20 MR. KRUMHOLZ: I don't recall which ones
21 were admitted in the 507(b) context, frankly, as we sit
22 here right now.

23 THE COURT: Well, I'm not admitting
24 something that wasn't admitted --

25 MR. KRUMHOLZ: Okay.

1 THE COURT: -- in the 507(b) context.

2 Yes, sir.

3 MR. HOLZER: Your Honor, as I mentioned
4 at the close of the hearing yesterday, we filed a motion
5 to approve Palco's pension plan payment that's due next
6 Tuesday last night. There are no objections from the
7 committee, from Marathon or MRC. And this is like the
8 fifth time we have done this. You found that's
9 appropriate under the ordinary -- under the necessity of
10 payment doctrine in the past.

11 THE COURT: What about the IT?

12 MR. HOLZER: They have no standing.

13 MR. GREENDYKE: I agree.

14 THE COURT: All right. Next witness is
15 Mr. Young.

16 MR. KRUMHOLZ: No. Actually, Your Honor,
17 we're calling Hughey Long.

18 THE COURT: Okay. Hughey Long, come
19 forward.

20 HUGHEY LONG,
21 having been duly sworn, testified as follows:

22 DIRECT EXAMINATION

23 BY MR. KRUMHOLZ:

24 Q. Mr. Long, could you go ahead and state your
25 full name.

1 A. My full name is Henry Sodoth Long, Jr. Hughey
2 is a nickname.

3 **Q. And you go by Colonel Long or Mr. Long? I**
4 **understand that you were in the military at one time.**

5 A. That's correct. Both. Either.

6 **Q. Either. I'll call you Colonel in just a**
7 **second, or I may just interchange from time to time.**
8 **Could you give us your educational background, Mr. Long.**

9 A. Yes, I'm a graduate of Auburn University in
10 forest management and some additional courses in real
11 estate attending State Technical University, and then
12 the Commanding General Staff College in the United
13 States Army.

14 **Q. Are you currently an officer of Palco?**

15 A. I am.

16 **Q. All right. And how long have you been an**
17 **officer of Palco?**

18 A. Late February 2006.

19 **Q. What is your -- what are your responsibilities**
20 **as an officer of Palco?**

21 A. As vice president of operations, I have
22 obviously the sawmill manufacturing facilities, which
23 includes the planner and the fence plant, the power
24 plant, the harvesting operations, which is part of the
25 procurement operations, as well as road construction,

1 safety and fleet management.

2 **Q. Now, prior to working at Palco, how many**
3 **sawmills have you worked for?**

4 A. Basically four.

5 **Q. Which ones are those?**

6 A. I started with East Brainerd Company in
7 Chattanooga, Tennessee. I went to Tolleson Lumber
8 Company in Coleman, Alabama. Then Boise Cascades in
9 Jackson, Alabama. And then I came to California with
10 Palco as the director of sawmill operations. And at
11 that time we had three sawmills, which have since been
12 consolidated into one.

13 **Q. Do you also have some experience in connection**
14 **with forest and timberlands, operating forest and**
15 **timberlands?**

16 A. Yes, very much. My degree is in forest
17 management, and my primary responsibilities as the first
18 two mills were in timber management and procurement.

19 **Q. When did you first become employed by Palco**
20 **approximately?**

21 A. July the 8th, 2002.

22 **Q. So you've been with them approximately six**
23 **years?**

24 A. Six years. That's correct.

25 **Q. Are you the person who runs Palco on a**

1 **day-to-day basis as to the assets that you described**
2 **just a moment ago?**

3 A. That's correct.

4 Q. **Is there anyone more knowledgeable than you**
5 **about the sawmill at Palco in terms of its operations,**
6 **its profitability, and how it works on a day-to-day**
7 **basis?**

8 A. In a broad sense, as far as understanding the
9 relationship between all the different entities, I would
10 say that I am.

11 Q. **Do you operate the mill on a day-to-day basis?**

12 A. Yes.

13 Q. **Are you the lead person in that regard on the**
14 **ground?**

15 A. No.

16 Q. **Okay. But do you supervise the lead person in**
17 **that regard?**

18 A. Yes.

19 Q. **Okay. And are you -- let me ask you this.**
20 **There was a comment yesterday by Mr. Litvak that why**
21 **don't we call Mr. O'Brien to talk about the sawmill and**
22 **the cogen plant, etcetera. Do you have more knowledge**
23 **about the operation than Mr. O'Brien about the sawmill?**

24 A. I would have to speculate. I don't know how
25 much he knows about the operations.

1 Q. You work with Mr. O'Brien?

2 A. That's correct.

3 Q. How many times has he visited the sawmill over
4 the past two years, let's say, to assess the performance
5 of the sawmill?

6 A. I could only answer to those times that I
7 accompanied him and that I knew that he was there. And
8 I would say five or six.

9 Q. Have you felt as though he has not given the
10 attention to the sawmill that he should as CEO of Palco?

11 A. I couldn't speculate as to what he should. He
12 has given me fairly wide ranging latitude in the
13 operations arena, so I don't know how to quantify what
14 he should.

15 Q. Do you have meetings with the officers of
16 Palco and Scopac routinely?

17 A. I do, yes.

18 Q. Do you have meetings over time with the senior
19 management of Scopac and Palco over time?

20 A. Yes.

21 Q. Do you routinely communicate with officers of
22 both companies?

23 A. Yes.

24 Q. Do you bring up issues or concerns that
25 significantly impact the company during those meetings?

1 A. Yes.

2 Q. Do you participate in the preparation of the
3 Palco forecasts and budgets, provide information that is
4 used in connection with those budgeting issues?

5 A. I or my staff.

6 Q. So you supervise those issues?

7 A. That's correct.

8 Q. And do you review them for accuracy from time
9 to time?

10 A. Yes, I do.

11 Q. And do you assure yourself that they're as
12 reliable as they can be in terms of making sure the
13 right people are doing the right things based on the
14 correct information?

15 A. I am not an accountant, but, yes, I do that to
16 the best of my ability.

17 Q. You determine how Palco can become profitable
18 or more profitable, if possible; that's something you
19 attempt to do?

20 A. Yes.

21 Q. That's an issue high in your mind in
22 connection with your job?

23 A. There is nothing any higher.

24 Q. And you try to assess how they can become more
25 cash flow positive or to become cash flow positive?

1 A. Yes.

2 Q. And that's something near and dear to your
3 heart, I assume, in connection with the mill?

4 A. Yes. Yes, it is.

5 Q. And so you review these budgets forecasts and
6 other similar documents in connection with your work at
7 Palco and actually have input into them?

8 A. Yes.

9 Q. Okay. And that's routinely done by you; is
10 that accurate?

11 A. The review part is certainly routine, but I
12 have a business manager who works with Gary Clark and
13 works with the accounting staff, and they do the
14 details.

15 Q. If during the pendency of any appeal in this
16 case -- and you understand the context of what the Court
17 is assessing here in this courtroom during this hearing,
18 do you not?

19 A. Yes, I do.

20 Q. Whether or not to grant a stay pending appeal
21 and the issue of continued operations of Palco and
22 Scopac?

23 A. Yes.

24 Q. Okay. During the pendency of any appeal or
25 stated differently over the next 6 to 12 months, if

1 Scopac gives Palco 5 million board feet per month of
2 logs without requiring them to pay for their logs, can
3 you and the rest of Palco's management run Palco
4 profitably?

5 A. I couldn't speculate without looking at what
6 the current budget numbers look like relative to the
7 total expenses involved.

8 Q. Do you believe, given that hypothetical, that
9 you could keep running Palco from an operational
10 perspective as it currently runs through the end of
11 December 2008, if you were given 5 million board feet of
12 logs without the requirement of having to pay for them?

13 A. Yes.

14 Q. Okay. And can you and the rest of your senior
15 management run Palco in the same manner and maintaining
16 the same operations under that hypothetical through
17 December 31, 2008?

18 A. Yes.

19 Q. Okay. Do you have any doubt about that?

20 A. No.

21 Q. I want to talk to you about some things that
22 Mr. O'Brien has stated in his declaration. Have you
23 seen that document by chance?

24 A. Yes, I have.

25 Q. Okay. I'm going to ask you about certain

1 things that have been stated. In paragraph 8, it
2 states: "If Marathon/MRC plan is confirmed and a stay
3 of the confirmation order is granted, Palco would have
4 no choice but to close down mill operations
5 immediately." Do you see that on the screen?

6 A. Yes.

7 Q. If Palco is given 5 million board feet per
8 month of logs by Scopac without requiring any payment
9 for those --

10 MR. McDOWELL: Your Honor, I have an
11 objection. I would like him to please finish reading
12 the entire sentence under the doctrine of completeness.
13 He can't stop half --

14 THE COURT: The entire sentence is
15 already in --

16 MR. McDOWELL: Thank you, Your Honor.

17 THE COURT: -- so I've already read it.
18 Continue on. If we had a jury, I'd make him read the
19 whole thing, but I can read it much faster.

20 MR. McDOWELL: It's a fair objection,
21 Your Honor, and I --

22 THE COURT: I understand, though, and I
23 have directed him to be more concise in this hearing.

24 MR. McDOWELL: Yes, Your Honor.

25 THE COURT: He's following my advice and

1 direction. Go ahead.

2 Q. (By Mr. Krumholz) If indeed Scopac is going
3 to give 5 million board feet of logs to Palco without
4 requiring repayment, do you agree with that statement?

5 A. I did not know about the possibility of a
6 change in our log pricing when I read this document.

7 Q. Now, I understand that. I'm not fussing at
8 you as to whether it was right or wrong when it was
9 filed, whether you had knowledge of it. That's not
10 where I'm going.

11 I'm just wondering now that you know what we
12 have told you in court and what you've seen probably in
13 Mr. Young's affidavit or the declaration -- have you
14 read that affidavit?

15 A. Yes.

16 Q. Okay. Do you believe this statement is true
17 under those conditions?

18 A. Under those conditions, I do not believe that
19 statement is true.

20 Q. Mr. O'Brien suggests key personnel will leave
21 Palco. Do you believe that you will be able to keep key
22 personnel to maintain the status quo in terms of
23 operations through at least December 31, 2008 with the
24 assumption that this 5 million board feet of logs is
25 going to be delivered without any requirement to repay

1 **it?**

2 A. I don't have direct control over the reasons
3 that people have left. I am very confident in the cross
4 training that we have done that we will continue to
5 operate at status quo or better with the personnel that
6 we are able to retain.

7 **Q. Do you believe there will be any significant**
8 **interruptions in business if the 5 million board feet of**
9 **logs is given without any requirement to repay other**
10 **than th roads and reforestation offset?**

11 A. Well, again, I would have to look at the
12 complete budget analysis to see what, if any, other
13 costs there might be. But just on the face of the
14 provision of the logs, I would think there shouldn't be
15 an interruption of service.

16 **Q. Mr. O'Brien suggests that many people will be**
17 **without employment if there is a stay pending appeal.**
18 **Do you believe that would be the case if Palco got 5**
19 **million board feet of logs for free?**

20 A. You'll have to excuse me, but I think that
21 that's the same answer.

22 **Q. Well, a lot of people will be out of business.**
23 **I think it's because he's assuming the mill will close**
24 **down, and you don't think that will happen if 5 million**
25 **board feet are given, correct?**

1 A. Correct.

2 **Q. Okay. He also suggests that the cogen power**
3 **will be shut down if there's a stay pending appeal. Do**
4 **you believe that's the case if the 5 million board feet**
5 **of logs are delivered without requirement of repayment?**

6 A. If we're talking about status quo.

7 **Q. Yes.**

8 A. Then as long as the sawmill is operating and
9 generating fuel, the power plant would be able to
10 continue to operate.

11 **Q. And then he talks about some sort of net for**
12 **megawatt -- net decrease of available power in**
13 **California state electrical grid in the declaration.**
14 **Obviously that presumes also that the mill closes down.**
15 **Does that issue go away under our proposal?**

16 A. The contract that we have with PG & E is
17 extremely broad. There are a number of variables.
18 Again, from the standpoint of status quo, I would not
19 think that to be the case. But I couldn't say so
20 positively.

21 **Q. You couldn't say so with 100 percent**
22 **certainty. You're reasonably certain; is that fair?**

23 A. That can change if we were running three
24 shifts or whatever. My point is that the way the
25 agreement is with PG & E, they can ask for or not accept

1 exported power. So as far, again, as status quo goes, I
2 would think that there would not be a drain on the PG &
3 E grid.

4 Q. Let me make sure I understand. The status quo
5 would be maintained if you got the 5 million board feet
6 of logs with respect to the cogen plant, PG & E, and any
7 issue of this four -- net four megawatt against the
8 California state grid, be in the same position as they
9 are today?

10 A. Exactly. Exactly.

11 Q. And whatever the contracts are, they are?

12 A. Yeah. It could change, and it wouldn't have
13 anything to do with what we run or not.

14 Q. And Mr. O'Brien suggests that elementary
15 schools and hospitals and factories and manufacturing
16 plants and other facilities will close down and people
17 will be out of work and the town of Scotia and the
18 county of Humboldt will be significantly impacted by
19 taxes. All of those issues are all in your mind
20 contingent on whether the mill is able to stay open as a
21 status quo; correct?

22 A. That is correct.

23 Q. And those are the issues as long as the status
24 quo is maintained?

25 A. Yes.

1 **Q. And you believe the status quo can be**
2 **maintained under our proposal?**

3 A. If it is your proposal to provide 5 million
4 feet of logs per month, then yes.

5 **Q. Okay. He also talks about water treatment and**
6 **sewage treatment at the town. Are the same answers**
7 **applicable to those issues or concerns that he expressed**
8 **in his affidavit?**

9 A. I am not responsible for the sewage treatment
10 plant and the water facility, water purification
11 facilities. It all ends up being a factor of the status
12 quo, the availability. But I couldn't speculate
13 specifically. But the infrastructure requirements are
14 pretty well fixed.

15 **Q. I think I understand what you're saying. You**
16 **don't -- you're not overseeing those particular issues,**
17 **but as long as the status quo is maintained generally,**
18 **there's no reason to think that the water treatment**
19 **plant or the sewage treatment plant will be impacted?**

20 A. Yes.

21 **Q. Okay. He suggests the volunteer fire**
22 **department would somehow be impacted. Would they if**
23 **this 5 million board feet were provided, to your**
24 **knowledge?**

25 A. I just don't know.

1 Q. Do you know of any reason to believe that?

2 A. No, I do not.

3 Q. He talks about vendors or critical vendors in
4 connection --

5 A. Excuse me, let me -- the volunteer fire
6 department is a volunteer fire department.

7 Q. Fair enough.

8 A. So it would be up to the volunteers to
9 volunteer. So it's going to --

10 Q. Do you have any reason to believe that if they
11 were continuing operations at -- status quo operations,
12 that key personnel at the fire department would somehow
13 flee?

14 A. I could only speculate, but I think that if
15 they -- if the volunteers are employees of either the --
16 of the operations division, which most of them are, then
17 as long as there's work, they live there; and as long as
18 they live there, they're likely to volunteer being in
19 the fire department.

20 Q. You don't have any reason to believe that
21 vendors would not be paid or refuse to work if the
22 status quo was maintained with these 5 million board
23 feet, true?

24 A. Yes, that is true.

25 Q. Have you heard of any indications at joint

1 management meetings that you had with Scopac or Palco
2 senior management or officers that critical vendors are
3 at risk? Mr. Barrett says he's been at these and has
4 offered a proffer that suggests that hasn't occurred.
5 He hasn't heard that. Have you heard that?

6 A. Bankruptcy -- and I assume there's some
7 bankruptcy experts here in the room -- brings on a lot
8 of conditions just because of the nature of the
9 bankruptcy. So we have had issues with vendors. We
10 have not been unable to get any of the parts and
11 supplies that are needed. And obviously the operations
12 division uses the bulk of items purchased through
13 vendors.

14 Q. Do you have any reason to believe that you
15 wouldn't be able to get those parts and services of
16 those goods and services if the -- if you were able to
17 maintain the status quo?

18 A. I don't have any reason to believe that, but
19 it's still speculative because I don't know how a vendor
20 would look at a stay. I mean, if they would understand
21 it, know what it means or, you know, change their terms,
22 I don't know.

23 Q. No one has come to you and said under those
24 conditions study this, figure it out?

25 A. No.

1 Q. And you haven't done so, right?

2 A. No one has come to me; that is correct.

3 Q. And to your knowledge, no one else has done so
4 at Palco who understands the goods and services required
5 during the stay period?

6 A. That's correct.

7 Q. So we have no reason and no evidence to --
8 here in the courtroom to suggest that critical vendors
9 would somehow flee, particularly in light of the fact
10 that during the bankruptcy they haven't; is that fair?

11 A. I'm trying to figure out where the question
12 was. Yes, it's fair. I don't have any reason to
13 believe we would not be able to continue to get the
14 parts and supplies that we need to operate.

15 Q. Mr. O'Brien's declaration mentions
16 environmental obligations somehow would not be
17 fulfilled. I think that's also conditioned on the mill
18 closing. If the 5 million board feet provided and the
19 mill didn't close, continued to operate as is, do you
20 have any reason to believe that the environmental
21 obligations would not be met?

22 A. Certainly not as they apply to the operations
23 division.

24 Q. As to Scopac issues, whether Scopac would be
25 harmed, who is the best person in this courtroom to

1 **answer those questions under this scenario, in your**
2 **mind?**

3 MR. BRILLIANT: Well, Your Honor, I'm
4 going to object. I don't know if Your Honor noticed,
5 but Mr. Krumholz pointed to Mr. Barrett. I think it's
6 inappropriate for counsel to be coaching the witness.

7 THE COURT: Don't coach the witness. No
8 pointing in the courtroom.

9 MR. KRUMHOLZ: I admit to pointing, Your
10 Honor. I thought I could lead.

11 **Q. (By Mr. Krumholz) Is Mr. Barrett -- without**
12 **pointing to him, is Mr. Barrett the person who is most**
13 **knowledgeable about any harm to Scopac under the**
14 **proposal by the IT in terms of these 5 million board**
15 **feet and the DIP loan that's been discussed, in your**
16 **mind?**

17 A. Again, I think the question is who would I go
18 to to get the best information about Scopac. I would go
19 to Dr. Barrett.

20 **Q. Is he a reliable source?**

21 A. He is a reliable source.

22 **Q. Do you feel like that you and Mr. Barrett**
23 **employ diligent, knowledgeable, competent people at**
24 **Scopac and Palco to continue operations during this stay**
25 **period?**

1 A. Absolutely.

2 **Q. Do you have full confidence in both Scopac's**
3 **senior management in the form of Mr. Barrett and you and**
4 **your senior management at Palco?**

5 A. Yes.

6 **Q. Now, I want to show you some clips from**
7 **Mr. O'Brien's deposition and ask you some questions**
8 **about that.**

9 MR. KRUMHOLZ: Let's go ahead and play
10 clips 2 and 3.

11 (Clip is played as follows:)

12 "Have you had any conversations with any
13 MRC representatives about their plans for the mill or
14 for Palco generally?

15 No, I haven't. I have tried very hard
16 not to.

17 Have you heard any rumors in terms of
18 what they intend to do with the mill or Palco generally?

19 The only thing I've heard is what they've
20 said in public forums, you know, about their own plans,
21 you know, what they've made public."

22 (End of clip.)

23 **Q. (By Mr. Krumholz) Sir, those were not true**
24 **statements on June 24th, 2008 that Mr. O'Brien swore to**
25 **under oath, were they?**

1 A. I don't know exactly when and where and to
2 what extent he's had conversations with MRC.

3 **Q. You have been present with Mr. O'Brien in**
4 **discussions with MRC employees and officers, true?**

5 A. True.

6 **Q. And in fact, Mr. O'Brien had discussions with**
7 **Mr. Higginbottom in your presence about transition**
8 **planning that MRC was proposing?**

9 A. Not to my -- no, he did not.

10 **Q. Tell me about the discussions that you did**
11 **have with MRC representatives with Mr. O'Brien.**

12 A. I have met with MRC representative, Richard
13 Higginbottom particularly, on three specific occasions
14 beginning, I think, January the -- we had a session
15 there at the mill where everybody showed up, all the
16 different sides. I don't recollect George O'Brien being
17 with me when I was with Richard Higginbottom.

18 **Q. Did you communicate to Mr. O'Brien that those**
19 **meetings occurred?**

20 A. Yes.

21 **Q. So when he says -- when I asked him "have you**
22 **heard any rumors of what they intend the do with the**
23 **mill or Palco generally," did you tell them what they**
24 **said in that regard?**

25 A. Yes.

1 Q. And so when he says he hadn't heard anything
2 other than what's been public, that wasn't true in June
3 of 2008; you had told him?

4 A. That is correct.

5 Q. Okay. What other meetings and discussions
6 have you had with MRC since January of 2008 about
7 transitioning?

8 A. I have had a couple of telephone conversations
9 with Richard Higginbottom in general terms about
10 planning for transition. And then I discussed those
11 with Mr. O'Brien, and he said that he was going to
12 handle the transition planning. The other meetings with
13 Richard Higginbottom were very specifically tours of the
14 facility and where we walked around, looked at the
15 different things. They made different observations
16 about changes they would like to make and stuff like
17 that.

18 Q. And those were meetings that occurred prior to
19 June of 2008, correct?

20 A. Yes.

21 Q. And those were specifically communicated to
22 Mr. O'Brien prior to June of 2008?

23 A. Yes.

24 Q. And you discussed in full detail to your CEO
25 as to what they were intending in terms of transition

1 **planning?**

2 A. Well, I still don't know exactly what MRC's
3 operational plan is, but everything that we did and
4 everything that we discussed, whether that is actually
5 the plan they're going to do or if it is some part of an
6 evolution of a plan. But all those conversations were
7 discussed with Mr. O'Brien.

8 Q. I know you've been focusing on
9 Mr. Higginbottom in particular because of my questions.
10 But I want to know about all conversations that you have
11 had with MRC or Marathon representatives about
12 transition planning.

13 A. Talked with Sandy Dean probably the first time
14 right after the confirmation hearing. He asked -- and I
15 called to congratulate and wish him well and so forth.
16 I told him that I was in a situation where I needed to
17 be out of town the following week. They talked about
18 coming up, making the visit and so forth. He said that
19 wasn't any concern of -- he said I needed to talk to
20 Richard Higginbottom and find out if there was any type
21 of coordination or anything like that that would be
22 required. Richard called me, as I recollect -- and I
23 really don't remember exactly what the dates were. I
24 probably could figure it out backing up. But then I
25 talked with Richard earlier in the week. He said that

1 he was going to be coming, that he would be bringing
2 John Russell and several of his mill staff, which he
3 did. I brought my staff together, and we met, and we
4 discussed various issues and so forth, again, as to the
5 operating condition status and so forth. And then we
6 walked around and looked at some of the physical
7 equipment locations and discussed plans in a very
8 general -- I'm saying in a general sense.

9 **Q. Did you communicate those to Mr. O'Brien?**

10 A. Yes.

11 **Q. And were there other meetings or visits?**

12 A. Not that I can recollect.

13 **Q. Was Mr. -- did Mr. O'Brien, in your presence,
14 meet with any MRC representatives?**

15 A. Like I said, I do not remember Mr. O'Brien
16 being with me -- excuse me. January the 8th when we had
17 all of the attorneys at Palco to look and various
18 consultants and clients and so forth, he was at that
19 meeting. And Richard Higginbottom and John Russell and
20 all kinds of other people were there. So he was at
21 that -- that meeting on January 8th.

22 **Q. Did they tell you -- did the MRC
23 representatives tell you what investments they intended
24 to make or not make into the mill?**

25 MR. LITVAK: Objection, Your Honor.

1 First that's hearsay. And second of all, I'm at a loss
2 at to how this is relevant to issue a motion for stay of
3 appeal.

4 MR. KRUMHOLZ: I'll be happy to respond,
5 Your Honor.

6 THE COURT: I don't think it's hearsay,
7 but why is it relevant?

8 MR. KRUMHOLZ: It's relevant, Your Honor,
9 because I believe we can demonstrate -- Your Honor is
10 concerned about MRC walking. And I think that we can
11 elicit testimony from this witness about, A, what the
12 impact is of their plan in this witness's mind as the
13 Palco operations manager and whether -- and how that
14 impacts the decision in that regard. I think it will
15 become very relevant shortly, but I have to lay the
16 foundation.

17 THE COURT: Okay. Go ahead.

18 Q. (By Mr. Krumholz) Mr. Long, did they tell you
19 about what they intended to do -- and I know you don't
20 know specifically. They said one thing, I guess,
21 publicly. They've made some comments to you about what
22 they intend to do. But did they tell what they intend
23 to do in various respects at the mill generally?

24 A. Generally, certainly. They discussed options
25 that they would want to entertain to change some of the

1 processes to be more representative of the type of mill
2 that they have and the way they run that mill.

3 **Q. And you're talking about the Ukiah mill?**

4 A. That's correct.

5 **Q. Did they indicate whether they were going to**
6 **run multiple shifts at Palco, in the Palco mill or one**
7 **shift?**

8 A. At all of the meetings that I had with MRC
9 representatives, they were adamant about running one
10 shift.

11 **Q. Can the Palco mill be run profitably with a**
12 **one-shift model, in your opinion?**

13 A. No.

14 **Q. Now, they shift -- they send -- do they have a**
15 **proposal in this transition plan to ship certain of the**
16 **logs to Ukiah?**

17 A. I don't know that that is in -- I have not
18 seen a written transition plan. The written plans that
19 I've seen such as was described in the disclosure
20 statement is fairly broad and not -- does not have the
21 specificity that I would look for in an operations plan.
22 Having said that, there was a very specific discussion
23 about taking the small diameter, short logs, which we
24 collectively refer to as fence logs that they --

25 **Q. That's the green logs?**

1 A. Those are green logs, right. There was some
2 very specific discussion about the fact that those logs
3 to be taken south to Ukiah and run at their facility
4 there. And they would backhaul logs of larger diameters
5 that would be more conducive to running on the facility
6 that we have in Scotia.

7 **Q. Now, the green logs are the most expensive to**
8 **transfer, is that right, because they weigh a whole lot**
9 **more?**

10 A. Exactly.

11 **Q. They haven't dried out yet; is that right?**
12 **Maybe I'm -- maybe I'm not assessing it properly.**

13 A. That's a fairly broad statement, but from the
14 time a tree is severed at the stump, it begins to lose
15 moisture, so it loses weight.

16 **Q. How much weight is generally lost as a**
17 **percentage until it's optimally sold? What percentage**
18 **of the weight, do you know?**

19 A. Well, our logs -- I mean, that's --
20 Dr. Barrett would be a far -- have a far better answer
21 for redwood. In very general terms, you will end up
22 losing from -- from green logs to green lumber, you will
23 lose maybe 35 or 40 percent of its weight from water
24 loss.

25 **Q. Does that impact the cost of transportation?**

1 A. Yes.

2 **Q. How?**

3 A. You can only carry so many pounds on a
4 trailer, so the older the logs are or the closer to a
5 finished product the lumber is, the more volume you can
6 put on a truck and, therefore, your costs per
7 incremental mile is going to be less.

8 **Q. If the plan is to have a one-shift model at**
9 **the Palco mill that you believe cannot be run**
10 **profitably, do you think it makes any economic sense for**
11 **MRC to decide to keep running two mills in this**
12 **proximity?**

13 A. There's no way I can know what MRC's cost
14 structure is. There's no way that I can know what their
15 revenue stream looks like. So I can -- my statement is
16 based on the way we design that mill and the way we
17 intended that mill to be run. And what we have, I
18 think, probably proven is that it is not going to be
19 profitable at one shift. Someone else comes in. They
20 can do -- I mean, you know, the sky is the limit. They
21 can do all kinds of different things. But that mill --
22 it's not likely, in my mind, that that mill can be run
23 the way it's currently being run on one shift and make a
24 profit.

25 **Q. And if that's -- and is there a certain amount**

1 of money that MRC suggests that they're going to invest
2 into the mill?

3 MR. LITVAK: Your Honor --

4 Q. (By Mr. Krumholz) According to these
5 conversations?

6 MR. LITVAK: I don't mean to interrupt,
7 but I tried to give Mr. Krumholz some leeway here, but I
8 still don't see the relevance. It sounds like it's an
9 attack on Mendocino's business plans --

10 THE COURT: One of the issues we have in
11 this stay pending appeal is can the assets be maintained
12 and during the time when there's a stay.

13 MR. LITVAK: Right.

14 THE COURT: I think that's certainly --
15 this testimony certainly goes to that. I guess he's
16 trying to explain that he can do a better job than
17 Mendocino, that the impact on the community is going to
18 be less by maintaining the status quo than by converting
19 to the Mendocino plan.

20 MR. KRUMHOLZ: And if it's run
21 improperly, Your Honor --

22 THE COURT: I think he's entitled to put
23 that evidence in, if that's what he believes. Let's
24 move on.

25 MR. KRUMHOLZ: And, Your Honor, just to

1 be clear.

2 THE COURT: Don't argue. You won, unless
3 you want --

4 MR. KRUMHOLZ: No. I was going to argue
5 just for -- you're right. I apologize.

6 Q. (By Mr. Krumholz) Now, Mr. Long, if it's
7 unprofitable and there aren't any of these bells and
8 whistles that you don't know about despite your years in
9 the business and at this plant, do you see any economic
10 reason for them to carry two plants? Isn't that a
11 concern of yours that they're going to shut down the
12 mill? Isn't that the truth of the matter?

13 A. That's several questions. It is a big concern
14 of mine that anybody would shut down that mill. But
15 again, I cannot speak to MRC's operating plan. I just
16 don't know what it is.

17 Q. Now, you have received an offer from Sierra
18 Pacific to purchase the mill. You've seen and talked to
19 Mr. Emerson and discussed it in detail?

20 A. That's correct.

21 Q. And you've studied that offer? You've
22 reviewed it and talked to him over a period of time?

23 A. In my words, I have looked at it and I have
24 given it some consideration. I don't know if I would
25 quantify that by saying I've studied it diligently or

1 anything like that.

2 Q. I don't mean to put words in your mouth.

3 You've reviewed it?

4 A. Yes.

5 Q. You've assessed it to some degree?

6 A. Yes.

7 Q. Okay. And you've talked to Mr. Emerson?

8 A. Yes.

9 Q. And you know the details of that offer?

10 A. Again, when people walk around the sawmill
11 with me, they talk.

12 Q. What did they tell you that they were
13 intending to do?

14 A. They --

15 MR. LITVAK: Objection, Your Honor,
16 hearsay.

17 MR. KRUMHOLZ: This is an operative fact.
18 It's been an offer to purchase the mill. An operative
19 fact is not hearsay, Your Honor.

20 MR. McDOWELL: Statements during the tour
21 are not an operative fact, Your Honor. It's been
22 offered. It's part of their paper.

23 MR. KRUMHOLZ: It doesn't have to be a
24 paper. It can be an oral offer, oral contract, oral
25 offer.

1 THE COURT: Go ahead. Answer the
2 question.

3 MR. PENN: One other part is he already
4 said he does not have the authority to accept any type
5 of offers since he has limited responsibility.

6 THE COURT: That's all right. I'll let
7 him answer the question. Now, let's start over with the
8 question.

9 Q. (By Mr. Krumholz) Have they told you about
10 what they --

11 THE COURT: Start over. Who told you?

12 Q. (By Mr. Krumholz) Has Red Emerson and others
13 that represent Sierra Pacific described what they are
14 intending to offer or what they have offered in
15 connection with the sawmill?

16 A. Yes.

17 Q. Okay. And tell me what your understanding of
18 what their offer is.

19 A. Again, so that you understand the context, Red
20 Emerson is -- I consider him to be a professional
21 friend, if you will. We know each other. We know each
22 other reasonably well. He has been through that sawmill
23 15 times in the last four years since it has been built.

24 Q. Has he been there more than Mr. O'Brien?

25 MR. McDOWELL: Objection, Your Honor.

1 The witness previously testified he didn't know how many
2 times Mr. O'Brien had been through the sawmill.

3 THE COURT: So you don't know the answer
4 to that, do you?

5 THE WITNESS: I really don't.

6 THE COURT: All right.

7 THE WITNESS: I just know how many times
8 Mr. Emerson has been through there with me.

9 Q. (By Mr. Krumholz) Has he asked you a lot of
10 questions about the sawmill?

11 A. He has asked a lot of questions about the
12 sawmill.

13 Q. Is your sense that he knows more, given your
14 working relationship, than Mr. O'Brien and how to make
15 it profitable than Mr. O'Brien?

16 A. Red Emerson's business is different than
17 Palco's. So Mr. Emerson's assessment of the mill and
18 its operations and what its capabilities are, are based
19 on the way he would want to run it. So it would be
20 difficult to compare how he would want to run it with
21 how I'm running it or anyone else would want to run it.
22 But I understood clearly what he was proposing.

23 Q. Okay. And let's go ahead and describe what he
24 was proposing. I think I interrupted your train of
25 thought.

1 A. He said early on that he was interested in --
2 let me back up. He had his sons, different sons,
3 different visits with him. And he spoke collectively to
4 all of us. He did not say: Hughey, this is what I'm
5 going to do if I get this mill. It's -- we're walking
6 along, and he's talking. Now, what he said was that he
7 wanted to move the operations from Samoa, his current
8 Douglas Fir operation at Samoa, to Scotia and bring the
9 fiber supply that he is currently using there, and then
10 adapt our facilities to where they would very
11 efficiently, and in his terms, cost-effectively, run
12 with two species and what would be generally considered
13 two separate mills. But that's -- that needs -- you
14 know, so he could run one species on one part of the
15 mill and one species on a different part of the mill and
16 run multiple shifts.

17 He made two very specific capital related
18 comments. One, that he wanted to do some improvements
19 to the cogen facility, the power plant. And the other
20 was that his suggestion for fixing the kilns was to
21 knock them down and start all over.

22 **Q. How much money -- you've read his declaration?**

23 A. Yes.

24 **Q. How much money is he intending to invest in**
25 **the sawmill according to his declaration and your**

1 **conversations with him?**

2 A. I don't recollect specifically. I think that
3 \$45 million was somewhere, I think, the total of what he
4 ultimately planned to put in to improving the operation.

5 **Q. And MRC's plan suggests only \$7 million; is**
6 **that correct?**

7 A. That's correct.

8 **Q. Okay. And how many shifts after all is said**
9 **and done is Mr. Emerson and his team proposing to**
10 **operate at the mill?**

11 A. He did not say to me, nor did I hear in the
12 course of our conversation a specific statement about
13 I'm going to run two shifts. However, in discussing the
14 power plant, he did say that two shifts of production
15 would generate enough fuel for him to make the power
16 plant profitable.

17 **Q. And in connection -- have you read his**
18 **declaration in that regard?**

19 A. No.

20 **Q. Do you recall that it says he would run**
21 **multiple shifts in the power plant?**

22 MR. McDOWELL: Your Honor.

23 MR. KRUMHOLZ: It's already in evidence.

24 A. I don't recall that.

25 MR. McDOWELL: He asked if he read it.

1 He said he didn't recall.

2 MR. KRUMHOLZ: He did say he read it. He
3 doesn't recall is what the testimony is, Luckey.

4 A. I read it when it first came out. I do not
5 recall a specific entry where he mentioned mull till
6 shifts.

7 Q. If he said he would run multiple shifts, is
8 that the best way in your mind to make the mill
9 profitable so that there isn't this risk of the loss of
10 the mill and the loss of jobs that are attendant to it?

11 A. That is a far more complicated question than
12 you can imagine. The fact of the matter is that that
13 would be a step in the right direction, but there are --
14 and, you know, Gary Clark or John Young or someone like
15 that can give you the details on where all the costs
16 are, both specifically and generally. But the fact of
17 the matter is that's a step in the right direction.
18 Production, you know, on a per hour basis, you know,
19 offsets fixed costs, so the more volume that you can
20 get, the lower the increment of your fixed costs are.

21 Q. You're familiar with Sierra Pacific?

22 A. Yes.

23 Q. Can you describe for the Court your experience
24 with respect to sawmills and the capacity of Sierra
25 Pacific to operate a sawmill like this one, given your

1 **relationship with Mr. Emerson and your understanding of**
2 **the industry?**

3 A. Every sawmiller is different. They have
4 different views on how their sawmill should compare to
5 others. I couldn't speculate on how Red would try to
6 run this mill from an operational standpoint. I have a
7 great deal of respect for what he has done with the
8 mills and the operations that he currently is operating.
9 I also have come to know a number of his key employees,
10 so I have an equal level of respect for the quality of
11 his management.

12 Q. Do you have confidence in Mr. Emerson and his
13 team?

14 A. Yes.

15 Q. Do you respect Mr. Emerson and his team?

16 A. Yes.

17 Q. Do you believe them to be trustworthy and
18 credible?

19 A. Yes.

20 Q. Do you believe they're qualified to run this
21 mill?

22 A. Yes.

23 Q. If the Court has suggested that if MRC, for
24 whatever reason walks this deal, that there is a concern
25 that the mill close. And I just want to address

1 something with you. If Sierra Pacific were willing to
2 come in and personnel and pick up the pieces, would that
3 be a good option in your mind?

4 A. I think that Sierra Pacific would be a good
5 operator of the mill. As to picking up the pieces, I'm
6 not sure what all that means, but...

7 Q. Well, fair enough. What I really meant to
8 say -- and it was a poorly worded question -- is if they
9 were to come in, purchase the mill and operate it, would
10 you have confidence in that solution?

11 A. Yes.

12 MR. KRUMHOLZ: Your Honor, I'll pass the
13 witness and reserve for recross.

14 THE COURT: All right. Although I don't
15 know about recross, but go ahead.

16 CROSS-EXAMINATION

17 BY MR. McDOWELL:

18 Q. Mr. Long, a couple of foundational questions
19 first. You recall some testimony early on that you were
20 not the lead person on the ground at the mill, right?

21 A. Yes.

22 Q. But that you were in a supervisory capacity?

23 A. Yes.

24 Q. Does the fact that you weren't the lead person
25 on the ground of the mill, does that in any way make you

1 less knowledgeable about what's going on with respect to
2 the mill?

3 A. I hope not.

4 Q. Is it your experience at Palco, I believe you
5 testified was limited to what areas? Let me ask you
6 that question. What areas is your responsibilities at
7 Palco? What areas is that limited to?

8 A. My responsibilities at Palco initially and
9 through today have been the sawmill and the
10 manufacturing facilities primarily. That includes the
11 fence plant and the plant facility and all the drying
12 operation in addition to the sawmill itself, and the log
13 yards. Additionally, I have the responsibility for the
14 cogeneration plant. I have the responsibility for fleet
15 management, for harvesting, and for road construction,
16 and third-party log procurement. And we're kind of in a
17 transition to where purchasing will also report to me.

18 Q. Do you have any responsibilities with respect
19 to the water treatment facility?

20 A. I do not.

21 Q. Do you have any responsibilities with respect
22 to the town operations or town maintenance?

23 A. We have a -- we have -- let's see.

24 Q. Let me rephrase the question. Do you have --
25 are you in charge of or oversee Palco's responsibility

1 **with respect to the town?**

2 A. No.

3 **Q. Are you in charge of or oversee Palco's**
4 **environmental responsibilities?**

5 A. Certainly I have the responsibility for
6 environmental compliance with any operation of the
7 sawmill, but the oversight is not one of my
8 responsibilities.

9 **Q. Outside of the sawmill, do you have any**
10 **responsibilities or do you have any -- are you in charge**
11 **of or oversee any of Palco's environmental**
12 **responsibilities outside of the sawmill operations?**

13 A. To the extent that Dr. Barrett and I work very
14 closely together on making sure that the road
15 construction is -- meets all the compliance criteria
16 relative to environmental constraints in the woods.

17 **Q. Are you ultimately responsible for Palco's**
18 **corporate governance issues?**

19 A. No.

20 **Q. Are you ultimately responsible for Palco's**
21 **responsibilities with respect to fire?**

22 A. Again, there's -- and we prove the value of
23 that relationship here two weeks ago. But I have the
24 road construction personnel who has the bulldozers and
25 the road graders and the water trucks and so forth.

1 Dr. Barrett has some very highly skilled and
2 accomplished foresters who take the lead on all of our
3 wildfire suppression activities, and obviously they use
4 the equipment that we have available. So it's a
5 cooperative effort.

6 Q. Are you the -- do you have ultimate
7 responsible for Palco's legal considerations?

8 A. No.

9 Q. With respect to the water treatment, the town,
10 the legal considerations, the corporate governance, and
11 ultimately the mill, who is the sole individual at Palco
12 who has responsibility for those issues?

13 A. George O'Brien.

14 Q. I believe you testified that as the mill is
15 currently structured running one shift is unprofitable;
16 is that correct?

17 A. That's correct.

18 Q. And is that true even if Palco is not paying
19 for logs?

20 A. Again, same answer as before. Without looking
21 at the budget and the financial plan, I don't have any
22 way of knowing.

23 Q. And is that because there are other expenses
24 that are outside of your responsibilities?

25 A. Yes.

1 Q. So you don't know for sure whether supplying
2 the 5 million board feet would be sufficient for Palco
3 to make all of its other obligations, outside of just
4 the sawmill?

5 A. That's one of those double negative lawyer
6 questions. I think the right answer is yes.

7 Q. I don't want you to think. I want to make
8 this an important point here. Perhaps I do want you to
9 think. But I don't want you to guess at the answers.

10 You testified that there were some expenses
11 that you weren't familiar with or you weren't
12 responsible for with respect to Palco?

13 A. Yes.

14 Q. And your area of expertise is limited to just
15 the sawmill operations and road construction and power
16 plant?

17 A. Yes.

18 Q. And the 5 million board feet would be
19 sufficient to keep that activity going, but you don't
20 know -- well, would that be sufficient to keep those
21 limited activities going?

22 A. Again, I would have to look. The way that the
23 company is set up, the operations division includes
24 things that are outside the realm of the manufacturing
25 process. Some of those costs I would have to sit down

1 with Mr. Young just simply because of the way the road
2 costs are handled and those things that are interrelate
3 to Scopac and the timberland.

4 So, again, I don't know. I know that that is
5 a good step in the right direction as far as the
6 manufacturing part of the operations division goes. But
7 beyond that, I just have to look and see what other
8 costs roll into it.

9 Q. So it's your testimony that you're not --
10 sitting here today, you don't know whether a free supply
11 of 5 million board feet would be sufficient for Palco to
12 pay all of its administrative expenses and maintain a
13 status quo for the next 12 months?

14 A. Yes, I do not know.

15 MR. McDOWELL: No further questions.

16 CROSS-EXAMINATION

17 BY MR. LITVAK:

18 Q. Good morning. Max Litvak for the creditor's
19 committee. You testified before about your opinion that
20 if Palco received 5 million board feet of logs
21 essentially free for the next six months, that the
22 status quo, at least as to the mill could be maintained;
23 is that correct?

24 A. That's correct.

25 Q. Okay. But wouldn't you want to know what

1 happens at the end of those six months?

2 A. Yes.

3 Q. Don't you think your employees would want to
4 know what happens at the end of those six months?

5 A. Yes.

6 Q. And don't you think that would impact employee
7 moral essentially not know what happens when these free
8 logs cease?

9 A. Morale is a very tricky area. I cannot
10 predict it, but I can influence it. So the message that
11 I would give to my subordinates and what I would deliver
12 would have some hopefully positive impact on morale.
13 This whole bankruptcy situation has driven morale to a
14 new level, which I'm still trying to figure out where it
15 is. So I just -- I don't know. I mean, everybody has
16 different issues. And all of those go to morale.
17 Certainty is the one thing that has been absent. Or
18 uncertainty has been the biggest detriment to morale.
19 So anything that goes toward giving them a definable
20 prospect for the future is going to help morale. But
21 how much, I don't know.

22 Q. Okay.

23 A. Maybe not at all.

24 Q. Let me put it this way. You were in the
25 courtroom yesterday, right?

1 A. Yes.

2 **Q. And did you hear one of the attorneys for the**
3 **noteholders or maybe it was the indenture trustee**
4 **mention that they would have the right to withdraw their**
5 **consent to free log deliveries. Did you hear that?**

6 A. Yes, I did.

7 **Q. If they, in fact, exercise that right to**
8 **withdraw their consent to free log deliveries to Palco,**
9 **would that impact mill operations?**

10 MR. KRUMHOLZ: Your Honor, this calls for
11 a legal conclusion. The context of that comment, Your
12 Honor, was -- well, let me tell you. I'll explain. The
13 reason -- the context of that comment, Your Honor, was
14 that it could then -- it would withdraw the appeal
15 essentially, the stay pending appeal.

16 THE COURT: Are you conducting the offer
17 from this table over here with respect to -- I don't
18 know what you want to call it, security for the stay
19 pending appeal is that you agree that you will allow
20 during this entire time of the appeal -- unless you
21 withdraw your appeal -- 5 million board feet of logs to
22 be given free to Palco each month.

23 MR. KRUMHOLZ: Through December 2008.
24 That's the case. And --

25 THE COURT: But after December 2008 if

1 you haven't withdrawn your appeal, you're not willing to
2 extend it beyond that at this time.

3 MR. KRUMHOLZ: At this time, Your Honor.

4 THE COURT: Okay.

5 MR. KRUMHOLZ: But with that said, the
6 point is and why it calls for a legal conclusion is if
7 it's withdrawn in December 2008, then the confirmation,
8 which this witness doesn't know a thing about, probably
9 or at least I wouldn't if I were him, the plan goes
10 effective.

11 MR. LITVAK: Your Honor, we don't know
12 that.

13 MR. KRUMHOLZ: So it calls for way too
14 many variables for this witness to speculate about.

15 THE COURT: You're agreeing that the stay
16 would terminate December of 2008 if --

17 MR. KRUMHOLZ: No.

18 THE COURT: To allow the plan to be
19 effective if there hasn't been a ruling on appeal?

20 MR. GREENDYKE: No, I don't think
21 there's -- pardon me for butting in. This is his
22 witness, but I'm addressing the question from the Court.

23 THE COURT: That's all right.

24 MR. GREENDYKE: I don't think there's
25 been a termination of this free logs suggestion that has

1 been put into evidence. That decision can be made later
2 on.

3 THE COURT: I thought you reserved the
4 right to stop giving out the logs if you wanted to.

5 MR. GREENDYKE: I don't think anybody --

6 THE COURT: And you reserve the right to
7 withdraw your appeal.

8 MR. KRUMHOLZ: Actually, it's the DIP
9 that's been withdrawn, not the free logs is my
10 understanding. Maybe I got that wrong and needed some
11 clarity.

12 THE COURT: I think that the issue of the
13 control of what's being offered is an important one.
14 And I think that it's fair for him to ask questions
15 because you have not committed to indefinitely --
16 pending the appeal, we don't know what the district
17 court and then the Fifth Circuit or the Fifth Circuit
18 will do with respect to timing. The odds are good it's
19 going to take more than -- I mean, certainly more than
20 three months and perhaps more than six months. I don't
21 remember. How long did the SAR motion take?

22 MR. KRUMHOLZ: Five months.

23 THE COURT: It took five months. And it
24 was basically a simple appeal. I mean, it either was or
25 it wasn't. And this one, you believe there are, what,

1 20 different legal issues. They believe there's no
2 legal issue. You believe there are 20 different legal
3 issues. It's a complicated factual pattern. Even if
4 there are no legal issues, it's a complicated factual
5 issue. It will take a while for judges to -- some of
6 them have bankruptcy experience, some of them don't, if
7 we're assuming it's going all the way to the Fifth
8 Circuit.

9 So, I mean, the odds that it would be
10 finished by December are probably slim. And I don't
11 know -- I mean, you're agreeing right now that you'll
12 let them do it through December unless you withdraw your
13 appeal?

14 MR. GREENDYKE: I think the choice of
15 words is extremely important.

16 THE COURT: I do, too.

17 MR. GREENDYKE: I don't think anybody has
18 addressed the question of how long the free logs
19 concession would last. I think the only mention was
20 made at some point if the bond -- depending upon the
21 type of bond or alternate security that was required by
22 the Court. If it was too expensive at some point
23 somebody might decide -- the bondholders might decide
24 we've had enough.

25 MR. KRUMHOLZ: But the answer to your

1 question is yes, Your Honor.

2 MR. GREENDYKE: But with regard to the
3 timber agreement, there has been no decision that that
4 should stop on December 31st. There's been no decision
5 that it could not go beyond December 31st, in other
6 words, that it could extend indefinitely.

7 THE COURT: I guess I want you to tell me
8 whether you're prepared --

9 MR. KRUMHOLZ: The answer is yes, Your
10 Honor, to your question.

11 THE COURT: -- as long as there's an
12 appeal to maintain the log purchase agreement, using the
13 word purchase loosely.

14 MR. KRUMHOLZ: The answer is yes, subject
15 to the December 2008 cut off.

16 THE COURT: Because the DIP -- what do we
17 do beyond December, in other words.

18 MR. KRUMHOLZ: That's right, and you're
19 going to have an opportunity to reassess that.

20 THE COURT: I thought that the issue
21 prior to the decision on appeal is pretty easy. I think
22 there is probably -- because, like I said, you've got
23 five million plus things to provide security with.
24 There's a way for you to provide security for the period
25 during the appeal. Now, what you can't provide security

1 for perhaps -- and I'm not sure how we address this and
2 it's an issue we are going to talk about eventually is
3 what happens if Marathon pulls out -- or maybe not
4 Marathon, but Mendocino pulls out. They have 60 days,
5 so we've got something beyond 60 days, but even at the
6 end of the appeal if they look at it there and say what
7 do we do there. Forget that one right now because
8 that's not what we're dealing with. Right now we're
9 dealing with the time period during the appeal assuming
10 that they would -- let's just assume that there is no
11 other issue, that it's just that they're going to stay
12 in it, it's going to be fine. If they win, they close
13 the deal. Everything then works out. And all we have
14 to do then is adjust your claim down for any loss that's
15 been made by the appeal, right?

16 MR. GREENDYKE: I'm not sure whether
17 you're negotiating with us or --

18 THE COURT: No. I'm asking. Isn't that
19 what you're offering.

20 MR. GREENDYKE: I don't know that we have
21 accepted that type of arrangement. We don't have a
22 conclusion about what the bond should be.

23 THE COURT: I don't know why there should
24 be a bond in this case.

25 MR. KRUMHOLZ: Security.

1 THE COURT: Do you think I'm going to
2 make you put something more than your claim?

3 MR. GREENDYKE: No.

4 THE COURT: And do you think that I'm
5 going to allow you to have stay pending appeal and not
6 at least subject your claim to the losses occasioned by
7 the appeal? I mean, there's no chance that will happen.
8 Now, I mean -- I mean, at some point you're going to see
9 what they are, and you might decide they're too much and
10 give up and then you still got what's left of your
11 claim. But now, I don't know whether you're willing to
12 do that or not. If you're not willing to do that, I
13 mean, I think this gets real easy also. But I'm
14 assuming you're willing to at least pay the tab on the
15 cost of the appeal, the cost to the company on the
16 appeal if there are additional -- if it goes down --
17 whatever it goes down, whatever its cost. I mean, I
18 agree with you that I'm not going to make you post some
19 extraordinary bond because there might be a hurricane or
20 whatever they call them up there. I mean that's not --
21 or there might be, you know, I'm not going to make you
22 post some sort of a bond because the big one might hit
23 and half of California goes into the ocean. We're not
24 going to do that.

25 MR. GREENDYKE: What we're trying to show

1 you today, Judge, is that the status quo is going to be
2 maintained based upon the free log concession.

3 THE COURT: The status quo can be
4 maintained in terms of -- I agree with you that there is
5 a way with the appropriate DIP and the appropriate
6 security in the event that that DIP -- you know, it may
7 be the price goes up, and they make lots of money during
8 the appeal, and you won't lose a thing.

9 MR. GREENDYKE: Right.

10 THE COURT: But you have to protect any
11 loss. And I don't think the loss is going to be more
12 than \$513.6 million. And I've got the 513.6. Now,
13 whether you agree to subject it to whatever loss there
14 might be, if the big one hits, and you lose your appeal,
15 you lose the whole thing.

16 MR. PACHULSKI: Your Honor?

17 THE COURT: Yes.

18 MR. PACHULSKI: This is Isaac Pachulski
19 on behalf of certain noteholders. I am not going to
20 make my closing argument now. But there are very
21 serious practical problems with what Your Honor has
22 suggested, and I don't want to cut in the middle now and
23 make a closing argument. But for reasons which we will
24 describe, among other things, the fact that the result
25 of that is even if there are no damages our claim will

1 be held hostage and our distribution will be held
2 hostage for years to potentially specious damage claims.

3 And we'll get into that in closing argument but --

4 THE COURT: Of course, isn't that a
5 function of how we define what it is that you're
6 insuring?

7 MR. PACHULSKI: No, Your Honor, it's not.
8 And let me -- and I'm sorry for doing this, but I'm
9 concerned. Sometimes courts reach decisions before
10 closing argument. And let me just summarize with two
11 bullet points. The first is unlike the situation with
12 the DIP and the log supply whereas you'll see there is a
13 mechanism in the indenture for the majority noteholders
14 to consent and bind everyone, in essence, so that we can
15 do -- I mean, everyone is making a big deal about this,
16 and that's actually a nonissue. But there is no
17 mechanism that permits the indenture trustee or anything
18 less than 100 percent of the noteholders to effect the
19 right to receive distribution.

20 Second -- and this is critical, Your
21 Honor. If you hold that any part of that distribution
22 is subject to reduction, then what you've really done is
23 to say that all you need is someone to come in with a
24 damage claim of any kind. Let me give you an example.
25 Yesterday Mr. Brilliant when you asked him to come up

1 with a number, not only is Mr. Brilliant brilliant, he
2 has a vivid imagination, he came up with \$100 million.
3 And I don't know where he got that number. I suspect it
4 just sounded good. The problem we're going to face --
5 we have to be clear here because this is balancing, Your
6 Honor.

7 If you hold that any part of that
8 distribution is subject to a damage claim in the real
9 world what that means is that -- is that if anyone
10 asserts a damage claim, if any clever lawyer comes up
11 with a damage claim -- and it's not hard for clever
12 lawyers to do it, they do it all the time -- the
13 distribution is tied up for years. That's a huge cost
14 because basically the distribution is sitting in escrow
15 earning money market interest.

16 And the one thing that should be clear,
17 Your Honor, and the interest that Marathon, which is
18 basically a distressed fund in a sense, charges --
19 indicates that these funds do not look for money market
20 returns. So what's going to happen is that you're going
21 to be holding some portion of the distribution hostage,
22 and people are going to have to pay ransom to get it
23 out, even if there are no damages. And what we'll get
24 to in closing argument is that before imposing a cost
25 like that -- and basically if you impose a cost like

1 that, Your Honor, nobody can agree to that because
2 nobody can agree to have their distribution tied up so
3 that people can shoot at it because, as you know, if you
4 create a pot of money for people to go after, they will
5 come up with arguments to go after it.

6 THE COURT: Okay.

7 MR. PACHULSKI: So the point is, Your
8 Honor, unless these risks -- and I just want to lay this
9 out now. It's a preview of coming attractions because
10 the parties --

11 THE COURT: Do we all agree that there is
12 no mechanism by which you can, under this indenture
13 agreement, subject your claim to set-offs for the
14 damages occasioned by the appeal?

15 MR. PACHULSKI: You cannot subject the
16 claims of all noteholders.

17 THE COURT: I'm just asking if you can do
18 it.

19 MR. PACHULSKI: Your Honor, that is a
20 separate question whether some noteholders and not
21 others should be subject to it. And there's an
22 additional question, Your Honor, that you are requiring
23 people to do something that is completely economically
24 irrational because --

25 THE COURT: I haven't required anything.

1 I was thinking I was giving you a break by allowing you
2 to do that rather than posting a bond. But you're
3 convincing me that I should consider a bond rather than
4 your claim, so let's move on. You convinced me,
5 Mr. Pachulski. I agree with you.

6 MR. NEIER: Your Honor, just very briefly
7 on the indenture.

8 THE COURT: Let's move on. I don't want
9 to deal with this now. Let's move on. Ask your
10 question.

11 Q. (By Mr. Litvak) Mr. Long, you heard the
12 exchange just now between the Judge and Mr. Greendyke
13 and Mr. Krumholz, right?

14 A. Yes.

15 Q. Okay. Are you satisfied that the noteholders
16 are committing to deliver free logs to Palco? Are you
17 satisfied from a mill operations perspective? Are you
18 comfortable with their commitment?

19 A. Yes.

20 Q. You're comfortable that they will, in fact,
21 deliver free logs even though it's not entirely clear
22 based on the various attorneys who have spoken that
23 whether or not they can withdraw that -- withdraw those
24 free deliveries at any time?

25 MR. KRUMHOLZ: Your Honor, I object as,

1 A, asked and answered. It mischaracterizes material
2 that has been discussed here in the courtroom.

3 THE COURT: I think he just said are you
4 comfortable after hearing the last interchange, so --

5 MR. KRUMHOLZ: He already said that.

6 THE COURT: He was here. So he's still
7 comfortable. Let's move on.

8 Q. (By Mr. Litvak) If it turns out though
9 hypothetically that the noteholders withdraw their
10 consent to free log deliveries, would that have an
11 impact on mill operations?

12 A. Yes.

13 Q. Okay. How much lead time would you want to
14 have from a mill operations perspective in terms of
15 knowing whether or not you're going to have the free log
16 deliveries continue?

17 A. The issue on that has more to do with customer
18 commitments for the lumber that is planned to be sawed
19 from the logs. So certainly customers want as much
20 certainty as anyone else when they place an order. So
21 ideally I would -- I mean, you know, I'd like to have as
22 much time as possible. But we can react and have done
23 so in the past for various other reasons for log
24 shortages in as little time as, I would say, maybe two
25 weeks. I don't like being inside that time. I mean,

1 we've had problematic shutdowns for various and sundry
2 reasons, and we've always tried to give everyone at
3 least two weeks notice. So, you know, I would say at
4 least 15 to 30 days would certainly be an ideal period.
5 But if I could get longer, I would love to have longer,
6 yeah.

7 MR. LITVAK: Thank you, Your Honor.

8 CROSS-EXAMINATION

9 BY MR. NEIER:

10 Q. David Neier on behalf of Marathon. Good
11 morning, Mr. -- Colonel Long?

12 A. Good morning.

13 Q. I'm confused about one thing with respect to
14 the mill operations. You're currently running one shift
15 now; is that right?

16 A. That's correct.

17 Q. And one shift is not sufficient for Palco to
18 be profitable, is that correct, in your view?

19 A. In my view, based on the operating experience
20 that I have and we have had, that's correct.

21 Q. And 5 million board feet free or on whatever
22 terms, is that going to take more than one shift or just
23 one shift?

24 A. Well, we use that number as a single shift log
25 requirement, but it moves by 10 percent. So it could be

1 4 and a half or it could be 5 and a half.

2 Q. Okay. So still does not get you more than one
3 shift, if I understand what you're saying?

4 A. Correct.

5 Q. So we have one shift now. It's not
6 profitable. You're getting, let's say, some kind of
7 commitment for six months for logs that will get you one
8 shift. It's still not going to be profitable, right?

9 MR. KRUMHOLZ: Objection, Your Honor. It
10 assumes facts not in evidence. The whole -- it's an
11 incomplete hypothetical is the objection. We're talking
12 about the reduction in costs.

13 THE COURT: Overruled. Go ahead. I
14 think it's a fair question. Go ahead.

15 A. It goes back to, again, looking at two things.
16 First of all, will the mill manufacturing process be
17 profitable or will all of Palco be profitable? In
18 either case, it certainly makes it more likely to be
19 profitable, but I'd still have to get with our financial
20 people and see exactly where all the costs and expenses
21 are and go from there.

22 Q. I take your point. What you're talking about
23 is the mill, which is under your supervision?

24 A. Correct.

25 Q. But Palco as a whole is not profitable with

1 **the mill running one shift now, correct?**

2 A. Yes.

3 **Q. And Palco as a whole is not going to be**
4 **profitable going forward if it's still running one**
5 **shift, in your view?**

6 MR. KRUMHOLZ: I'll object as an
7 incomplete hypothetical based on the exact same
8 objection, Your Honor, with 5 million board feet free.

9 MR. NEIER: Okay. That objection was
10 already overruled.

11 MR. KRUMHOLZ: The costs have to be
12 considered.

13 THE COURT: I don't think that there's a
14 big leap here. I mean, I think just ask the question.
15 Go ahead. You can answer it.

16 A. I do not know if free logs will make the mill
17 or Palco profitable.

18 **Q. And I understand you're not a financial -- our**
19 **you're not in charge of the financial operations. But**
20 **assuming that there's \$75 million due in 30 days, you**
21 **haven't heard anybody by Palco, you haven't heard**
22 **anybody step up and say, yeah, that \$75 million is going**
23 **to be paid?**

24 A. No, I have not.

25 **Q. And as far as you're concerned, Palco can't**

1 **pay that \$75 million 30 days from today, correct?**

2 A. I don't know that either.

3 **Q. Okay. And there are a bunch of expenses that**
4 **have been deferred and not paid, correct?**

5 A. That's my understanding, but I don't know what
6 those numbers are.

7 **Q. Right. And when we're talking about this free**
8 **log program, do you know if that free log program will**
9 **be able to pay off those deferred expenses?**

10 A. I do not.

11 **Q. The deferred -- go ahead.**

12 A. I was shown a -- I think it was marked draft
13 of a 13-week budget. And the numbers that I was shown
14 would have indicated that the free logs would not have
15 fully covered all the expenses.

16 **Q. And do you -- you said earlier that there's a**
17 **good deal of uncertainty at Palco these days as to**
18 **what's going to happen?**

19 A. Yes.

20 **Q. And that affects morale?**

21 A. Yes.

22 **Q. Do you know where you're going to be six**
23 **months from now?**

24 A. No.

25 **Q. Do you have any plans to leave?**

1 A. I am doing my best to try to find new
2 employment.

3 **Q. So during this six months, if a good**
4 **opportunity comes your way, you may leave?**

5 A. What's a good opportunity?

6 **Q. Well, I'm just saying, you said you're**
7 **looking. You're looking towards the future, and you**
8 **don't think that future includes staying at Palco,**
9 **right?**

10 A. I didn't say that.

11 **Q. Okay. What did you say? I apologize.**

12 A. I have not been told anything about my future
13 with Palco. I have been -- I guess, in MRC's disclosure
14 statement, it is very clear that they are not retaining
15 any officers or directors. Since I am one of those,
16 that would mean I would not be retained by MRC.
17 Mr. O'Brien has not discussed with any of the senior
18 management, because we've been down here, what we would
19 do if there was a stay pending appeal. So I don't know.

20 My first obligation and certainly my fiduciary
21 obligation is to Palco. So if -- like Dr. Barrett said
22 yesterday, if I become unemployed, I'm going to have to
23 look for a job. That's how that works.

24 **Q. That makes sense to me. But maybe the best**
25 **way to do it is to talk -- you were here when**

1 **Dr. Barrett testified, correct?**

2 A. Yes.

3 **Q. And Dr. Barrett basically committed to staying**
4 **for the next six months, correct?**

5 A. Yes.

6 **Q. Have you made a similar commitment?**

7 A. Nobody's asked.

8 **Q. Okay. Are you willing to stay for the next**
9 **six months?**

10 A. I'd have to ask my wife.

11 **Q. And she doesn't want you to stay, does she?**
12 **You don't have to -- you don't have to answer that**
13 **question.**

14 A. We want to talk about grandkids?

15 **Q. That's all right.**

16 A. I don't know. She is -- in truth, she is not
17 aware of any of these other opportunities. I mean,
18 we're operating on the basis of what I said to begin
19 with.

20 **Q. Understood. And if Palco were to shut down,**
21 **would that be good or bad for Scopac?**

22 A. I can only speculate.

23 **Q. Maybe instead of speculating, what would**
24 **happen in your view -- take a step back. Who's in**
25 **charge of procuring logs for the mill?**

1 A. I am.

2 Q. Okay. And the vast majority of those logs
3 come from Scopac, correct?

4 A. Yes.

5 Q. Okay. So if the Palco mill were to shut down,
6 what would happen to prices of logs for Scopac?

7 A. I would suspect -- the log market is a very,
8 very simple supply and demand business. So if there is
9 more supply, it would be a reasonable assumption that
10 the prices would go down.

11 Q. Because you're taking the largest, closest
12 mill out of the picture?

13 A. That is correct.

14 Q. So you have a lot of supply and one less
15 customer for that supply?

16 A. That is correct. There is not currently
17 manufacturing capacity to handle the additional logs
18 within a reasonable transportation rating.

19 Q. So on that basis, at least with respect to log
20 prices, the shutdown of the Palco mill would be bad for
21 Scopac?

22 A. Yes.

23 Q. We've heard some testimony about a fire that's
24 in Mendocino County and on Mendocino redwoods lands.
25 You're aware of that?

1 A. Yes.

2 **Q. And that fire, would that create additional**
3 **logs on the market?**

4 A. My understanding of the ownership
5 configuration that comprises the Mendocino complex,
6 which as of yesterday was about 50,000 acres, would tell
7 me that there's probably going to be a substantial
8 amount of redwood and Douglas Fir that is going to
9 require salvage in some period of time in the future.
10 Each individual landowner is going to have to make the
11 decision as to how quickly that can occur. The ability
12 to remove that volume will be immediately constrained by
13 the availability of the infrastructure, loggers and so
14 forth.

15 So with all of those caveats, certainly if
16 there is an increased volume of wood available as a
17 result of those fires, that, too, again, the supply and
18 demand, I mean, that, too, is going to -- it could and
19 would be likely to depress the log market. But stranger
20 things have happened in Humboldt, Mendocino County.

21 **Q. Right. So if I understand you correctly, what**
22 **you're saying is fire creates felled trees. Felled**
23 **trees creates a salvage operation. A salvage operation**
24 **creates more logs. And it's a supply and demand market.**
25 **There's now more -- there's now a greater supply of logs**

1 **than there would be just in normal harvesting?**

2 A. In general terms, that's correct. It will
3 create. But you didn't quite describe it correctly, but
4 that's okay.

5 Q. Okay. But it's fair to say that when you
6 have -- just like you said, when you have more supply of
7 logs, that tends to depress prices?

8 A. That's correct.

9 MR. NEIER: I have no further questions.
10 Thank you.

11 THE COURT: All right.

12 CROSS-EXAMINATION

13 BY MR. HAIL:

14 Q. Brian Hail from Mendocino Redwood Company for
15 Mendocino Redwood Company. Mr. Long, in your testimony,
16 earlier describing your operations, finance is not one
17 of your responsibilities, is it?

18 A. That is correct.

19 Q. Okay. And in connection with preparing
20 budgets at Palco, you reference you had seen a 13-week
21 draft cash flow budget, correct?

22 A. Correct.

23 Q. Have you ever seen a 26-week cash flow budget
24 created by Palco?

25 A. I'm sure that I have seen a document, you

1 know, titled that. I have -- I don't recollect sitting
2 down and studying it in great depth. We produced them
3 on a pretty rapid rate.

4 Q. How about a 26-week budget that was prepared
5 in the last couple of weeks; have you seen it?

6 A. No, I have not.

7 Q. And have you seen one any Palco-created budget
8 that attempts to forecast what might happen if there
9 were free logs?

10 A. No, I have not.

11 Q. Do you know if anyone at Palco has prepared
12 any financial analysis about what might happen if they
13 didn't have to pay Scopac for logs?

14 A. I have absolutely no idea. I didn't hear
15 about it till yesterday, so I doubt that anybody that
16 crunches numbers back in Scotia knew about it before
17 yesterday.

18 Q. Okay. And you haven't seen any written
19 proposal from anyone, to the best of your knowledge, on
20 the free log program, have you?

21 A. No.

22 Q. Okay. Now, are you also in charge of sales at
23 Palco?

24 A. No.

25 Q. I'm sorry?

1 A. No.

2 Q. Have you heard of a company called Mendocino
3 Forest Products?

4 A. Yes.

5 Q. Okay. What is Mendocino Forest Products?

6 A. It's my understanding that it is one of the
7 two Mendocino companies, along with Mendocino/MRC. I
8 don't know if it's, you know, a subsidiary or what, but
9 I'm aware of both of them.

10 Q. It's a sales distribution company, isn't it?

11 A. I don't know. That might be.

12 Q. Okay. Are you familiar with the Mendocino
13 Redwood plan for purchasing the Mendocino Redwood
14 Marathon plan in this case? Have you read the business
15 plan?

16 A. Yes.

17 Q. And as part of the that business plan to bring
18 Mendocino Forest Products, the sales distribution
19 business, to bring that to the products that are
20 produced by the Scotia mill?

21 A. That is my understanding.

22 Q. Is that sales and distribution business
23 significantly different than Palco's current sales and
24 distribution business?

25 A. Yes.

1 **Q. Okay. And would there be additional**
2 **synergies, additional value, additional revenue**
3 **generated by this sales business for the products**
4 **produced by the Scotia mill?**

5 MR. KRUMHOLZ: Objection, based on
6 speculation based on his prior testimony.

7 THE COURT: Overruled. Go ahead.

8 A. I don't know. I could only speculate. My
9 knowledge of Mendocino's distribution business is just
10 based on what Mr. Higginbottom and Mr. Dean have told me
11 about how those synergies would develop in their mind.
12 But I have not been included in any specifics
13 whatsoever, so --

14 **Q. So you don't know if there's only one shift**
15 **running and the sales and distribution business is**
16 **significantly more profitable, that it might affect the**
17 **profitability of the operation, do you?**

18 A. I do not.

19 **Q. Are you familiar with MRC's cost structure in**
20 **general?**

21 A. In general is kind of a defining term. In
22 general, I would say that I only have knowledge of their
23 cost based on the information they provided in the
24 public forum in Fortuna earlier in the year.

25 **Q. Now, MRC has gone out and made several public**

1 **statements, haven't they? They met with lots of people**
2 **in Humboldt County?**

3 A. Yes.

4 Q. They talked about their plans for the mill?

5 A. Yes.

6 Q. They made a commitment to invest and operate
7 **the mill, haven't they?**

8 A. Yes.

9 Q. Do you have any reason to doubt that
10 **commitment?**

11 A. No.

12 Q. Okay. Mr. Krumholz asked you about green
13 **logs. Do you remember that?**

14 A. Yes.

15 Q. Aren't all logs green logs?

16 A. No.

17 Q. Isn't there a distinction between green lumber
18 **and dry lumber?**

19 A. Yes.

20 Q. Okay. Scopac currently supplies about 5
21 **million -- how much does Scopac provide currently to the**
22 **Palco mill?**

23 A. Currently?

24 Q. **Yes.**

25 A. They are -- again, they're providing roughly 5

1 million feet per month.

2 **Q. Does Palco sometimes have to go out onto the**
3 **market and buy logs?**

4 A. Yes.

5 **Q. Okay. If this -- when does Palco have to go**
6 **buy logs generally? Is there any seasonality to that?**

7 A. Logs become available by private landowners on
8 a seasonal basis. Usually it peaks around late May to
9 early June. There are a limited number of sales,
10 landowners and situations where that -- where there is
11 some volume that would be available during other parts
12 of the year. So that, I guess, says that it's seasonal.

13 **Q. If Scopac doesn't provide 5 million of redwood**
14 **on a monthly basis, would Palco have to buy logs on the**
15 **market to hit a \$5 million threshold or run rate through**
16 **the mill?**

17 A. There are a number of factors, including what
18 is existing inventory. So after you take into effect or
19 take into account the impact of inventory levels,
20 then -- so if they didn't deliver 5 million one month,
21 but you may have a shortfall from inventory, then you're
22 okay. But if the mill does not have 5 million feet
23 available to it -- if the mill does not have about 5
24 million board feet of logs available to it, I would have
25 to acquire logs from another source.

1 **Q. Okay. And do you know if under the free log**
2 **agreement there would be any liquidity or any cash to go**
3 **out and make any log purchases? Has anyone talked to**
4 **you about that?**

5 A. Again, I have not seen anything specific to
6 that, so I do not know.

7 **Q. Okay. Who is Dave Carter?**

8 A. Dave Carter was my roads manager, road
9 construction manager.

10 **Q. He was the roads manager, right?**

11 A. That's right.

12 **Q. When did Mr. Carter leave?**

13 A. It's my understanding -- well, his last day
14 was -- I believe it was Friday two weeks ago.

15 **Q. Now, is Mr. Carter --**

16 A. Although I think he has some vacation that
17 he's getting out of the way.

18 **Q. Was he one of the senior executives, like one**
19 **of the top four people?**

20 A. No.

21 **Q. Was he one of the middle managers? How would**
22 **you describe his job? How about that?**

23 A. He worked for my procurement operations
24 manager, who reports directly to me. So he would be --
25 hierarchically, he would be three levels down. He was a

1 highly proficient and very knowledgeable individual and
2 was accorded the respect of everyone at a higher level
3 than I would say his position was. So I don't know if
4 that answers your question, but he was a very important
5 person to me.

6 **Q. You didn't want to lose him, did you?**

7 A. No, I did not.

8 **Q. Do you think you can replace Mr. Carter with**
9 **another similar employee, a similar person?**

10 A. In time I can replace anybody.

11 **Q. Has it been difficult to attract new employees**
12 **to the Palco operations?**

13 A. Yes.

14 **Q. Can you describe those difficulties for us.**

15 A. Well, obviously there's a great deal of
16 apprehension about -- again, it goes to the uncertainty
17 about how long we're going to be here, what happens down
18 the road, what configuration, you know, a new entity
19 might take. So there's all kinds of questions that are
20 hanging out there that cause people and have caused
21 people to be very reluctant about even applying for a
22 job.

23 **Q. Okay. Is Mr. Carter the only important**
24 **employee that Palco has lost in the last several months?**

25 A. That's pure conjecture. I mean, each manager

1 or supervisor has got to decide who's important to him.

2 Q. Okay. Now, you mentioned that after the
3 confirmation hearing you called Mr. Dean, didn't you?

4 A. That's correct.

5 Q. Okay. And you called to congratulate Mr. Dean
6 on the confirmation win?

7 A. That's correct.

8 Q. Do you also ask Mr. Dean if there would be a
9 position for you at the new company?

10 A. I asked him if he had any idea what my future
11 would be like with MRC, and that I was in the process
12 for applying for some additional jobs and that I needed
13 to know in case that issue came up if there was going to
14 be anything.

15 Q. And what did Mr. Dean tell you?

16 A. Mr. Dean --

17 MR. KRUMHOLZ: Your Honor, I object as
18 hearsay for his own client. It's not a client -- it's
19 not a party admission.

20 THE COURT: Overruled.

21 MR. KRUMHOLZ: It's rank hearsay.

22 THE COURT: It may be rank hearsay, but
23 it's not the truth that we're talking about. I think
24 his future is an issue during this period. I don't know
25 how we would run Palco without him if he gets hired away

1 by somebody else. But I'm not sure. If he's covered
2 by -- if Mr. Dean is going to hire him, then we don't
3 have to worry about that. He'll be here and stay on
4 until everything is good. I don't know what the answer
5 is. It's certainly relevant, so let's go on.

6 **Q. (By Mr. Hail) What did Mr. Dean tell you?**

7 A. Mr. Dean told me that he appreciated my value,
8 but that decision would ultimately be made by Richard
9 Higginbottom.

10 **Q. Did you talk to Mr. Higginbottom about that?**

11 A. Mr. Higginbottom called me on Monday. In
12 fact, I think -- I believe it was Monday that Richard
13 called. And he said he appreciated my interest and that
14 it was too early to make any of those kinds of
15 decisions. And I said just fine, I just wanted to know
16 if there was anything specific that I should be aware of
17 before I started offering myself to other people for
18 other opportunities.

19 **Q. And what did he say?**

20 A. That's what he said. And he said fine. He
21 didn't expand.

22 MR. HAIL: No more questions, Your Honor.

23 THE COURT: All right. Scopac.

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CROSS-EXAMINATION

BY MR. FROMME:

Q. Good morning, Mr. Young -- I'm sorry, Mr. Long. What was the last time Palco has been profitable?

A. I don't know. I could guess, but I'm not going to.

Q. Well, has it been since the Headwaters agreement?

A. Again, that was before I arrived at Palco, so I don't know.

Q. Well, you've been there since, you said, 2002, right?

A. Yes.

Q. Has Palco been profitable since you've been there?

A. No.

Q. Now, that's been a concern of yours, right?

A. Yes.

Q. So have you done any analyses to determine -- well, one of the concerns -- one of the causes for Palco's unprofitability has been the price per logs; is that fair to say?

A. Yes, that is one of the concerns.

Q. And have you done any analyses to determine

1 **what would be a price for Palco to pay logs from Scopac**
2 **that would make Palco profitable?**

3 A. Yes.

4 **Q. And what did you find?**

5 A. Let me back up and say Mr. O'Brien and I had
6 our business manager, operations business manager,
7 develop a break-even spreadsheet, so you could assume if
8 you could get it for a dollar less, then that would show
9 what it would take to be profitable. But we had that
10 done, so we figured out what that number is.

11 **Q. When did you have that done?**

12 A. That was done a week and a half ago.

13 **Q. What did you find?**

14 A. We found out what the fiber costs and the
15 resulting log costs break-even number would be.

16 **Q. What was the break-even number?**

17 A. The actual break-even number was -- I don't
18 want to confuse you, but it was \$588 delivered on
19 scribner short log scale.

20 **Q. Help -- at least help me out and the Court.**
21 **Compare that to the SBE price that Palco pays Scopac.**

22 A. Well --

23 **Q. I mean, explain it in your own words that you**
24 **think would be the most helpful.**

25 A. I am not an expert on the way SBE is

1 calculated. But basically the SBE price, you have to
2 add the logging costs to it. So I think -- my
3 recollection is that the current SBE price is about
4 \$590, short log, scribner. And that is a stumpage price
5 to which you have to add log and haul costs.

6 **Q. So it's a little bit -- the break-even point**
7 **is a little bit less than the SBE price plus the log and**
8 **haul costs or the harvest costs?**

9 A. Yes.

10 **Q. And log and haul costs are approximately how**
11 **much per thousand?**

12 A. Right now today year-to-date it's running a
13 little over \$210 per thousand board feet log measured.

14 **Q. So roughly speaking the break-even point is a**
15 **little over \$200 per thousand more than -- or less than**
16 **what you're currently paying; Palco is currently paying?**

17 A. I'd have to look at the breakdown in front of
18 me, but that sounds like it's reasonable.

19 **Q. Well, I guess what I'm trying to get at is**
20 **that the break-even point is much -- the break-even**
21 **point price for log is much more than 3, isn't it?**

22 MR. McDOWELL: Your Honor, I'm going to
23 object on the line of questioning. I tried to give some
24 latitude here, but I'm a little confused about the
25 break-even point. Break even of what exactly are we

1 talking about? If counsel's questions were a little
2 more specific, I think we could --

3 THE COURT: As I understood him to say
4 that there is not a break-even point at 500 million. He
5 wasn't sure there was a break even point at 500 million
6 logs, right, 500 million board feet because that's just
7 one -- even if you had them free, that's one mill run.
8 I mean, that's one run and he thinks you need more than
9 one run to break even. Now, whether or not the price
10 for free would compensate enough for that, I don't know
11 if he knows the answer or not.

12 THE WITNESS: Yes.

13 THE COURT: You do know?

14 THE WITNESS: No. I mean, you are
15 correct. I don't know specifically.

16 MR. FROMME: That's what I wanted to get
17 out of him.

18 THE COURT: There are two separate
19 issues: What the break even price is -- assuming you
20 got enough logs to run the mill at its break even level,
21 which is more than one shift. Am I correct?

22 THE WITNESS: On one shift -- I'm trying
23 to --

24 THE COURT: Well, forget the one shift.
25 When you calculated a break even price for Palco, it was

1 contemplating running all the shifts?

2 THE WITNESS: No, sir.

3 THE COURT: Okay. What was contemplated?

4 THE WITNESS: It was the status quo,
5 running one shift that we are currently operating.

6 THE COURT: And you have a break even
7 price for one shift, and it's more than zero.

8 THE WITNESS: That's correct.

9 THE COURT: Okay. Go ahead.

10 MR. McDOWELL: Your Honor, I just don't
11 want bad testimony to come out here because it's
12 conflicting from what I said earlier. I think it's a
13 distinction of break even of the Palco mill and break
14 even of Palco, and the questions have bounced backwards
15 and forwards.

16 THE COURT: Is that a distinction that
17 also needs to be made?

18 THE WITNESS: The spreadsheet that was
19 provided to us basically included all of Palco. But
20 when Mr. Warren, our business manager, when he developed
21 that, I don't know that he had a good handle on all of
22 the costs that have been discussed relative to the
23 operating budget. So he was looking -- it was a global
24 request, if you will, taking a lot of averages over time
25 based on history and everything else. So I cannot say

1 that that number, that \$588 number is exactly the number
2 that we would have to be at or below to make all of
3 Palco profitable. We have people that can tell you
4 that. I'm just not one of them.

5 Q. (By Mr. Fromme) I recognize it wasn't -- that
6 the analysis wasn't actually finalized or complete?

7 A. Correct.

8 MR. FROMME: I have no further questions,
9 Your Honor.

10 MR. KRUMHOLZ: Your Honor, I have very
11 few.

12 THE COURT: All right.

13 REDIRECT EXAMINATION

14 BY MR. KRUMHOLZ:

15 Q. First of all, Mr. Long, we talked about
16 earlier about Mr. Barrett and his credibility problems?

17 A. Yes.

18 Q. Do you believe him when he says he's going to
19 be able to deliver 5 million board feet per month as he
20 indicated in his testimony yesterday?

21 A. Yes.

22 Q. Okay. And, in fact, there's a surplus in
23 inventory at Scopac if there's any unforeseeable issue
24 as you understand it, as it currently exists?

25 A. There is some inventory, yes. I don't know --

1 I wouldn't hardly call it surplus, but there is some
2 inventory.

3 **Q. And that can be accessed as needed?**

4 A. Yes, within the constraints of the agreement
5 that Jeff and I have been doing on transfers and so
6 forth, Dr. Barrett.

7 **Q. Mr. Hail asked you a question about green logs
8 and whether there's a difference between green logs and
9 dry logs. And I just want to follow-up. It's your
10 understanding that they're going to be drying green
11 logs -- that is, MRC back in Ukiah based upon your
12 discussions with MRC representatives, true?**

13 A. No. Mr. Higginbottom told me that they wanted
14 to take short, small diameter logs that had been
15 delivered to Scotia or directly from the woods to Ukiah
16 and backhaul larger logs. All of those logs would be
17 considered green.

18 **Q. And what impact would that have on the kiln,
19 if any, and the employees that operate the kiln back at
20 the Palco mill, if any?**

21 A. That would not have any impact on the kilns,
22 but our discussion was relative to the impact to the
23 fence plant. Those are the logs from which we primarily
24 develop our fence products.

25 **Q. And what impact would that have on Palco?**

1 A. Without knowing specific volumes, I don't
2 know.

3 **Q. What would be the concern that you would need
4 to be assessed?**

5 A. That it would diminish the availability of
6 material to provide for the fence plant.

7 **Q. And what would the concern be in that regard
8 in terms of the financial impact?**

9 A. If I don't have logs to run through the
10 sawmill to make fence blanks from, then I have to shut
11 down the fence plant.

12 **Q. And I heard a lot of questions about 5 million
13 board foot delivered free and whether that makes Palco
14 profitable or not. But you do understand that Mr. Young
15 has prepared a forecast for us that describes cash flow
16 projections if that is done?**

17 A. Certainly I have heard that referenced here in
18 court.

19 **Q. And Mr. Young, you understand, is a CFO of
20 Scopac currently?**

21 A. Yes.

22 **Q. And you understand that Mr. Young works
23 closely with Palco folks in the accounting department on
24 a consistent basis?**

25 A. Yes.

1 Q. And you understand that he's accessed
2 information in connection with that?

3 A. Yes.

4 Q. And you would defer to him in that regard?

5 A. Yes.

6 Q. Okay. The last question I have is we all have
7 to ask our wives, if anything like at my home, pretty
8 much about anything. In fact, we're having a discussion
9 about the situation we might have to stay over tonight
10 for tomorrow. But with all that said, if your wife is
11 willing to do what you would suggest or you would want
12 to do, are you willing to stay on board during the
13 pendency of any stay if 5 million board feet are
14 delivered to Palco?

15 A. Yes.

16 MR. KRUMHOLZ: Pass the witness.

17 THE COURT: All right. You can step
18 down. Next witness.

19 MR. KRUMHOLZ: Your Honor, I've been
20 asked -- there seems to be another issue and I don't
21 want to delay anything. I think a five-minute recess --

22 THE COURT: Ten minutes.

23 (A recess was taken.)

24 THE CLERK: All rise.

25 THE COURT: Be seated.

1 MR. HOLZER: Your Honor, what is the
2 Court's plans with regard to a lunch break at anytime?

3 THE COURT: Well, you know, I think the
4 other side has a reasonable opportunity to put on their
5 case. We've already gone -- we're about halfway
6 through, so this side needs to finish so that this side,
7 whoever it is, gets their chance. But somebody
8 mentioned Saturday. There's no Saturday. This is
9 ending today at 6:00.

10 MR. HOLZER: You had mentioned Saturday
11 earlier, but we also heard you that you were going to
12 say different.

13 THE COURT: I have to be in McAllen on
14 Saturday. Yes, sir.

15 MR. GREENDYKE: Bill Greendyke for the
16 indenture trustee.

17 THE COURT: The rest of them decide to
18 boycott?

19 MR. GREENDYKE: No. I'm sorry we're
20 late. Mr. Krumholz is on call with the noteholders and
21 with Lehman and talking to the debtor. We're trying to
22 answer questions that the Court has had.

23 THE COURT: Okay. What about witnesses?
24 Is Mr. Young next?

25 MR. GREENDYKE: I don't know where

1 Mr. Krumholz is at. I think that's right, but he's in
2 there on the same call.

3 THE COURT: Is that the last witness?

4 MR. GREENDYKE: I think so, but don't
5 hold me to it.

6 THE COURT: We ain't even close to being
7 halfway through this hearing. We spent a lot of time
8 arguing so, you know, that will perhaps cut down on
9 arguments at the end, but I need to give them some time
10 to put on their side of the case, too.

11 MR. GREENDYKE: I know. I'm aware of
12 that. And we're, again, trying to answer questions that
13 the Court has.

14 THE COURT: I understand.

15 MR. NEIER: Your Honor, is there any way
16 we can proceed with one of the other lawyers for the
17 noteholders?

18 THE COURT: On Young?

19 MR. GREENDYKE: No.

20 MR. HAIL: Young has a proffer.

21 MR. GREENDYKE: I understand, but I'm not
22 litigating. Mr. Krumholz is.

23 THE COURT: I understand. I know how you
24 have divided it, so hopefully he'll be in shortly.

25 MR. FIERO: Your Honor, I guess I call it

1 a point of personal privilege. The last flight out
2 tonight is 7:00.

3 THE COURT: You will be making a 7
4 o'clock flight because I have to pick up my daughter in
5 Victoria. So these are the deadlines that we're running
6 up again, so everybody needs to be thinking about now
7 cutting down their witnesses and getting just the stuff
8 you need in because we have to finish this hearing.

9 MR. KRUMHOLZ: Your Honor, our next
10 witness is John Young.

11 THE COURT: Okay. Mr. Young, come
12 forward.

13 MR. KRUMHOLZ: And before he comes
14 forward, I do have an answer to each specific question.

15 THE COURT: As he's walking forward, you
16 may make it.

17 MR. KRUMHOLZ: As he's walking forward, I
18 have authority to tell you that the \$20 million DIP and
19 what's being called the free log program which some
20 people don't like very much, but we'll get into that,
21 are committed to through December subject only to an
22 appeal existing pending the entire time frame.

23 THE COURT: Okay. I understand. Raise
24 your right hand.

25 MR. KRUMHOLZ: Just to be clear, the

1 majority of the steering committee has approved that.

2 THE COURT: All right. Thank you.

3 JOHN T. YOUNG, JR.,

4 having been duly sworn, testified as follows:

5 DIRECT EXAMINATION

6 BY MR. KRUMHOLZ:

7 Q. Good morning, Mr. Young. Can you please state
8 your full name for the record.

9 A. My name is John T. Young, Jr.

10 Q. And you've prepared a proffer in this case; is
11 that right?

12 A. Yes, I have.

13 MR. KRUMHOLZ: And Your Honor, we would
14 offer the proffer into evidence.

15 THE COURT: Any objections to the
16 proffer?

17 MR. NEIER: No, Your Honor.

18 THE COURT: It's admitted. In fact, I
19 think we admitted everything.

20 MR. KRUMHOLZ: It's Exhibit 9, but just
21 to be safe.

22 Q. (By Mr. Krumholz) Could you briefly describe
23 your educational background.

24 THE COURT: We've already had that, so
25 let's move on. Didn't he testify before and he talked

1 about his educational background?

2 MR. NEIER: Yes, Your Honor.

3 MR. McDOWELL: We're also not summarizing
4 on direct.

5 THE COURT: It's not really direct, so he
6 gets a little latitude, but I don't think we need to
7 hear about his credentials. We all know his
8 credentials.

9 Q. (By Mr. Krumholz) You are a CPA?

10 A. I am a CPA.

11 Q. And where do you work now?

12 A. I work for Xroads Solutions Group, and I'm
13 also the interim chief financial officer of Scotia
14 Pacific.

15 Q. What's your title at Xroads?

16 A. Principal.

17 Q. And can you give us an understanding of what
18 that means at Xroads?

19 A. I think from most of the people in this room
20 it would be best to describe that as a position similar
21 to a partner in a law firm.

22 Q. How long have you been at Xroads?

23 A. Since 1999.

24 Q. Have you worked on some pretty significant
25 bankruptcy cases in your career?

1 MR. NEIER: Your Honor, we covered this
2 last time he testified.

3 THE COURT: I know. I mean, I remember
4 what he said before about all Xroads and now. Unless
5 you think there's something else, I'll consider that
6 before.

7 Q. (By Mr. Krumholz) Is there anything
8 additional that you haven't previously testified to in
9 that regard?

10 A. The only thing I would say is we haven't
11 really talked about my case experience if you'd like to
12 go into that.

13 Q. Just a quick summary of that.

14 A. Sure. Prior to this case I worked with Winn
15 Dixie stores. We were also debtor financial advisor.
16 That restructuring was regarded the by the turnaround
17 management association. I've also been involved in
18 matters associated with PSI net, MCI Worldcom, Enron and
19 a number of other large bankruptcies.

20 Q. I know that the Court understands that Xroads
21 has helped with the course of the bankruptcy in terms of
22 oversight of contract negotiations and oversight of
23 various claims reconciliation and ad hoc support, I
24 guess, but when did you become more involved in an
25 accounting department of Scopac?

1 A. I've always had some involvement with the
2 accounting department of Scopac really because we had to
3 work with the Scopac accounting people and in order to
4 produce the Scopac monthly operating reports. I stepped
5 up my involvement with Scopac in March of 2008
6 approximately with the third final cash collateral
7 order, which simply because that required more
8 day-to-day involvement with management of cash flows.
9 And reporting on those cash flows.

10 **Q. Did it require more controls be put into**
11 **place?**

12 A. It certainly did.

13 **Q. And can you describe those for the Court, that**
14 **you've implemented?**

15 A. I can. We really reset the variance reporting
16 with the third final cash collateral order, so we didn't
17 have the benefit of, say, 40 weeks of cumulative cash
18 flows and variances that we were -- would make
19 incremental additions to in order to calculate a
20 variance. We started over. And there were new variance
21 thresholds in place that we had to live by, and they
22 were more strict. So in order to do that, I had to be
23 in more day-to-day contact with the Scopac accounting
24 people and more closely monitor the receipts and
25 disbursements of Scopac to make sure we were in

1 compliance with that order.

2 **Q. Is there greater quality assurance or has**
3 **there been since March of 2008 than there has been in**
4 **the past in terms of cash flow projections and**
5 **budgeting?**

6 A. I think the best way to answer your question
7 is really just to cite the success we've had compared to
8 the budget. And most of the people in this room have
9 seen the variance report that I release each week. And
10 generally those -- you know, those variances we've
11 exceeded the budget and we've had favorable variances,
12 so --

13 **Q. And you say they exceeded the budget. You**
14 **mean you beat the expectations?**

15 A. We have beat the expectations.

16 **Q. In a positive way?**

17 A. In a positive way.

18 **Q. Okay. Now, in connection with this hearing**
19 **you prepared cash flow projections for Scopac and Palco;**
20 **is that right?**

21 A. That's correct.

22 **Q. Both individually and on a combined basis is**
23 **my understand; is that fair?**

24 A. That's fair. I mean, when you say a combined
25 base, really we've presented a combined set of cash

1 flows, but it's not one cash flow that represents both.

2 Let's just say you're correct. I mean, yeah.

3 **Q. Okay. In connection with the combined cash**
4 **flow projection, one of the assumptions that you made is**
5 **that there will be 5 million board feet of logs**
6 **delivered to Palco without any requirement to repay over**
7 **and above the roads and reforestation services that are**
8 **offset?**

9 A. Yeah. You know, you bring up a good point,
10 too. Everyone in this room, we keep calling this the
11 free log program, which I think is a
12 mischaracterization. It's not really a free log
13 program. Scopac would deliver 5 million board feet of
14 logs to Palco each month in exchange for Palco
15 continuing to provide roads and reforestation services.
16 And that has a value of approximately \$1 million a
17 month.

18 **Q. And net, what is the net benefit to Palco,**
19 **though, from a dollars perspective in this arrangement?**

20 A. Approximately 3, 3 and a half million a month.

21 **Q. And times six months?**

22 A. Yes.

23 **Q. So they would benefit \$18 to \$21 million?**

24 A. \$21 million over a six-month period.

25 **Q. Whose idea was it to come up with this**

1 **program?**

2 A. Let me back up. And I'll tell the story of
3 how this happened.

4 **Q. Okay.**

5 A. It started out -- I mean, it was really
6 counter-intuitive, I think, at first. But we were -- we
7 were presented with -- I think the best way to present
8 it -- to describe it is we were presented with a
9 problem. And that problem was how do we get Palco and
10 Scopac to operate on a status quo basis through an
11 appeal. And I didn't have an answer to that. I don't
12 think anyone else did.

13 So the first thing we tried to do is evaluate,
14 is there some way that Scopac can borrow money and
15 Scopac can lend money to Palco. And it got too
16 complicated. It wasn't going to work out. And it had
17 issues with claims developing at Palco, and it wasn't
18 going to work.

19 From there we decided to deliver logs to Palco
20 and let Palco build up an admin claim and then we would
21 somehow or another recover it at the end of the appeal.
22 That didn't work because the status quo would not --
23 would not leave Palco with an admin claim at the end of
24 the appeal period.

25 So then, you know, I've been screamed at and

1 argued with on this, but I think everyone's finally come
2 around on our side. The best thing to do that we
3 decided to operate Palco and Scopac both on a status quo
4 situation is to deliver Palco logs for free with the
5 exception of Palco having to provide the roads and
6 reforestation services. That way Palco doesn't build up
7 an admin claim. And then the DIP used to fund Scopac
8 would come out of the noteholders' recovery.

9 **Q. Is that an idea that you came up with or is**
10 **that an idea -- and Scopac came up with or is that an**
11 **idea someone else?**

12 A. Well, I'll take credit for it now. I didn't
13 take credit for it when I was being screamed at by your
14 clients.

15 **Q. But at the end of the day, was it your idea?**

16 A. Dr. Barrett and I came up with it, yeah.

17 **Q. Okay. And there were some questions by**
18 **various counsel in this courtroom about whether or not**
19 **the DIP facility has been approved by the Scopac Board**
20 **of Directors, that is, the \$20 million proposed DIP, has**
21 **it been approved?**

22 A. It has been approved.

23 **Q. Has it -- has this log purchase program, that**
24 **is, the 5 million board feet of logs delivered to Palco**
25 **each month without any requirement to pay for those logs**

1 other than providing these services, the roads and
2 reforestation services, has that now been approved by
3 the Board of Directors at Scopac?

4 A. In specific terms. In the context of the DIP,
5 that's approved. Without the DIP, that's not approved.
6 We can't -- yeah, in the context of the DIP, the log
7 deliveries without repayment from Scopac.

8 Q. So that has now been approved by the Scopac
9 board subject only to the provision of the DIP?

10 A. That's correct.

11 Q. Okay. And has Lehman approved the budget that
12 this is based upon?

13 A. Lehman has approved the budget.

14 Q. And who did you speak with at Lehman?

15 A. Mainly Rich Devito at Lehman, and he and I
16 have been in regular contact on that issue.

17 Q. Now, when you prepared these budgets, did you
18 have access to all the information at Palco and at
19 Scopac that you needed to make them reliable?

20 A. We did. We did.

21 Q. Did you feel like you were given all the
22 necessary information to make them reliable?

23 A. Yeah. You know, as Colonel Long pointed out
24 earlier, I'm in regular contact with the accounting
25 people at Palco. You know, I've worked with them for 18

1 months. I help them with their monthly operating
2 reports. And I frankly rely on Palco financial data to
3 monitor the -- or to project the future financial
4 performance, mainly cash flow performance of Scopac. So
5 we -- we do generally have access to any kind of
6 accounting data that we would need from Palco.

7 **Q. And when you were making assumptions or**
8 **projections and you had any questions whatsoever, did**
9 **you have access to those folks to determine what you**
10 **should decide upon in connection with any particular**
11 **issue?**

12 A. Yeah, we did. And maybe I should back up and
13 just describe the process.

14 **Q. Yeah. Tell us the methodology you used to**
15 **develop these forecasts?**

16 A. Shortly -- shortly after I took the interim
17 chief financial officer position at Scopac, I met with
18 Dr. Barrett and suggested to him that we take a bit of a
19 deeper dive into the cash flow projections for both
20 Scopac and also for Palco, just so we could have a
21 better sense of Palco's ability to pay us in a budget
22 not prepared by Palco, but one for Palco prepared by us
23 in case there were any type of errors or anything in the
24 Palco budget or something that maybe we didn't agree
25 with.

1 Dr. Barrett gave me the authority to use two
2 of my analysts to come in and really do a -- prepare a
3 bottom's up cash flow projections for both Palco and
4 Scopac. These -- what these guys did is they looked
5 at -- I think they looked at 52 weeks of historical cash
6 flow data and developed an understanding by category of
7 any kind of trends or run rates by account. And they
8 did that for both Palco and Scopac.

9 What we -- well, and based on the -- based on
10 the run rates and the historical spending data and
11 receipts data, they put together cash flow projections
12 again for both Palco and Scopac. The Scopac side, since
13 I've been involved with the projections more at Scopac,
14 I didn't have to rely on them as heavily. The Palco
15 projections --

16 **Q. On them meaning these two individuals?**

17 A. I'm sorry, on the two individuals. And these
18 are the same two individuals that I discussed in my
19 deposition.

20 **Q. Are these accountants or analysts?**

21 A. They're analysts. I mean, these are what
22 these guys do. They go and they dig for -- they dig
23 through geo data and accounting data, and this is what
24 they do.

25 **Q. Okay. And what did they come up with?**

1 A. And they came up with a first draft or first
2 pass at a set of cash flow projections through the end
3 of the year. And that was the directive that I gave
4 them.

5 **Q. And -- go ahead.**

6 A. Do you want me to --

7 **Q. Go ahead, please.**

8 A. Okay. When that was complete, we looked it
9 over and I said: Guys, this is what I'm going to do.
10 Let's sit down with the Palco accountants and kind of go
11 through this and talk about our assumptions. We also
12 involved Brian Gaston in that because of his knowledge
13 of the town and the power plant. He's also a Xroads
14 employee who's been working largely with the town and
15 power plant. And, you know, let's make sure that our
16 assumptions make sense. And so we went through that
17 process.

18 And, you know, frankly, I think they probably
19 learned a couple of things. We learned a couple of
20 things. It was a very constructive process for both
21 parties. So we then had, you know, kind of a second
22 pass at the development of a cash flow projection for
23 Palco. Then the last thing that we did -- and, I mean,
24 this happened some through the process, but then we
25 really took a look at what our projections looked like

1 for Palco compared to Palco's own projections and found
2 them to be fairly similar.

3 You know, one of the things I was looking at
4 last night, you know, David Neier suggested that we be
5 sure the pension payments were in there. And I'm sure
6 that was just -- I'm sure he knew they were in there,
7 but I looked at their budget and I looked at our budget.
8 And I think ours had the -- in next plan at 156 and they
9 were at 160. It was probably because we took it
10 straight off a schedule, and they used an approximate
11 number.

12 So I feel very confident that these
13 projections are reliable and have been developed using
14 standards that would be accepted in my profession and
15 probably in any profession in putting projections
16 together. They're based on historical -- largely based
17 on historical cash flow and interviews of the two
18 companies.

19 **Q. Do you believe them to be reliable and**
20 **credible forecasts through December of 2008?**

21 A. I do.

22 **Q. Are they conservative?**

23 A. They are.

24 **Q. And can you explain to the Court why you feel**
25 **that they're conservative?**

1 A. I can. On the Palco side -- I just want to
2 make sure I get the number right. But on the Palco
3 side, you see that Palco has cash balances ranging from
4 2 million to \$4 million throughout the six-month period,
5 which would provide for anything foreseeable that we may
6 have missed.

7 I could have added a line called contingency
8 and put \$100,000 a week or a month, but instead we know
9 we have a large balance of cash at Palco based on these
10 projections. I also believe the revenue numbers are
11 conservative. They are based on recent trend, but we
12 also know that we've been selling green lumber recently,
13 which will not have as high of a recovery as aged
14 lumber. I'm not an expert in types of lumber, but I
15 think I described that as best we can. I mean, we're
16 not selling a premium product right now.

17 **Q. And that's all taken into account?**

18 A. Yeah, because we are using current run rates.

19 **Q. And the methodology that you've used is the**
20 **same type of methodology that is systematically used in**
21 **the accounting profession; is that true?**

22 A. Yeah, that's true.

23 **Q. And in the restructuring context since you're**
24 **also restructuring?**

25 A. I think accountants make the best

1 restructuring people sometimes.

2 **Q. You think it's time tested?**

3 A. Of course. I mean, this is the way I've done
4 it for ten years.

5 **Q. Was it important for you to get this right?**

6 A. It was important, and it was important for a
7 number of reasons. I can't -- when someone hires me,
8 one of the things that they are hiring is credibility.
9 I mean, they -- I get called in because someone needs
10 credibility oftentimes. And if I don't have
11 credibility, I can't be effective. And if I can't be
12 effective, I have to go find something else to do. I
13 mean, this is what I do for a living. And I have to
14 have credibility. I spend a great deal of time making
15 sure that these forecasts make sense. And it's largely
16 because of credibility.

17 I mean, I think even the people in this room
18 based on hearing my prior testimony, you know, I don't
19 always answer the questions quickly. I want to be
20 credible here on the stand. I want to be credible in my
21 projections. I want to be very accurate and precise, as
22 credible as possible because that's my livelihood is
23 being credible.

24 **Q. Now, I want to talk about your forecast in**
25 **particular. And I understand you did a Scopac as-is or**

1 a Scopac alone forecast; is that right?

2 A. That's right.

3 Q. And you understand that IT, through me, has
4 stated that it needed only funding Scopac and not Palco
5 in terms of legal theory. And I know that you're not a
6 lawyer, but you understand that's our position?

7 A. I understand that assumption, yeah.

8 Q. Have you prepared -- and Exhibit A to your
9 proffer is that Scopac only projection; is that right?

10 A. That's correct.

11 Q. And what assumptions did you use in connection
12 with that projection?

13 A. In that set of projections we assumed that
14 Scopac would continue to deliver 5 million board feet of
15 logs per month to Palco at SBE and would continue to be
16 paid for those logs. I guess there's an underlying
17 assumption there that Marathon would continue to support
18 Palco through the -- through the appeal process.

19 Q. But haven't you heard Mr. Neier stand up and
20 tell the Court that they're not going to do that?

21 A. I don't know that I heard Mr. Neier say that,
22 but I think we -- he's shaking his head yes. You know,
23 I did hear the Judge -- I think the Judge and I might
24 have a similar opinion on this, at least what he said
25 yesterday. We don't think -- I don't think anyway that

1 Marathon would pull the plug on this, given the level of
2 debt and the net orderly liquidation value of the
3 underlying collateral.

4 Q. Do you think it's an economically
5 irrational --

6 A. That's just my opinion.

7 Q. Do you believe based on your knowledge of the
8 circumstances at Palco and -- do you think that would be
9 an economically rational decision, let me put it that
10 way?

11 A. I do not think that would be a rational
12 decision.

13 Q. Okay. Scopac, is it cash flow positive or
14 negative before professional fees over the forecast
15 period?

16 A. It's approximately, I believe, \$5 million
17 positive before you pay out professional fees.

18 Q. And then through December 31, 2008, what is
19 Scopac's borrowing need, including for professional
20 fees, that is, includes those professional fees?

21 A. At the end of the periods -- at the end of the
22 period, Palco would -- I need to describe this a little
23 more thoroughly because I don't think your question
24 really --

25 Q. I appreciate that.

1 A. -- allows me to give an honest answer.

2 Q. Okay.

3 A. Well, I think --

4 Q. Go ahead.

5 A. Sure. In the interim period in the Scopac
6 stand-alone scenario where Palco continues to pay for
7 logs, after the payment of professionals Scopac would
8 need to borrow on a DIP to the tune of approximately 2
9 and a half million. What happens though is toward the
10 end -- at the end of the period, Scopac would not have
11 any outstanding balance on the DIP. So there would be a
12 need for borrowing, but at the end of the period there
13 would be no outstanding balance.

14 Q. So when I looked at the line and it said zero
15 at the end of 2008, what that meant was that it didn't
16 have a borrowing need as of that date, but it did
17 previously?

18 A. That's right.

19 Q. And what's the most in any one month in a
20 period that was needed?

21 A. I believe it was approximately 2 and a half
22 million. Let me just look.

23 Q. Sure.

24 A. It's approximately 2 and a half million. I
25 think I addressed that in my declaration.

1 **Q. In that regard, the \$2 and a half million, is**
2 **that the most you think, based on your forecast, that**
3 **Scopac would need to be funded during that six-month**
4 **period in order to operate as is, assuming that Marathon**
5 **continues to support Palco?**

6 A. No. And the reason I say that is -- the
7 reason that's not a reasonable assumption -- that would
8 assume that at some point you're operating with a zero
9 cash balance, and that's not reasonable.

10 **Q. So \$3 million?**

11 A. I would say 4.

12 **Q. Okay. So \$4 million? Would that be**
13 **sufficient in terms of any security for Scopac only?**

14 A. Yeah. And the reason I say that -- I should
15 add one other thing. In this scenario, I believe you're
16 still operating with some degree of uncertainty. It's
17 different than the -- what we all call the free log
18 program. Because I think there's a high level of
19 certainty in the free log program scenario. In this
20 scenario, I don't know for certain if Marathon is going
21 to pull out. I have no way of knowing that. I don't
22 think they will. But there is a higher degree of
23 execution risk associated with operating on a
24 stand-alone basis, so I would want more -- I would want
25 more working capital in a situation of -- in a situation

1 of uncertainty than I would in a situation with more
2 certainty such as that of the free log program scenario.

3 **Q. Have you included property taxes in your**
4 **forecast?**

5 A. I have.

6 **Q. Have you included the same insurance on the**
7 **properties of Scopac for the forecasted period that it**
8 **currently has?**

9 A. This goes back to how we prepared the budgets.
10 What we did -- you know, because I had 15 months
11 experience looking at the cash flows of these -- of
12 these two companies. We know when the -- there are
13 irregular payments that are made. There are payments of
14 insurance. There are payment of property taxes. We --
15 there are pension payments. And, you know, these are
16 the pitfalls that you run into in preparing cash flow
17 projections is missing the large non-recurring or
18 irregularly occurring payments. I feel we have very
19 appropriately and accurately identified those payments,
20 and they are all included in the budgets.

21 **Q. Turning to Palco, have you also projected what**
22 **Palco will burn on an as-is basis assuming nothing**
23 **changes in operations? And this is not the combined --**
24 **the combined forecast that you've developed or the free**
25 **log program basis. But I'm just saying on an as-is**

1 **operations basis.**

2 A. That analysis has been done.

3 **Q. And are they cash flow negative? Is Palco**
4 **cash flow negative?**

5 A. It is cash flow negative.

6 **Q. And by what magnitude through December 31,**
7 **2008?**

8 A. I don't have it in front of me. I think it's
9 approximately \$12 million.

10 **Q. Is that with or without professional fees?**

11 A. Palco is not currently paying professional
12 fees. So that would be without. Without professional
13 fees and without any payment to Marathon interest.

14 **Q. Okay. So just to be clear -- so before**
15 **professional fees, Scopac is cash flow positive?**

16 A. Yeah, approximately.

17 **Q. And without professional fees, Palco is cash**
18 **flow negative?**

19 A. That's correct.

20 **Q. And you've also prepared a combined forecast**
21 **that's Exhibit B to your proffer; is that correct?**

22 A. Actually, may I --

23 **Q. Sure.**

24 A. May I provide a statement. It's like Scopac
25 would be slightly cash flow negative. Scopac has a

1 beginning balance of cash, so I think Scopac -- and
2 again, the number is here. I think it probably -- after
3 professional fees, it burns through \$2.8 million.

4 **Q. Okay. Turning to your combined forecast, that**
5 **is, for Palco and Scopac based upon these new**
6 **assumptions that you've come up with. That's Exhibit B**
7 **to your proffer, first of all, right?**

8 A. That's correct.

9 **Q. We've gone through why you prepared the**
10 **combined forecast, but can we talk about the assumptions**
11 **just for a minute. What assumptions have you made in**
12 **connection with that combined forecast?**

13 A. The assumptions used in the combined
14 forecast -- and it's page 1 of 5 of Exhibit B -- are
15 that Scopac will deliver logs -- will deliver 5 million
16 board feet of logs to Palco each month and will not
17 require any repayment, will not require a receivable.
18 All we will require is that Palco continue to provide us
19 with roads and reforestation services.

20 **Q. And the \$20 million DIP is also included in**
21 **those assumptions?**

22 A. It is. Scopac -- yeah, Scopac has a \$20
23 million DIP on which they can draw, we can draw. So we
24 provide our working capital needs by drawing on the DIP.
25 We provide Palco with 5 million board feet a month of

1 logs. Palco then converts those logs into lumber and
2 sells that lumber. And so that's the source of cash for
3 Palco.

4 **Q. And that's what -- you're talking about --**
5 **when we talk about net benefit earlier, \$21 million of**
6 **net benefit to Palco over a time period; is that**
7 **correct?**

8 A. That's approximately correct. Would you like
9 to -- would you like me to run the Court through a high
10 level calculation of how we get to the 21 million?

11 **Q. Sure, quickly.**

12 A. Okay. If I'm taking too much time, stop me,
13 please. The SBE price that we're using -- okay, over a
14 six-month period we would deliver approximately 30,000
15 board feet of logs -- I'm sorry, 30 million board feet
16 of logs. So using SBE of 620 and assuming log and haul
17 costs of 225, that gets you to \$845 per thousand. You
18 multiply that by 30,000 because he 485 is on a per
19 thousand basis to get to 21 -- 25.4 million. From that,
20 you would deduct approximately 6 million. That's \$6
21 million a month. So we would deliver logs to Palco for
22 free that we otherwise would have charged \$25.4 million
23 to.

24 I should also point out -- well, let me finish
25 this, and then I'll send something else up. From the

1 25.4 you would deduct approximately \$6 million that
2 would be the cost to Palco for its reforestation to get
3 to approximately \$19.4 million of value that we would
4 provide to Palco.

5 **Q. At the end of the forecast period, how much of**
6 **the DIP is used up?**

7 A. Approximately \$19.7 million.

8 **Q. There was a question by Mr. Litvak, I believe,**
9 **or one of the counsel, if there's -- there's a \$3.9**
10 **million cash ending balance to Palco at the end of the**
11 **forecast; is that right?**

12 A. I'm sorry, would you please repeat?

13 THE COURT: 3.9 Palco cash balance.

14 A. Yes, sir, that's correct.

15 **Q. And there's a \$300,000 cash balance at Scopac**
16 **at the end of the period; is that correct?**

17 A. That is correct. Well, there's \$300,000
18 availability.

19 **Q. Availability. Fair enough. Are you concerned**
20 **as CFO that there's only \$300,000 left of availability**
21 **through December of 2008 for Scopac?**

22 A. I feel that our projections are conservative,
23 especially based -- again, I'll go back to the variance
24 report. We've all seen the available variances on the
25 variance reports. We used similar methodology in

1 preparing these reports. Because this is a DIP budget,
2 I would be more conservative seeking authority to spend,
3 but not necessarily planning to spend every penny of it.

4 Q. And so is the answer that you're not
5 concerned?

6 A. No, I am comfortable with the \$300,000
7 availability. I don't anticipate it to actually get
8 that tight.

9 Q. Okay. Is there any cash -- I wanted -- this
10 is a little bit unrelated, but under the Marathon plan,
11 the MRC/Marathon plan, does Marathon get any cash if it
12 goes ahead and closes the transaction?

13 A. No.

14 Q. Does it receive -- does Marathon receive cash
15 payments under your forecast under this combined
16 forecasting modeling that you've done?

17 A. We did assume that Marathon continues to
18 collect the interest on the -- on the DIP, which is
19 approximately \$375,000 a month or \$400,000 a month.

20 Q. And would this be a good proxy, that is, the
21 six months forecast that you've done, using the
22 assumption of 5 million board feet and the \$20 million
23 DIP for future periods of time less than \$5.47 million
24 of attorneys' fees or professional fees that are being
25 paid during this time frame?

1 A. Yeah, that's true. You would take the current
2 combined run -- the current combined loss -- or cash
3 flow for the six-month period, and you'd have to deduct
4 out the roughly 5 and a half million dollars that goes
5 toward paying down the legal accrual, and then the
6 remainder of the DIP fee and legal fees associated with
7 the DIP. So you pull out the 5 and a half million. And
8 I think it's a reasonable proxy for any six-month
9 period.

10 **Q. And that gets by my calculations somewhere**
11 **around 14 and a half --**

12 A. That sounds about right.

13 **Q. -- to \$15 million?**

14 A. That sounds about right.

15 **Q. That would be needed in the next six-month**
16 **period?**

17 A. Yeah, I reflect \$15 million.

18 **Q. And then do you believe that your forecast**
19 **that you've developed preserves the status quo for both**
20 **Scopac and Palco?**

21 A. Yeah, I think I explained that earlier.

22 **Q. And is there any reason in your mind that they**
23 **can't continue to operate from a financial or**
24 **operational perspective given your analysis?**

25 A. Based on what the numbers -- based on what the

1 numbers demonstrate, they should be able to operate.

2 **Q. What is Exhibit E to your proffer, that is,**
3 **the last page attached to your proffer?**

4 A. I believe that's the analysis of the
5 distribution. Let me just look. Yeah, that's the -- I
6 had been calling it the distribution analysis, but it's
7 an analysis of distributions to creditors. And what we
8 did is we applied the federal judgment rate to what
9 those distributions would have been to determine that in
10 order -- in order to compensate those who would have
11 received distributions for not receiving a distribution,
12 we would provide them with -- I think the adjustment
13 rate is 2.35 percent, which results in approximately a
14 million dollars of payments to compensate those who
15 would have been -- those who would have received
16 distributions.

17 **Q. So the purpose is to compensate for any delay**
18 **in receiving the distributions caused by a stay?**

19 A. That's correct.

20 **Q. Okay. And you've calculated, I see, by**
21 **looking at the page it's \$300,000 for Palco creditors;**
22 **is that right?**

23 A. Yes.

24 **Q. And \$700,000 for Scopac creditors?**

25 A. That's correct.

1 Q. Have you also asked your attorneys about court
2 costs that might be impacted in the forecasting, that
3 might be applied in the context of a security?

4 A. No. I have. And it's my understanding those
5 are very small, probably even under \$5,000.

6 Q. And have you accounted for that in connection
7 with your forecast?

8 A. I have. I mean, to have an item less than
9 \$5,000 item in a forecast.

10 Q. You think it's diminimus?

11 A. It's diminimus.

12 Q. Okay. The last thing I want to talk to you
13 about is I want you to assume that the confirmation plan
14 as to MRC/Marathon does not go effective. Do you know
15 the amount of cash that MRC and Marathon get to keep if
16 that were the case, if there was a stay pending appeal
17 during the -- during the appeal period?

18 A. I guess -- I guess a way to look at it is if
19 the plan didn't go effective, the cash requirement of
20 Marathon/MRC is approximately 325 million, 225 million.
21 I know part of it is borrow and then there's a cash
22 requirement, so it's either 225 million or 325 million.

23 Q. So the cash portion of \$325 million they get
24 to keep during the pendency of the appeal; is that your
25 understanding?

1 A. That's right.

2 Q. And --

3 A. That's right.

4 Q. And it would get to earn interest on that,
5 correct?

6 A. They would.

7 Q. And then with respect to the debt, the bridge
8 loan, that's Exhibit 157, you've seen those documents,
9 have you not?

10 A. That's the American AgCredit.

11 Q. Yes.

12 A. Okay.

13 Q. With respect to the bridge financing
14 documents, it's liable or plus, I think, 225 basis
15 points is what Mr. Dean testified would be the interest
16 rate for the bridge loan; is that right?

17 A. Yeah. That would be about five percent.

18 Q. Okay. And how much would you say in
19 connection with the interest would be charged during the
20 pendency of the appeal through --

21 A. It would be five percent on 325 million for
22 six months. It's probably approximately 6 million
23 bucks.

24 Q. Okay. And does their business plan show that
25 they make money or lose money at Newco in the first year

1 of its operation?

2 A. It shows that they lose money during the first
3 year.

4 Q. Do you remember the magnitude of that?

5 A. I don't recall offhand.

6 Q. There is one last area that I noted in my
7 notes. Do you consider the redwood forest, the 200,000
8 acres at Scopac, to be unique -- a unique property?

9 A. Of course.

10 Q. Are you aware that Mr. Dean has pursued
11 these -- this property for a number of years?

12 A. Only based on the -- yes, of course.

13 Q. And you heard last weeks' testimony about his
14 belief that the value of timberlands is rising despite
15 the economic downturn?

16 A. I did.

17 Q. Do you see any economic reason why he would
18 choose to withdraw from the plan, based upon that
19 testimony and those circumstances?

20 A. No. No, I don't.

21 MR. KRUMHOLZ: Pass the witness.

22 THE COURT: All right. What about
23 Scopac; do you have any questions?

24 MR. FROMME: No, Your Honor.

25 THE COURT: All right. Mendocino.

1 CROSS-EXAMINATION

2 BY MR. HAIL:

3 Q. Brian Hail for Mendocino Redwood Company.
4 Mr. Young, picking up on the last point that counsel
5 just talked to you about, and that is specifically
6 financing cost and MRC walking, in your opinion, on
7 that, MRC is -- contemplates borrowing a significant
8 amount of money in connection with the steel, correct?

9 A. Yes.

10 Q. And isn't that about \$325 million?

11 A. That's my understanding.

12 Q. Okay. And you looked at the interest rates
13 available on that, correct, or the current deal, right?

14 A. Yeah.

15 Q. Okay. And that interest rate is a floating
16 rate, right?

17 A. I believe so.

18 Q. Okay. And MRC also contemplates taking out
19 the bridge financing with long-term financing?

20 A. Yeah, if it's liable. Yes, it would be a
21 floating rate. I'm sorry, yes.

22 Q. And MRC is going to take out any bridge
23 financing with long-term financing, right?

24 A. That's correct.

25 Q. Have you read Mr. Dean's deposition on this

1 point?

2 A. I've read through it. I don't recall the
3 specific testimony, though.

4 Q. Yeah. Mr. Dean testified that he would expect
5 the financing would end up being tied to treasury rate
6 plus about 250 to 300 basis points. Do you recall that?

7 A. I don't.

8 Q. Okay. And if you assume that the current
9 ten-year treasury rate is about 3.8 percent, 300 basis
10 points added to that is 6.8 percent; did I get that
11 right?

12 A. Yeah.

13 Q. Okay. And if interest rates move
14 significantly over the next several months, that cost of
15 financing could go significantly higher, couldn't it?

16 A. Or lower.

17 Q. Or lower. That's right. But if it goes up,
18 there will be a significant higher cost, right?

19 A. That's correct.

20 Q. Okay. And if the interest rates move one
21 percent over the next couple of months on the ten-year
22 rate, do you have any idea what the increased cost to
23 MRC of financing this transaction would be? We can
24 figure it out, though, can't we?

25 A. I suspect we could.

1 Q. Okay. We could run a present value
2 calculation. One percent of 325 is 3.25 million a year,
3 the way I do my math; is that right?

4 A. That's correct.

5 Q. Okay. And over a 14-year period, which is the
6 financing cost Mr. Dean contemplated might be the length
7 of the loan; do you remember that?

8 A. Yes.

9 Q. Okay. And so to run a present value
10 calculation of 3.25 percent based on a 6.8 percent
11 discount rate, I asked you to bring your calculator up,
12 right?

13 A. You did.

14 Q. And do you know what the results of that
15 calculation are?

16 A. Okay. So we want to -- we want to discount
17 \$325,000 per year?

18 Q. 3.25 million.

19 A. I'm sorry, 3.25 million at 6.8 percent for 14
20 years.

21 Q. Right. My math gave me 28.77 million.

22 A. And that's based on your hypothetical that
23 interest rates increased.

24 Q. Well, that's just math. But I'm asking you if
25 that's the right math.

1 A. Do you really want me to verify this?

2 Q. You know, I really do, honestly.

3 A. So --

4 Q. 14, 3.25 million, 6.8 interest rate?

5 A. I think I'm actually getting a different
6 number than you.

7 Q. That's why I wanted you to do it. What are
8 you getting?

9 A. I got \$38 million.

10 Q. I'll take \$38 million.

11 A. But again, give me an Excel spreadsheet, and I
12 could probably do this more accurately.

13 Q. Okay. But that number could be calculated
14 relatively simply, right?

15 A. I'm sure it could.

16 Q. Okay. Now, long-term financing wouldn't be --
17 you read Mr. Dean's deposition that long-term financing
18 wouldn't be floating financing; it would be fixed rate
19 at a certain spread, right?

20 A. That's right.

21 Q. No, so if interest rates move one percent,
22 that cost on a present value basis to Mendocino Redwood
23 to stick around to cause them to pay roughly another \$30
24 million. Either 28 under my calculations or 38 under
25 your calculations, right?

1 A. Based on your hypothetical, yeah.

2 Q. Okay. And so if interest rates move two or
3 three points, we would just multiply that 28, 38,
4 whatever the right calculation is, times two or three.

5 A. Positive or negative, yeah.

6 Q. Now, you also spoke that MRC is, in fact,
7 going to lose money in its first year, right?

8 A. That's based on the documents that have been
9 released by MRC.

10 Q. I'm just asking --

11 A. Yeah, yeah.

12 Q. What you just testified, right?

13 A. Yes.

14 Q. Now, if that loss is put off one year, we're
15 still going to lose -- and we buy the company
16 ultimately, we're still going to have to lose the same
17 amount of money, aren't we? It's not like it's found
18 money?

19 A. During the first year of your operations, you
20 would. Yes.

21 Q. So it's just a timing differential is all it
22 would be?

23 A. My point is we are maintaining status quo, not
24 that you're not ultimately going to incur the loss.

25 Q. Well, in your proffer you actually have a set

1 of opinions about what MRC's announced loss is, didn't
2 you?

3 A. My -- I don't know that I would call them
4 opinions. They were straight out of your document, out
5 of your materials or MRC's materials.

6 Q. Now, this proffer was prepared relatively
7 quickly, wasn't it?

8 A. It was.

9 Q. Okay. And the spreadsheets and analysis that
10 accompanied it were prepared relatively quickly also,
11 weren't they?

12 A. No.

13 Q. How long had the projections for the free log
14 program been in existence?

15 A. As you and I discussed the other day, the
16 underlying budgets had been prepared. This was just a
17 change in assumption. So we didn't -- we didn't
18 frantically put together a bunch of spreadsheets in the
19 middle of the night. We simply changed some assumptions
20 to an existing --

21 Q. You prepared the Palco numbers relatively
22 quickly, right?

23 A. No. I just testified that those have been a
24 process since probably three or four weeks ago.

25 Q. The Palco 26-week cash budget had been in

1 **existence for a month?**

2 A. The base cash flow projection, yes. And we
3 just changed assumptions to that cash flow projection.

4 **Q. When did you first give to anyone, either at**
5 **Palco or at Mendocino Marathon a copy of your Palco cash**
6 **flow projections?**

7 A. I don't believe that I have.

8 **Q. Well, they're certainly attached to your**
9 **declaration?**

10 A. Other than through my declaration, yeah.

11 **Q. So the only time that I would have seen them**
12 **or Palco would have seen them or anyone at Palco would**
13 **have seen them was about midnight the night before last,**
14 **right?**

15 A. That's correct.

16 **Q. Okay. Now, focusing on your proffer and**
17 **specifically your statements as to what MRC's loss would**
18 **be, take a look at your declaration, page 5, please,**
19 **paragraph 22 and 23.**

20 A. Okay.

21 MR. HAIL: Does Your Honor have a copy of
22 that?

23 THE COURT: Yes.

24 MR. HAIL: Okay. For the record, I think
25 Exhibit 189.

1 **Q. (By Mr. Hail) Specifically Exhibit C, do you**
2 **see that you indicate that the disclosure statement**
3 **indicates that Newco's EBITDA for the first year will be**
4 **approximately negative 7 million. Do you see that?**

5 A. Yes.

6 **Q. Are you sure that's right?**

7 A. I can verify that. I hope that's right.

8 **Q. Turn to page 4 of Exhibit C to your proffer,**
9 **please. For the record it says in the upper right-hand**
10 **corner page 4 of 15.**

11 THE COURT: Upper right-hand corner.

12 MR. HAIL: Upper right-hand corner it
13 says 4 of 15, Your Honor, Exhibit C.

14 **Q. (By Mr. Hail) Do you see that, Mr. Young?**

15 A. I do.

16 **Q. At the bottom there is a negative 7.68 million**
17 **number. Do you see that?**

18 A. Yes.

19 **Q. Is that the number you were referencing?**

20 A. It is. You are correct in that that would be
21 an income number, not an EBITDA number.

22 **Q. So it doesn't represent EBITDA, does it?**

23 A. It's not income.

24 **Q. It's also not a full year, is it?**

25 A. That's true, too.

1 Q. If you go back up, in fact, that number has an
2 interest expense built into it of \$15.6 million, right?

3 A. You're correct.

4 Q. So on an EBITDA basis, actually that number is
5 significantly positive, isn't it?

6 A. That's correct.

7 Q. Okay. Go back to your proffer, please,
8 paragraph 23. You cite a different set of projections.
9 Do you see that?

10 A. I do.

11 Q. Okay. And it says the last sentence of
12 paragraph 23 says: "The MRC business plan provides that
13 Newco's EBITDA for the first year will be approximately
14 negative \$1.7 million." Do you see that?

15 A. Yes.

16 Q. Are you sure that's right?

17 A. Let me go back to the document, if I may.

18 Q. Absolutely. Well, you signed this. You
19 checked it before you signed it, right?

20 A. I did. Again, you know, this was, I think,
21 released at midnight after a night of being up until
22 5:00 in the morning, so we did our best to provide you
23 guys what you wanted.

24 Q. Why don't you turn to page 24 of Exhibit D,
25 please.

1 A. I'm there. I see the negative 1.7 million.

2 **Q. Now, is that the number you were referencing**
3 **in your proffer?**

4 A. Yes.

5 **Q. Okay.**

6 THE COURT: Exhibit D, where is that?

7 MR. HAIL: Exhibit D to his proffer, page
8 24. I don't think it has a number in the upper
9 right-hand.

10 THE COURT: Does it have a number at the
11 bottom that says 24?

12 MR. HAIL: Yes, Your Honor. And it's
13 also up on the screen.

14 THE COURT: Okay.

15 **Q. (By Mr. Hail) If you turn back a page to page**
16 **22 -- turn back two pages, I guess, you see the heading,**
17 **it says "financial projections." And the first sentence**
18 **says: "Although lands and mill will be closely**
19 **integrated, it is appropriate and possible to model them**
20 **separately financially." Do you see that?**

21 A. Yes.

22 **Q. Does that imply they are separate financials**
23 **for the mill and for the timberlands?**

24 A. I don't read that into that sentence.

25 **Q. Okay. Well, turn the page to page 23 then.**

1 Do you see a series of -- well, you can look at -- I
2 guess on page 22 it says: "Forest land income
3 statement," then we come back and we have a set of
4 projections here, don't we?

5 A. Yes.

6 Q. And, in fact, that shows a positive cash flow
7 of 8.59 million, doesn't it?

8 A. It does.

9 Q. Okay. And that's for the -- if you take a
10 look back, that's for the forest land side of the
11 business, right?

12 A. Yes, that appears to be true.

13 Q. Okay. And then underneath that positive 8.549
14 million there's another section that says "mill and
15 distribution income statement." Do you see that?

16 A. I do.

17 Q. And, in fact, when you go down the page down
18 to page 24, you show up with a negative \$1.7 million
19 number. Do you see that?

20 A. Yes.

21 Q. Do you still stand by your proffer statement
22 that this reflects a negative EBITDA for the first year
23 of negative \$1.7 million for Newco?

24 A. No. Based on what you just told me, I can't
25 stand by that fact any longer.

1 Q. And in fact, these documents show that there
2 will be positive cash flow at Newco in the first year,
3 isn't that right?

4 A. Yes.

5 Q. Okay. Now, turning back to your proffer and
6 your decisions about -- in your declaration you opine
7 that -- paragraph 9 -- that "it will be uneconomic and
8 unreasonable for Marathon or MRC to shut down Palco."
9 Do you see that sentence?

10 A. Yes.

11 Q. Have you ever spoken with Marathon about that?

12 A. No.

13 Q. Ever spoken to MRC about that?

14 A. No.

15 Q. And you would, in fact, assume then that
16 Marathon is going to continue to fund losses, right?

17 A. I assumed that it would be reasonable for them
18 to do so.

19 Q. Okay. When you prepared -- and you made a
20 statement. Were you aware that the Marathon DIP matured
21 in August 2008?

22 A. I have actually learned that since releasing
23 this declaration, but I still --

24 Q. But my question was: When you made the
25 statement, you didn't -- you didn't realize the DIP

1 **matured in a month, did you?**

2 A. At the time, no.

3 **Q. And any of the financial schedules that you**
4 **made in connection with your proffer didn't account for**
5 **the fact that the DIP matured, did it?**

6 A. That's correct.

7 **Q. So it's rather convenient that -- the fact**
8 **that the DIP matures and there's a \$7 million obligation**
9 **that expires in August, you think Marathon will just**
10 **roll over anyway, right?**

11 A. Yes.

12 **Q. Now, MRC faces a different set of factors in**
13 **deciding whether or not to close the transaction, right?**

14 A. Correct.

15 **Q. It faces interest rate risk, right?**

16 A. Correct.

17 **Q. It faces opportunity cost loss on investment**
18 **capital, right?**

19 A. Possibly.

20 **Q. What other risk would Marathon look at? Would**
21 **MRC have, in your opinion?**

22 A. You've given me two, and I'm fine with those
23 two.

24 **Q. There could be a big fire, couldn't there?**

25 A. There could be -- as we described yesterday,

1 there could be a nuclear war. It's -- there are --
2 yeah, there are --

3 Q. There could be lots of reasons that MRC --

4 A. Reasonable and unreasonable risk.

5 Q. There could be lots of reasons that MRC would
6 not want to close the transaction 60 days from now,
7 right?

8 A. There could be.

9 Q. Okay. And we can't predict those now, can we?

10 A. No.

11 Q. We can certainly foresee several of them,
12 though, right?

13 A. That's --

14 THE COURT: I thought MRC was bound to
15 close 30 days or 60 days from now.

16 MR. HAIL: You're right, Your Honor, but
17 after --

18 THE COURT: Beyond 60 days, is that what
19 your question was?

20 MR. HAIL: Yes, Your Honor.

21 A. If that wasn't clear, I'll rephrase it.

22 Q. Beyond 60 days, things might occur such that
23 MRC would not want to close the transaction, right?

24 A. That could happen.

25 Q. Now, if we go to the -- well, let me ask you a

1 series of questions about the free log program. I have
2 to claim credit at this point for naming it the free log
3 program. I think I did it about three hours after I got
4 your proffer in discussions.

5 Under the free log program, have you seen any
6 written proposal from the indenture trustee?

7 A. I have not.

8 Q. Have you seen any written description of the
9 offer or conditions or terms or anything like that?

10 A. No.

11 Q. And so --

12 A. I have nothing in writing if that's -- so you
13 know.

14 Q. Nothing in writing at all?

15 A. Nothing in writing.

16 Q. So when did you first learn, for example, that
17 they wanted to reserve the right to halt the free log
18 program before December 2008?

19 MR. KRUMHOLZ: I'll object. It
20 mischaracterizes the evidence.

21 A. There's no intent --

22 THE COURT: I think that they have now
23 adjusted the program to the point -- I mean, it is true
24 that when we came in yesterday and today that there was
25 no requirement other than withdrawing the appeal to

1 stopping the log program before the end of the year.
2 Now they have -- they have gotten permission to say that
3 they are willing for the -- what you call a free log
4 program, what he calls the combination of payment by
5 doing the roads and the DIP program.

6 MR. HAIL: The discount.

7 THE COURT: They will agree that that
8 will last through December and can only be eliminated by
9 them withdrawing their appeal. Isn't that correct?

10 MR. KRUMHOLZ: Yes, Your Honor.

11 THE COURT: Okay. So I know it's
12 changed. You can ask him about what it used to be, but
13 it's probably better to ask about what it is.

14 MR. HAIL: No problem, Your Honor.

15 Q. (By Mr. Hail) It's not the free log program;
16 it's the discount log program, right?

17 A. I like that better.

18 Q. Okay. And your modeling in connection with
19 the program assumed that the -- that the -- the cash
20 flow modeling, for example, assumed that the program
21 lasted through December 2008, correct?

22 A. That's correct.

23 Q. Okay. Now, if you pay particular attention to
24 the -- let's go specifically to Exhibit B to your
25 proffer, which is the combination cash flow statement.

1 **And this is -- this is the consolidated statement,**
2 **right?**

3 A. Yes.

4 **Q. And this shows specifically at Palco what**
5 **happens relative to cash balances if they don't have to**
6 **pay for logs, right?**

7 THE COURT: Exhibit D as in --

8 MR. HAIL: No, I'm sorry, Exhibit B as in
9 boy, Your Honor.

10 THE COURT: Oh, B. And it's how many
11 pages? 3 of 3?

12 MR. HAIL: No, I have 1 of 5, Your Honor.
13 It starts at 1 of 5.

14 THE COURT: Okay. I got it.

15 **Q. (By Mr. Hail) And if you over in the far**
16 **right -- there's a row that is net cash flow. Do you**
17 **see that?**

18 A. Yes.

19 **Q. And if you go over to the far right, I don't**
20 **want to -- watch out, Richard. There is a number that**
21 **is negative \$23.65 million; is that right?**

22 A. Yes.

23 **Q. So the effect of the running the business in**
24 **this manner is to lose approximately \$23.65 million,**
25 **right?**

1 A. Scopac alone or combined?

2 Q. Is this -- well, you tell me. Is this a
3 combined basis or is this on the Scopac?

4 A. That's Scopac. The combined number would be
5 down below. It would be 21.6 million --

6 Q. Okay.

7 A. -- which is the sum of those two.

8 Q. So just in the Scopac column then, the
9 negative effect is to lose \$23.6 million; is that right?

10 A. We would have \$23.6 million negative cash
11 flow, yeah.

12 Q. Now, you testified that the Scopac Board of
13 Directors has signed off on this arrangement; is that
14 right?

15 A. In the context of the DIP, yes.

16 Q. Did they pass any board resolutions on this
17 issue?

18 A. Did they pass any board -- I'm not 100 percent
19 certain. We had two -- we had two board meetings last
20 night. I was on one of them. I was not on the second
21 one because I had something else I needed to do. I was
22 told after that we're meeting, that everything had been
23 approved by the board in the context of the DIP. But I
24 do not know specifically if there's a -- a formal board
25 resolution.

1 **Q. Okay. And in fact --**

2 THE COURT: Can I just ask, what do you
3 mean by in the context of the DIP?

4 THE WITNESS: Sure. Without the DIP, the
5 board would not approve the discounted log program.

6 THE COURT: So that's not what's being
7 offered. The offer is the DIP and the discounted log
8 program. Did they approve that?

9 THE WITNESS: They did.

10 THE COURT: Okay.

11 **Q. (By Mr. Hail) You hadn't spoken to the Scopac**
12 **board about this program before last night, did you?**

13 A. That's correct.

14 **Q. And in connection with this, you have to have**
15 **the DIP, right? The DIP -- it only works with the DIP?**

16 A. What I've been saying, okay.

17 **Q. Now, the DIP is going to have to be**
18 **renegotiated, isn't it? The DIP with Lehman?**

19 A. Are you asking me if --

20 **Q. You're going to renegotiate the DIP with**
21 **Lehman, aren't you?**

22 A. The current credit agreement provides for us
23 to seek an additional commitment at a future date when
24 needed. I forget the exact -- the exact terms of that.

25 THE COURT: I think he sort of asked.

1 You're speaking it through. Do you know whether or not
2 the current agreement you have with Lehman allows you to
3 do this DIP or does it require additional negotiations?

4 THE WITNESS: You're correct, Your Honor.
5 We can do what you see here under the --

6 THE COURT: I'm not -- I didn't say
7 anything. I don't know. Does Lehman -- has Lehman
8 signed off on this DIP/discounted log program?

9 THE WITNESS: They have, Your Honor.

10 Q. (By Mr. Hail) When did Lehman sign off on it?

11 A. The dates run together so much lately. I
12 think it was on Wednesday of this week.

13 Q. And who did you speak to at Lehman?

14 A. Rich Devito and Dan Kamensky.

15 Q. You spoke to Dan Kamensky? Are you sure?

16 A. I've had calls from both of them.

17 Q. Remember, you told me that you hadn't spoken
18 to Dan Kamensky in several months?

19 A. No, this is subsequent to when you and I sat
20 down. The initial discussions on the approval were with
21 Rich Devito. Since you and I talked.

22 Q. Have you received a written commitment from
23 Mr. Kamensky?

24 A. Again, as I said before, I have no written
25 commitments.

1 **Q. And, in fact, the Lehman DIP commitment**
2 **expired yesterday, didn't it?**

3 A. It would have -- unless it's been extended and
4 I don't know about it, it was the 10th, that's correct.

5 **Q. Okay. And we'll look at the actual DIP**
6 **document.**

7 MR. KRUMHOLZ: Your Honor, I will
8 represent to the Court it has been extended.

9 MR. HAIL: We don't know that.

10 MS. COLEMAN: Your Honor, I hate to
11 interrupt, but there's been a -- there's a proffer of
12 Mr. Kamensky that's been filed today during the course
13 of the hearing that will probably clear a lot of this
14 up -- I'm sorry, the declaration.

15 THE COURT: Okay. So does the proffer
16 say notwithstanding any provisions of the commitment,
17 that they will commit to do the DIP in accordance with
18 the discounted log program?

19 MS. COLEMAN: Yes, it does, Your Honor.
20 And it also extends the date of the commitment.

21 THE COURT: Okay. So let's don't waste
22 any time on that.

23 MR. HAIL: Okay.

24 **Q. (By Mr. Hail) All right. Let's look at the**
25 **Palco budget, please, and that is page 205 of Exhibit B**

1 to the proffer.

2 A. Yes.

3 Q. Now, did you consult with Mr. O'Brien about
4 this budget?

5 A. No. Only on one item. You know, I briefly
6 suggested to him that we were going to assume 4.8
7 million of sales per month, and he agreed that that was
8 reasonable. Other than that, no.

9 Q. Did you consult with Mr. Long about this
10 budget?

11 A. I did not.

12 Q. Okay. And I guess I want to go -- I'm sorry,
13 let's go to page 3 of 5.

14 A. Would you like me to explain why I didn't? I
15 mean, I can if you'd like.

16 Q. No, not particularly. I want to know who you
17 consulted with at Palco, but I thought we heard from
18 your analysts, right? Your analysts consulted with
19 people at Palco?

20 A. That's correct. And I did, too.

21 Q. And you heard Mr. Long say that they hadn't
22 prepared a 26-week cash flow forecast like this one
23 recently?

24 A. That's correct. To the best of my knowledge,
25 that's correct.

1 Q. And, in fact, this is something you created
2 for Palco, right?

3 A. This is something I created for Scopac that
4 reflects the activity of Palco.

5 Q. Thank you. I mean, you didn't prepare it on
6 behalf of -- Palco didn't ask you to prepare this
7 analysis?

8 A. No, they didn't.

9 Q. So it's a Scopac document prepared and
10 forecasting another company's cash flow, right?

11 A. Correct.

12 Q. All right. Now, let's go to page 3 of 5. I'm
13 sorry, John. Specifically on revenue, the revenue
14 assumption is based on a constant assumption of lumber
15 per week, right?

16 A. Correct.

17 Q. There seems now to be lumber sales, isn't
18 there?

19 A. There is.

20 Q. And if you go out to the right, in fact,
21 lumber sales are highest in the spring and summer,
22 aren't they?

23 A. They -- yeah, I mean, I think that's a fair
24 statement.

25 Q. You didn't adjust for any seasonality in

1 **September, October, November, December, did you?**

2 A. No, I didn't. And the reason I didn't is
3 because, one, I think these are very conservative
4 revenue assumptions. Secondly, I think the -- I think
5 it's realistic, although not specifically reflected here
6 that the margin on -- or that the sales prices would
7 increase as the quality of the underlying lumber being
8 sold increases.

9 MR. HAIL: Your Honor, I think the answer
10 to the question was no. Beyond that, it's going to go
11 quicker.

12 THE COURT: If you didn't want him to say
13 it, why did you wait until the end?

14 MR. HAIL: I didn't want to interrupt
15 him.

16 THE WITNESS: You're too kind.

17 THE COURT: Just answer the questions
18 that he asks and don't go beyond that unless asked.

19 **Q. (By Mr. Hail) In consulting with your alleged**
20 **conservative nature of this, did you discuss that with**
21 **Mr. Long, for example?**

22 A. I did not.

23 **Q. Did you discuss that with -- did you run any**
24 **analysis to prove the conservative nature -- expose the**
25 **conservative nature, any sensitivity testing?**

1 A. We looked at historical -- we looked at
2 historical sales, which were frankly all higher than --
3 I think mostly higher than these.

4 **Q. Is it higher -- you think it's reasonable to**
5 **project a higher sales volume in the fall than in the**
6 **spring and summer; is that your testimony?**

7 A. We did -- it is flat-lined here. I agree with
8 that. But the --

9 **Q. Now, you also project --**

10 MR. KRUMHOLZ: He asked him if it was
11 reasonable, and he cut him off. And it was a responsive
12 answer, and I ask that he be allowed to finish.

13 MR. HAIL: I don't think I cut him off,
14 but --

15 MR. KRUMHOLZ: Your Honor, I ask that the
16 witness be allowed to finish his answer.

17 THE COURT: Go ahead. If you want to ask
18 him again, go ahead.

19 **Q. (By Mr. Hail) All right. Did you compare**
20 **this with -- did you test this assumption of constant**
21 **flat line sales and compare that to last year's, for**
22 **example, seasonality of lumber sales?**

23 A. We looked last year's weekly lumber sales,
24 yes.

25 **Q. When did you do that?**

1 A. Three or four weeks ago.

2 **Q. So when you prepared this budget forecasting**
3 **countless numbers, did you -- well, did you test it**
4 **against seasonality?**

5 A. We didn't and for a reason.

6 **Q. And what's that reason?**

7 A. That these sales are lower than the
8 historical -- these are still lower than the historical
9 sales in these given periods.

10 **Q. Now, you also make an assumption about chips,**
11 **right? 140,000 per month. Do you see that?**

12 A. I do.

13 **Q. What is Palco's projection of chip sales over**
14 **months; do you know?**

15 A. I don't recall offhand. I know that --

16 **Q. Would it surprise you that it's less?**

17 A. The price changes because there's a deal with
18 evergreen pulp that would result in an increase.

19 **Q. Well, you would agree though that in a 13-week**
20 **period that Palco projects and the 13 weeks that you**
21 **project, they should be roughly the same, shouldn't**
22 **they?**

23 A. I don't know if Palco's most recent set of
24 projections reflect that correctly. We may have
25 information that Palco is not using.

1 Q. So Palco's most recent projections produced a
2 week ago that circulated to everyone in bankruptcy, you
3 don't think is right?

4 A. It might not be.

5 Q. Okay. You think yours are right?

6 A. I have confidence in my -- in our numbers.

7 Q. All right. Let's come down to expenses in the
8 expense line item, please. Look at the post petition
9 interest line. And we might have to go to page -- I
10 think it's page -- the next page down. Hold on, I'm
11 sorry. No, this is the right page. Go back up. Where
12 is -- there is a payment on the DIP loan, right? Do I
13 get that right?

14 A. That's correct.

15 Q. Okay. What does that reflect?

16 A. That is the interest payment on the Marathon
17 DIP.

18 Q. Is that the right amount?

19 A. I believe so.

20 Q. But you don't know?

21 A. Well, I'm telling you I believe that it's the
22 right amount.

23 Q. Is Palco currently paying interest --

24 A. No.

25 Q. -- on the DIP loan?

1 A. No. This is a different assumption than that
2 used by Palco.

3 **Q. And this also doesn't account for the fact**
4 **that the DIP loan matures in this week, right?**

5 A. That's correct.

6 **Q. And you just assume that -- I guess when you**
7 **prepared this, you didn't assume they would roll it over**
8 **because you weren't aware of the maturity, right?**

9 A. That's correct.

10 **Q. All right. Now, if we come down again, you**
11 **have budgeted in the payment in here \$100,000 for --**
12 **\$100,000 a month, right? And what is that budget for,**
13 **if you want to go back over. I have Palco financial**
14 **advisory appraisal; is that right?**

15 A. That's correct. That is -- I don't think it's
16 reasonable to assume that we would pay zero dollars a
17 month in professional fees. I've never operated an
18 appeal. I spoke with my counsel to get a reasonable
19 estimate of what we should include there, and they
20 advised me that \$100,000 a month would be reasonable.

21 **Q. That's for everyone at Palco, right?**

22 A. People at Palco are not being paid.

23 **Q. Palco's legal fees?**

24 A. Palco's legal fees are not being paid.

25 **Q. But you think this is a reasonable estimate of**

1 **what you could pay, right?**

2 A. If -- it's a contingency item of what we might
3 have to pay.

4 Q. Now, you also estimated Scopac's legal fees,
5 didn't you, in the same period?

6 A. We did.

7 Q. And you estimated \$350,000 a month, right?

8 A. Yes.

9 Q. So you estimated about three and a half times
10 more for Scopac's legal fees than for Palco's legal
11 fees, right?

12 A. That's correct.

13 Q. And also, in fact, Palco has estimated these
14 legal and professional fees for this time period, hasn't
15 it?

16 A. I believe it is estimated them at zero.

17 Q. Why don't we go to Palco's most recent 13-week
18 budget, which I think it's Exhibit A to the O'Brien
19 proffer, and I think it's Exhibit 169. I could be
20 wrong. I know it's Exhibit 8 to our most recent Exhibit
21 7, I believe labeled this morning.

22 MR. HOLZER: Exhibit 7.

23 MR. HAIL: Exhibit 7. Thank you. This
24 is the highlighted version. The Exhibit 7 doesn't have
25 the highlight numbers, but it'd probably be easier for

1 everyone to look at the numbers.

2 Q. (By Mr. Hail) Do you recognize this document,
3 Mr. Young?

4 A. I recognize the form of this document, yes.

5 Q. Okay. And what does it say at the top,
6 Pacific Lumber 13-week cash budget, right?

7 A. Yes.

8 MR. KRUMHOLZ: I just want to be clear,
9 is this the same one I saw last night?

10 MR. HAIL: I have no idea what you saw
11 last night.

12 MR. KRUMHOLZ: Well, you sent it.

13 MR. HOLZER: It is the one I sent last
14 night.

15 Q. (By Mr. Hail) Now, this has a lower box at
16 the bottom, doesn't it, for DIP lender expenses, Palco
17 legal, Palco financial advisory and committee, creditors
18 committee professionals. Do you see that?

19 A. I do.

20 Q. And it has budgeted amounts for the same weeks
21 that your budgets exist, doesn't it?

22 A. Those are not disbursements. Those are
23 accrual items, as I understand.

24 Q. Well, this is a cash flow budget, isn't it?

25 A. I'm telling you that's not cash flow at the

1 bottom.

2 Q. Because they're not paying that in cash,
3 right?

4 A. That's correct.

5 Q. But that's what they estimate is going to
6 accrue, though, right?

7 A. That's correct.

8 Q. So were you attempting to in your budget that
9 we just saw where you had \$100,000 a month, that wasn't
10 the accrual amount, was it?

11 A. No.

12 Q. So you anticipate that they will accrue
13 significantly more legal fees than you actually paid?

14 A. I do.

15 Q. And if you take a look back -- why don't you
16 go back a little bit, John -- the current amount of
17 unpaid deferred fees and interest is about \$11 million.
18 Do you see that?

19 A. I do.

20 Q. And your proposed DIP/discount log program
21 pays zero on that amount, right?

22 A. That's correct.

23 Q. Okay. And, in fact, Palco then estimates just
24 over the next 13 weeks, if you go to the right, that
25 that amount will be \$16.4 million after 13 weeks. Do

1 **you see that?**

2 A. I do.

3 **Q. And your budget pays how much of that amount?**

4 A. Approximately \$600,000.

5 **Q. So at the end of the period, you would**
6 **anticipate -- you don't -- this is the end of October.**
7 **You don't have any reason to doubt Palco's projections**
8 **that even if you paid \$600,000 -- you wouldn't pay**
9 **\$600,000 of that, right? You're paying half that? This**
10 **is a 13-week budget. You had a 26-week budget, right?**

11 A. \$300,000 would be -- I see what you're saying.

12 **Q. So, in essence, you're still going to have \$16**
13 **million in accrued -- in cumulative deferred interest in**
14 **fees, right?**

15 A. You're correct.

16 **Q. And in this interim period are the Palco**
17 **professionals, in essence, working for free?**

18 A. They would be -- they would be building up an
19 admin claim.

20 **Q. And if the MRC/Marathon plan goes effective,**
21 **who pays that admin claim?**

22 A. MRC/Marathon.

23 **Q. So all of this accumulated deferred Palco fees**
24 **would ultimately be borne by MRC/Marathon, right?**

25 A. That's correct.

1 Q. Okay. And that's not accounted for in this
2 DIP loan discounted log program, is it?

3 A. Right.

4 Q. So MRC is being -- the ultimate cost to close
5 the plan is significantly more -- is at least \$6 million
6 more in October, ultimately many millions more whenever
7 we ultimately close, right?

8 A. I can't argue with that. You're right.

9 Q. All right. Now, if you take a look -- John,
10 if you want to take a step back.

11 THE COURT: What number is this?

12 MR. HOLZER: It's 7, Your Honor.

13 MR. HAIL: It's Exhibit 7.

14 THE COURT: To whose proffer?

15 MR. HOLZER: No, it's Exhibit 7 on the
16 multi-party exhibit list.

17 THE COURT: Oh, never mind.

18 Q. (By Mr. Hail) Now, if you take a look back,
19 did you use this document at all when you prepared your
20 financials?

21 A. We used a version, I believe, a week or two --
22 maybe two weeks before this. We did -- as we were
23 completing ours, just toward the end of the process, we
24 did have access to this and compared it quickly. But I
25 didn't have this document available for most of the

1 times we were working on the budget.

2 Q. And if you consider the effect of these
3 accumulated professional fees, do you know if Palco is
4 making any money, even if it has free logs?

5 A. On a P&L basis or --

6 Q. On a P&L basis?

7 A. I don't know the answer to that. I'd have
8 to --

9 Q. Well, we can look on the column on the right,
10 can't you, to figure that out?

11 A. No, this is a cash flow base document. You
12 can't get from a cash flow based document easily to a
13 P&L based or a gap based document to evaluate income or
14 loss.

15 Q. Okay. Fair enough. This document, you have
16 accruals down here. Do you know if you have taken into
17 account the effect of the \$6 million accrual, whether or
18 not Palco is going to even break even if you give them
19 free logs net of the road expense?

20 A. I don't have the information available here to
21 answer that question.

22 Q. Well, why don't we look back up. The effect
23 of the free log program over this 13-week period, right,
24 it's not the 26-week period that you did. The 13-week
25 period would be to net out these two numbers, right?

1 A. Agreed.

2 Q. And that produces roughly 12.3 million. Did I
3 get that right?

4 A. That looks right, yes.

5 Q. Okay. And you come on down and after all the
6 costs, you still have a loss of 6200, 6.2 million,
7 right?

8 A. Yes.

9 Q. And you come down, I thought we concluded we
10 had a deferral fees of about \$6 million. Do you see
11 that?

12 A. Yes.

13 Q. So if you account for the professional fees
14 that are going to be incurred, even if you give them
15 free logs, Palco is breaking even or losing money, isn't
16 it?

17 A. You're talking -- you're explaining this on a
18 cash flow basis, but earlier -- I mean, I need to know
19 if you want a cash flow number or if you want a P&L
20 number. You can't get a P&L number from looking at cash
21 flow information.

22 Q. I guess -- all I'm asking is on this cash flow
23 statement, accounting for the professional fees that are
24 accrued in the same period that are reflected on this
25 schedule, Palco's cash flow schedule, Palco still loses

1 **money even if you give them logs, right?**

2 A. I need you to explain to me what you mean by
3 losing money.

4 **Q. Cash is less?**

5 A. Okay. Based on the document that Palco has
6 produced, cash would be less.

7 **Q. Okay. Now, this -- your cash flow budget --**
8 **why don't we go back to his cash flow budget, which is**
9 **Exhibit B to his proffer. Are you familiar with**
10 **retention bonuses that are payable at Palco and Scopac?**

11 A. I am. Generally, yes.

12 **Q. And those retention bonuses total about \$1.2**
13 **million; is that right?**

14 A. That sounds reasonable.

15 **Q. You're aware those are -- I'm sorry, I didn't**
16 **mean to interrupt.**

17 A. You didn't.

18 **Q. Okay. Are you aware those retention bonuses**
19 **were triggered by the entry of a confirmation order?**

20 A. That's not my understanding. It's the
21 effective date, I believe.

22 **Q. If they are entered by the -- well, are they**
23 **all reflected on this schedule?**

24 A. No.

25 **Q. So if they were, in fact, triggered by the**

1 **confirmation order, we'd have a \$1.2 million hole**
2 **somewhere in this week, right?**

3 A. So you want me to run a hypothetical to assume
4 that they're effective on a date that I don't believe
5 they're effective or that they have to be paid. And
6 then -- remind me again.

7 **Q. I guess the point is if they're payable --**

8 THE COURT: They may not have to be paid,
9 but if the plan goes effective, they'd have to be paid,
10 wouldn't they?

11 MR. HAIL: Your Honor, we're afraid that
12 they were triggered by the confirmation date.

13 THE COURT: Well, I don't know. Either
14 way, there's still a \$1.2 million liability that's not
15 in here at the end of the deal, assuming the plan goes
16 into effect.

17 THE WITNESS: If the thing is effective
18 though, all that's wrong for this budget. It doesn't --
19 it no longer applies.

20 THE COURT: Okay. Go ahead.

21 **Q. (By Mr. Hail) You heard Dr. Barrett's**
22 **testimony yesterday, right, about a \$500,000**
23 **environmental fine?**

24 A. I did.

25 **Q. Is that reflected in this budget anywhere?**

1 A. I don't -- we don't have any provisions for
2 one-time fines, no.

3 Q. Well, that fine's been entered, though, right?
4 That's a payable, isn't it?

5 A. I believe so.

6 Q. I assume you're not familiar with California
7 law, whether you can defer the payment of an
8 environmental fine, can you?

9 A. I'm not familiar with Texas law on the same
10 issue, no.

11 Q. Fair enough. Now, if we go to the Scopac
12 budget, why don't we go to the first page. The first
13 page of your proffer, the first page of Exhibit B, it is
14 1 of 5. Well, maybe we should go to Exhibit A. Exhibit
15 A is the Scopac budget, right?

16 A. The Scopac stand-alone budget.

17 Q. Yes, the Scopac stand-alone as-is. And page 2
18 of 2, John. This contemplates the payment of \$5 million
19 next week, right? Or maybe it's this week. I don't
20 know. The first week.

21 A. It does contemplate a payment of \$5 million.

22 Q. What does that payment of \$5 million
23 represent?

24 A. That would be a pay down on the accrued
25 professional fees.

1 **Q. So how much -- how much has been accrued in**
2 **professional fees at the Scopac level?**

3 A. It's -- I think it's approximately \$15
4 million.

5 **Q. That's an accrued unpaid fees at the Scopac**
6 **level?**

7 A. Let me -- currently the -- the current unpaid
8 professional fees somewhere between -- probably
9 somewhere between 10 and 12 million, including unbilled
10 professional fees.

11 **Q. Unbilled? Do you know how much is unbilled on**
12 **the Palco side?**

13 A. I don't.

14 **Q. Okay. So this is a -- who receives that \$5**
15 **million?**

16 A. That would go to Gibson, Dunn.

17 **Q. And Gibson, Dunn is advising Scopac, right?**

18 A. That's correct.

19 **Q. And Gibson, Dunn is your legal counsel and**
20 **providing legal payments to you, correct?**

21 A. Correct.

22 **Q. Does any of that money go to Xroads?**

23 A. No.

24 **Q. What about this \$350,000 payment there; does**
25 **that go to Xroads?**

1 A. That would go to -- some of that would go to
2 Xroads; some of it would go to Gibson, Dunn.

3 Q. And, in fact, Xroads continues its engagement
4 throughout this period?

5 A. Yes.

6 Q. And they continue to get paid throughout the
7 period, right?

8 A. Correct.

9 Q. Okay. Now, if we come down and we look at --
10 you haven't studied the Lehman DIP, have you?

11 A. It's been a few weeks since I've really gone
12 through the document.

13 Q. So you don't know if the discount log program
14 violates a number of the covenants of that document, do
15 you?

16 A. I don't.

17 Q. Okay. And rather than -- well, drag you
18 through that or take you through that, we'll look at
19 Mr. Kamensky's proffer and see if that resolves the
20 issue.

21 The DIP agreement is only for \$20 million,
22 right?

23 A. Correct. Currently.

24 Q. And, in fact, you also have to make a payment
25 out in the first week for 475, right?

1 A. That's correct.

2 **Q. That's the commitment fee?**

3 A. 350 of that is a commitment fee and then 125
4 of that would be the legal fees.

5 **Q. Would be what? I'm sorry.**

6 A. Legal fees associated with the DIP paid to
7 Lehman's counsel.

8 **Q. Now, if the stay is entered in the case, the**
9 **SAR account remains as is, right?**

10 A. Correct.

11 **Q. And the SAR account contains auction rate**
12 **securities as we all know, right?**

13 A. That's correct.

14 **Q. Is there risks that those auction rate**
15 **securities decline in value over the next six months?**

16 A. Kind of like interest rates. They could go
17 up; they could go down. No one -- I don't think anyone
18 really has the answer to that.

19 **Q. But they could go down, right?**

20 A. They could go down.

21 **Q. They could go to zero, right? Isn't that the**
22 **testimony we heard out of the indenture trustee earlier?**

23 A. Highly unlikely, but yes.

24 **Q. All right. Have interest rates changed in the**
25 **last six months?**

1 A. They have.

2 Q. And they've been rather volatile in the last
3 six months, haven't they?

4 A. They have.

5 Q. And they're now kind of at -- particularly the
6 Fed fund rates and things like that, they're -- I don't
7 want to say historic lows, but they're at pretty
8 depressed levels relative to a year ago, right?

9 A. I believe that's correct. I haven't done any
10 analysis of interest rates, but that is consistent with
11 what I know, yes.

12 Q. Now, we've heard a lot about housing prices in
13 the housing market, haven't we?

14 A. Yes.

15 Q. And the housing market, prices have declined,
16 haven't they?

17 A. I believe so.

18 Q. And housing prices could further decline in
19 the next six months, a year, couldn't they?

20 A. Again, they could or they could -- they could
21 increase.

22 Q. Now, under the plan you testified -- or under
23 the distribution schedule you prepared, you said that
24 Marathon didn't get any cash, right? Correct?

25 A. Yeah.

1 Q. But they did get the real estate, right?

2 A. That's true.

3 Q. And the real estate, the value -- they could
4 turn around and sell that real estate the moment they
5 got it, couldn't they?

6 A. They perhaps could, yes.

7 Q. So the value of the collateral that they
8 would -- the distribution they would get, the real
9 estate could decline over the next six months, couldn't
10 it?

11 A. It could.

12 Q. What about -- did your distribution
13 schedule -- you take a look at Exhibit E to your
14 proffer. Did your distribution schedule account for
15 distributions to Bank of America?

16 A. It did.

17 Q. And where did it account for that?

18 A. In the Scopac loan claim Class 5.

19 Q. That's -- that represents the B of A payment,
20 right?

21 A. Yes.

22 Q. And does that value, the auction rate
23 securities at a dollar for dollar?

24 A. That values the Scopac loan claim at dollar
25 for dollar. It doesn't consider the current value of

1 the auction rate securities.

2 Q. Okay. You used a judgment rate down here,
3 didn't you? It was 2.35 percent?

4 A. Yes.

5 Q. You think that the cost of capital to
6 Marathon, to MRC, to any of the creditors is 2.35
7 percent?

8 A. No.

9 Q. Do you think it's significantly higher than
10 that?

11 A. I do think it's higher.

12 Q. Do you have any idea what it might be?

13 A. I don't know the cost to capital of those
14 organizations, no.

15 Q. Okay.

16 MR. HAIL: Your Honor, I'd like to take a
17 look at Mr. Kamensky's proffer to see what that says
18 about the Lehman DIP. But with that, I have no more
19 questions for the witness.

20 THE COURT: All right. Anyone else?
21 California.

22 CROSS-EXAMINATION

23 BY MR. PASCUZZI:

24 Q. Paul Pascuzzi for the California State
25 Agencies. Mr. Young, Mr. Hail asked you about the

1 testimony yesterday by Dr. Barrett, I think, when I was
2 asking him questions about cleanup and abatement
3 violations. Do you recall that?

4 A. Yes.

5 Q. And I think what he testified to is that the
6 \$500,000 potential or resolution number is not in this
7 budget for your six-month period, correct?

8 A. It's not specifically provided for, no.

9 Q. Okay. And you don't know when that \$500,000
10 or if they resolve it in a different amount is going to
11 be payable, do you?

12 A. I just learned of this yesterday.

13 Q. Okay. So you don't know when it will be
14 payable; is that correct?

15 A. I do not.

16 Q. Okay. Are there any other amounts in your
17 budgets for contingencies in case there are other
18 violations of environmental laws?

19 A. On the Palco budget you have the 3 or \$4
20 million or \$2 or \$3 million of cash that's available
21 that can be used. On the Scopac budget, you know, as I
22 suggested before, we feel those operating expense
23 numbers are conservative and don't expect to spend up
24 those levels. We would expect to spend less to cover
25 some of the items that you're describing, I believe.

1 Q. But that's not a cushion you specifically put
2 in there for environmental compliance; is that correct?

3 A. There is -- you're correct.

4 Q. And you heard Dr. Barrett testify when I was
5 asking questions about a violation -- a notice of a
6 violation of a THP in the South Scotia flats yesterday
7 as well, right?

8 A. That's correct.

9 Q. So there's nothing specifically in this budget
10 for potential fines that might result from that either,
11 right?

12 A. That's correct.

13 Q. And so if there isn't money in the budgets,
14 those will be further administrative claims that would
15 be building up; is that correct?

16 A. They -- they potentially could be, yes.

17 MR. PASCUZZI: I'll pass the witness,
18 Your Honor. Thank you.

19 THE COURT: Anyone else? Okay.

20 CROSS-EXAMINATION

21 BY MR. LITVAK:

22 Q. Good afternoon, Mr. Young. Max Litvak for the
23 creditors committee.

24 MR. KRUMHOLZ: Your Honor, I know
25 Mr. Litvak is usually brief and to the point. But we've

1 suffered through a number of questioners at one table
2 for every single witness over and again. Given the time
3 the Court has given us --

4 THE COURT: I have to give everybody a
5 certain right to question. Go ahead. They have
6 different issues.

7 Q. (By Mr. Litvak) Mr. Young, you mentioned that
8 you were or have had discussions with the indenture
9 trustee or representatives of the indenture trustee in
10 connection with what we've been calling or are now
11 calling the discount log program; is that correct?

12 A. That's correct.

13 Q. And who are those individuals?

14 A. Well, that would include members of the
15 steering committee -- I can't recall the names of all
16 these people -- and their counsel. So the members,
17 specific members of the committee, and their counsel.

18 Q. Was this a series of conversations or one big
19 conference call or a meeting? How did this all take
20 place?

21 A. No, it's a series of conversations.

22 Q. Which began when?

23 A. Midday Wednesday.

24 Q. Of this week?

25 A. Yes.

1 Q. Two days ago?

2 A. With respect to the discounted log program,
3 yes.

4 Q. And is that when you were presented with this
5 problem of how to maintain operations at Palco during
6 the pendency of an appeal?

7 A. No. That would have been earlier in the week,
8 probably -- I don't know, maybe Monday.

9 Q. Okay. So is it fair to say you've really been
10 burning the midnight oil to put this proposal together?

11 A. I have not slept much lately; that is correct.

12 Q. Okay. I want to move on to the issue of
13 status quo. The status quo today is that we have a
14 confirmed plan, correct?

15 A. Correct.

16 Q. And as far as you know, Marathon and Mendocino
17 are ready and able to consummate that plan and declare
18 an effective date for that plan, correct?

19 A. Correct.

20 Q. And under that plan, among other things, there
21 will be \$10.6 million that's funded to our committees
22 constituency. That's for the benefit of unsecured
23 creditors of Palco and trade creditors of Scopac; is
24 that correct?

25 A. Correct.

1 Q. And under that plan, the pension obligations
2 of the debtors are assumed, correct?

3 A. I believe that's correct, yes. Yes. Yes,
4 that's correct.

5 Q. Thank you. And are you aware that the pension
6 benefit guarantee corporation asserts a claim jointly
7 and severally against each of the debtors, including
8 Scopac, for approximately \$29 million?

9 A. I'm not aware of the specifics of that claim.

10 Q. Do you know -- does that number sound in the
11 range of reasonableness in terms of what they are
12 asserting?

13 A. It does.

14 Q. Okay. So if the Court grants a stay pending
15 appeal and Scopac implements its budget and the
16 discounted log program and the DIP financing, is there
17 any provision for the payment of 10.6 million to
18 unsecured creditors?

19 A. They would only be compensated by the interest
20 that -- and this would be outside of the budget at the
21 federal adjustment rate.

22 Q. Which you just went through with Mr. Hail,
23 right?

24 A. Correct.

25 Q. Okay. So if something happens and Mendocino

1 and Marathon during the period of this potential stay
2 pending appeal pull out of their plan, then unsecured
3 creditors will not get that \$10.6 million. We're at
4 risk; is that right?

5 A. You are at risk.

6 Q. And there's no -- also no proviso if a stay
7 pending appeal is granted, and you're permitted to go
8 forward with the discounted log program under your
9 budget and the DIP financing. There is no guarantee
10 and, in fact, there is a risk that the pension
11 obligations are not assumed; is that also true?

12 A. That could happen, yes.

13 Q. There's no provision in your budget for the
14 payment of 10.6 million to unsecured creditors and the
15 assumption of the pension claims, correct?

16 A. No. That would be -- that would be dealt with
17 at the -- at the end of the appeal period, however the
18 outcome might play out.

19 Q. But the outcome may be that the plan doesn't
20 go effective -- the Mendocino/Marathon plan does not go
21 effective, and so we're out of luck, right?

22 A. In that scenario that would be true.

23 Q. Okay. Now, I asked this of Dr. Barrett
24 yesterday, but I want to pose the question to you as
25 well. You don't really know how long an appeal will

1 take; isn't that right?

2 A. That's correct.

3 Q. It could take six months; it could take
4 longer, right?

5 A. Right.

6 Q. You have no commitment from the indenture
7 trustee or from the noteholders to continue to fund the
8 discounted log program, or for that matter, Scopac
9 operations after the end of this year; is that right?

10 A. That is correct, unless Mr. Kamensky's
11 declaration says otherwise.

12 Q. It doesn't.

13 A. Okay. I don't have the benefit of having
14 that. We are in talks with them about extending the
15 term of the --

16 Q. But sitting here today --

17 A. Sitting here today.

18 Q. -- as far as you know --

19 A. That's right.

20 Q. -- you have no commitment from them beyond the
21 end of this year?

22 A. That's correct.

23 Q. And you mentioned this before, but at the end
24 of this year, you're projecting that Scopac will have
25 approximately \$300,000 in cash availability remaining,

1 right?

2 A. That's correct.

3 Q. You're not going to have any other cash
4 reserves, right?

5 A. That's correct.

6 Q. Because the SAR account will be tied up
7 presumably in the form of these auction rate securities
8 and not liquid, right?

9 A. Right.

10 Q. And you testified earlier, but I just want to
11 make sure that I understood it, that given your belief
12 that these projections are conservative, that you're
13 comfortable as the CFO of Scopac that your company may
14 end up only having \$300,000 in availability at the end
15 of this year?

16 A. I believe I testified that I don't really --
17 that I believe that the result in six months would be
18 favorable to that which we've projected.

19 Q. Okay. So -- and do you recall giving a
20 deposition in connection with this bankruptcy case on
21 June 24th in Houston?

22 A. I do.

23 Q. Okay.

24 MR. LITVAK: I'm going to ask Mr. Penn to
25 pull up the deposition transcript. And I don't have the

1 page reference, but --

2 MR. NEIER: 17.

3 Q. (By Mr. Litvak) Okay. Page 17 of that
4 transcript at line 5 I asked you why do you think --
5 this was -- I'll represent to you this was me asking the
6 questions, and you were the deponent here at this
7 deposition. Why do you think that Scopac requires DIP
8 financing? You started providing an answer, and then at
9 line 15 through 17 I'll just read the part that I think
10 is relevant to the issue here today, and that is you
11 testified "and I don't think that it's reasonable to try
12 to run a business this size with an average of \$3
13 million of liquidity." Do you recall giving that
14 testimony?

15 A. I do. And, again, as I said earlier it was in
16 a period of uncertainty.

17 Q. I just asked if you recall.

18 A. Yes, I recall giving that testimony.

19 Q. And was it true testimony at the time?

20 A. Yes.

21 Q. But today you're saying that at the end of the
22 projection period you're comfortable with \$300,000 at
23 Scopac, is that right? Yes or no?

24 A. Yes.

25 Q. Now, I want to ask you a little bit about this

1 whole concept of how -- how you justify these discounted
2 log deliveries to Palco. And let me ask you just this
3 preliminary question: Do you think it's in the best
4 interest of Scopac to remain in bankruptcy?

5 A. I believe it's in the best interest of
6 Scopac's most significant creditors, yes.

7 Q. The noteholders?

8 A. The noteholders.

9 Q. And are they basically directing Scopac's
10 actions in this regard?

11 A. No, but we are observing our fiduciary duty to
12 the noteholders.

13 Q. How are you observing your fiduciary duty to
14 other unsecured creditors?

15 A. The -- I think that we are considering the
16 creditor mix as a whole in evaluating our fiduciary
17 duty. And with the largest creditors -- with the
18 largest -- with the largest percentage of the creditors
19 being those of the noteholders -- let me back up. I
20 have a better answer for your question.

21 We feel -- no, no. I stumbled there. If we
22 are able to go to market with the asset -- with the
23 asset that we call Scopac and enter into a fair sale
24 process and have a market check on the value and
25 potential recovery, there is no argument that the

1 value -- true value of Scopac will be recognized by its
2 creditors. So in that sense I feel like we are giving
3 the creditors of Scopac the ability to recognize the
4 true value of the asset through a market process.

5 **Q. I understand that. But basically you're**
6 **asking unsecured creditors to take the risk that the**
7 **\$500,000 at least that's been set aside under the**
8 **Mendocino/Marathon plan will never be paid, correct?**

9 A. That's correct. Arguably, it shouldn't be.

10 **Q. I'm not going to argue with you. In terms of**
11 **how you justify the discounted log program from Scopac's**
12 **perspective, did you actually make a presentation to**
13 **your board last night with respect to that proposal?**

14 A. We explained it to them last night, yes.

15 **Q. Did you make a recommendation?**

16 A. Yes.

17 **Q. What was your recommendation?**

18 A. We recommended that the board -- well, the
19 board had already approved the DIP, and we recommended
20 that we move forward with the -- with the -- really the
21 status quo program except that we would do the
22 discounted log deal.

23 **Q. And when you say "we," who is that?**

24 A. Scopac.

25 **Q. Scopac management?**

1 A. Yes.

2 Q. That's you -- you and Dr. Barrett?

3 A. Yes.

4 Q. Anyone else?

5 A. Well, and arguably the board.

6 Q. Well, I'm asking you about the presentation to
7 the board?

8 A. Yeah. Yes, Scopac management, yes.

9 Q. So how is it that you justify in your own mind
10 and perhaps you justified to the board that Scopac can
11 deliver logs essentially for free, minus the offset that
12 you mentioned to Palco? How is that in the best
13 interest of Scopac?

14 A. Because it allows Scopac to operate on a
15 status quo basis during an appeal period.

16 Q. Okay. Well, let me get to the issue that I'm
17 really asking about, and that is -- and we heard about
18 that yesterday. And that is that the \$20 million in
19 financing that you're going to incur for purposes of
20 funding this program -- do I have it right so far;
21 you're going to incur \$20 million from Scopac to fund
22 this discounted log program?

23 A. \$20 million of --

24 Q. The DIP financing?

25 A. Yes.

1 Q. Okay. That that \$20 million the noteholders
2 will offset against their claim; is that your
3 understanding?

4 A. Yes, it will be taxed on the noteholders.

5 Q. Okay. So what claim will it offset? The
6 principal amount, the total principal amount of the
7 their claim, the \$714 million, or some other amount?

8 A. What I know is -- and I don't know that I can
9 give you the technically correct answer to that.

10 THE COURT: If you don't know the answer,
11 don't give us an answer.

12 A. Okay. It's not that -- I'm not -- I don't
13 know that that might require a lawyer to answer that. I
14 don't know that I can properly answer that.

15 Q. I don't want to go there then. But let me ask
16 you this. Do you -- I think you mentioned it before
17 with respect to the discount log program, but do you
18 have anything in writing from the noteholders that
19 confirms this potential offset?

20 A. No.

21 Q. And you don't know sitting here today whether
22 that would be a \$20 million offset off of the principal
23 amount of their claim?

24 THE COURT: That's what he said. So is
25 that your understanding? Do you have any understanding

1 where you think at the end of this term all things
2 happen perfectly, the Court rules in favor of -- and
3 this may not be considered perfect -- but let's just
4 assume that under the circumstances so we don't have to
5 worry about other consideration, in December the Court
6 rules that Marathon and Mendocino win their appeal. And
7 Mendocino and Marathon have gone ahead and abided by the
8 terms of what the offer was, didn't call their note,
9 didn't back out, didn't do anything else. And so they
10 still have the deal on the table, the best of all
11 possible worlds for everyone.

12 Under that circumstances, do the
13 noteholders get 513.6, or do they get that less than the
14 \$20 million DIP?

15 THE WITNESS: The latter. They get that
16 less the 20 --

17 THE COURT: That's your understanding?

18 THE WITNESS: Yes, sir.

19 THE COURT: Okay. Go ahead. Is that
20 your understanding?

21 MR. GREENDYKE: Yes. I was listening,
22 yes, that's correct, Judge. The Lehman DIP would come
23 on top of prime.

24 THE COURT: Your 510, not your -- because
25 words mean different things.

1 MR. GREENDYKE: It would come before.

2 Just as Mr. Young testified. It would come before the
3 noteholder recovery because it's being a DIP, and it's
4 taking priority position, and it would come before the
5 noteholders.

6 MR. NEIER: That doesn't answer the
7 question. That doesn't answer the question.

8 MR. GREENDYKE: Then I misunderstood the
9 question.

10 THE COURT: We're going to have to get
11 this worded out because those words might be interpreted
12 to mean that it comes out, but you'd still get 513.6.

13 MR. KRUMHOLZ: It subtracts from the
14 513.6, Your Honor, okay?

15 THE COURT: It comes out of the -- not of
16 your claim -- your claim, not -- it comes out of the
17 Court's determination of the amount of your secured
18 claim.

19 MR. KRUMHOLZ: Yes. And in addition,
20 Your Honor, just so that it's clear, it's our view that
21 the free logs that we talked about or the discounted
22 logs that we talked about yesterday under the Marathon
23 plan, if it's approved, not barring we lose the appeal
24 or whatever, that's it's --

25 THE COURT: They get the value of that.

1 They might actually have to pay less.

2 MR. KRUMHOLZ: That's right. Now, if it
3 goes under and there's a 363 sale of some sort, it would
4 be less collateral that would be sold, the accounts
5 receivable that would be there.

6 THE COURT: Okay. Let's move on. I'd
7 like to get these out of the way, please. Go ahead.

8 MR. LITVAK: Pass the witness.

9 THE COURT: Anybody else?

10 MR. BARR: Your Honor, I'm sorry. This
11 Matt Barr from Beal Bank on behalf of Lehman. Do you
12 want me to clarify what the order, the DIP order, which
13 were approved, the DIP financing provide with respect to
14 the repayment of the DIP?

15 THE COURT: Well, if you would just -- I
16 think probably everybody would love for you to confirm
17 that Lehman has agreed to support the position that the
18 noteholders are taking with respect to the DIP. I mean,
19 the DIP you proposed is significantly different from the
20 DIP that they're offering at the present time. But if
21 you don't care, you know, let's not waste any time on
22 it.

23 MR. BARR: Your Honor, I can commit -- I
24 can tell you on the phone now and Mr. Kamensky is on the
25 phone now and he can commit or make a comment if you

1 like. The proffer that we saw this morning provides
2 that the offer or the commitment is through tomorrow,
3 that the log issue, Your Honor, that you've been
4 spending a lot of time with, we will clarify through any
5 amendments that need to be made to the DIP financing
6 that it would not be in the event of default under the
7 documents. So the DIP financing would not trigger in
8 the event of default at that point.

9 Your Honor -- and Mr. Kamensky, I assume
10 this is okay, but you can tell me if it's not. Your
11 Honor, also, we have informed the debtors that Lehman is
12 committed to extend the financing to \$25 million, and
13 the term would be a year, Your Honor, not the six months
14 that we've talked about. Then you have to come back and
15 get consent, but a year term.

16 THE COURT: Okay. And you commit the
17 fact that your DIP, I mean, can prime the amount that is
18 paid -- I don't know if prime is the right word. The
19 amount that is being paid to the -- in the event that
20 the Marathon plan wins and closes its prime, it's carved
21 out of the amount paid -- is paid out of -- part of the
22 amount that would have gone to pay the secured portion
23 of the noteholders' claim.

24 MR. BARR: That's right, Your Honor. It
25 provides that the DIP will be repaid first from

1 distributions to the prepetition noteholders trustee and
2 prepetition noteholders.

3 THE COURT: All right. Let's move on to
4 questions. I need to get these witnesses behind us.

5 MR. McDOWELL: Two topics, Your Honor.

6 CROSS-EXAMINATION

7 BY MR. McDOWELL:

8 Q. Mr. Young, I recall you testified at the
9 beginning that you first considered having Scopac borrow
10 money and then Scopac loan money to Palco; is that
11 right?

12 A. That's right.

13 Q. And you rejected that consideration because --
14 and I think I wrote down your words -- "there was an
15 issue with Palco accruing administrative claims, and
16 that wasn't going to work." Do you recall that
17 testimony?

18 A. I believe that's what I said.

19 Q. And then you talked about the solution that
20 you've come up with, and you said that that solution,
21 this discounted log solution works because -- and I
22 quote again -- "that way Palco doesn't build up an
23 administrative claim." Was that your testimony earlier
24 today?

25 A. I believe so.

1 Q. And I don't want to belabor the point, but I
2 think that other -- other attorneys up here have really
3 shown you that, in fact, there isn't an administrative
4 claim that builds up at the Palco level; do you agree
5 with that or --

6 A. There is some that will continue to build up,
7 yes.

8 Q. Approximately I think it was in the
9 neighborhood of at least \$6 million?

10 A. That's what I recall.

11 Q. And that \$6 million was just over the first 13
12 weeks, right?

13 A. That's correct.

14 Q. And so as you did your math you kind of
15 flipped it and overlaid and made 26, so if it was \$6
16 million in the first 13 weeks. It's reasonable it would
17 be another \$6 million in the next 13?

18 A. No, it's not, and I can explain that if you
19 like.

20 Q. Okay. But you at least have \$6 million the
21 first 13 weeks?

22 A. Based on Palco's assumptions, yes.

23 Q. And there is an additional amount that would
24 continue to accrue for the next 13 weeks?

25 A. Yes.

1 Q. What effect -- let me strike that. Does that
2 have any effect on your view of the discount program?

3 A. It does not.

4 Q. Notwithstanding the fact that the reason you
5 rejected the first one was that Palco would accrue
6 administrative expense claim, and this way Palco doesn't
7 build up administrative expense claims. That's no
8 longer -- that rationale no longer works, right?

9 A. First of all, I don't necessarily agree that
10 the \$6 million number is correct. I mean, there will be
11 some admin claim built up at Palco. I don't believe
12 it's \$12 million or \$18 million. I think it might be
13 significantly smaller, and that will be dealt with.

14 Q. But the rationale you gave -- let me go back
15 here. The rationale you gave in the first proposal was
16 Palco wasn't enough -- Palco would build up
17 administrative claims, so you rejected that proposal,
18 right?

19 A. Yes.

20 Q. And you liked this other proposal because
21 initially you thought Palco was not going to build up
22 administrative claims, right?

23 A. Correct.

24 Q. And now you know that Palco, in fact, is going
25 to be building up administrative claims, right?

1 A. But not in context with the DIP or the
2 loggings.

3 **Q. Over the stay pending the appeal you**
4 **understand that Palco will be building up administrative**
5 **claims?**

6 A. Of course they will.

7 MR. McDOWELL: Can you please pull up
8 Exhibit B. Oh, we have it, Exhibit B, 3 of 5. This is
9 my second topic, and I'll be done.

10 **Q. (By Mr. McDowell) Xroads also serves as**
11 **Palco's financial -- one of Palco's financial advisors,**
12 **right?**

13 A. That's correct.

14 **Q. And if you look here, Palco financial**
15 **advisory/appraisal line, they're not doing any**
16 **appraisals, right, over the next -- during the stay**
17 **pending the appeal?**

18 A. That's correct.

19 **Q. So this is just really Palco financial**
20 **advisor -- that's Xroads, your firm, right?**

21 A. That -- we put it on one line, but it's
22 really -- it just covers legal or any other type of
23 advisory that they would receive.

24 **Q. But it doesn't cover Palco legal, which has no**
25 **numbers the entire way?**

1 A. I could have put it 50/50, you know.

2 **Q. But your put it all on your firm's line,**
3 **right?**

4 A. It's not -- I have no anticipation at all of
5 that coming to my firm.

6 **Q. No, none, you have no -- you put 100 --**

7 A. The \$100,000 because not intended to be a
8 Xroads payment.

9 **Q. So it's a mistake; it should have been on the**
10 **legal side?**

11 A. It's there to -- as a contingency in case
12 anyone files -- you know, in case for whatever reason we
13 have to pay some professionals. And I can't anticipate
14 what that would be.

15 **Q. Do you expect Palco to have -- do you expect**
16 **the committee, unsecured creditors committee, to have**
17 **counsel during the pendency of an appeal?**

18 A. I do.

19 **Q. Do you expect Palco to have legal**
20 **representation during the pendency of an appeal?**

21 A. I do.

22 **Q. Do you expect Palco to pay for either one of**
23 **those during the pendency of an appeal?**

24 A. The assumption here is that they would not.

25 MR. McDOWELL: No further questions.

1 THE COURT: All right. Any additional
2 questions?

3 MR. KRUMHOLZ: Yes, Your Honor.

4 MR. FROMME: Before Mr. Krumholz goes, I
5 have a couple of quick questions, Your Honor.

6 CROSS-EXAMINATION

7 BY MR. FROMME:

8 Q. You were asked a couple of questions,
9 Mr. Young, about not consulting with Palco before you
10 presented the forecast contained in your declaration.
11 Remember that?

12 A. Yes.

13 Q. And you wanted to explain. Why didn't you
14 consult with Palco, with anyone at Palco before you
15 produced that?

16 A. I don't recall the specific context now of the
17 comment.

18 Q. You don't feel the need to further explain
19 that, why you didn't consult with Palco before you
20 produced --

21 A. I mean, we did consult with Palco's accounting
22 and -- accounting and finance staff, the people that
23 actually work on these budgets. But, yeah, I don't
24 think there's any further clarification needed there.

25 Q. Do you remember Mr. Hail asked you a

1 hypothetical about the interest rates and interest costs
2 for MRC?

3 A. Yes.

4 Q. Do you remember that? And one of the
5 assumptions in his hypothetical -- I don't think he
6 stated but -- well, he did state that the interest rate
7 will go up one percent. Do you remember that?

8 A. Yes.

9 Q. But also that -- I don't think he stated that
10 the hypothetical also assumed that the interest rate
11 would not go down during the 14-year period?

12 A. Correct.

13 Q. And if the interest rate did go down, MRC
14 could refinance, correct?

15 A. Correct.

16 MR. FROMME: No further questions, Your
17 Honor.

18 THE COURT: All right.

19 REDIRECT EXAMINATION

20 BY MR. KRUMHOLZ:

21 Q. I'll try to be brief. First of all, I heard
22 some questions by Mr. Hail concerning -- I think he was
23 talking about the bridge loan and the cost of financing
24 that bridge loan and if interest rates went up or down.
25 Do you recall that?

1 A. I do.

2 Q. You were here during the confirmation trial;
3 is that right?

4 A. Most of it, yes.

5 Q. Do you recall the position taken by MRS and
6 Marathon was there were no conditions to the
7 confirmation in terms of exit financing; it was a cash
8 deal. Do you remember that?

9 A. I do.

10 Q. And so if that's true, they have to come up
11 with this cash, from whatever source, that was the basis
12 for the MRC Marathon plan, not this exit financing that
13 they keep on talking about, right?

14 A. That's right.

15 Q. Okay. Now, they mentioned, I think, something
16 about Marathon funding losses during the forecast
17 period. Marathon is not funding any losses during this
18 forecast period of yours, correct? It's the IT that's
19 funding it, true?

20 A. Under my assumption that would be true, yes.
21 Well, in the Exhibit B assumption, yes.

22 Q. This's what I'm talking about, Exhibit B?

23 A. Yes, that is correct.

24 Q. The one you talked about is the best way to
25 retain the status quo?

1 A. Yeah, the noteholders fund the losses.

2 Q. He also showed you one of the pages of your
3 pro forma, and it showed a \$21 million number as the net
4 cash flow or negative net cash flow of Scopac. Do you
5 recall that?

6 A. I do.

7 Q. That's largely because of this discounted log
8 program, correct?

9 A. It is.

10 Q. And the reason why they don't have a negative
11 balance at the end of December is kind of twofold, isn't
12 that right? One, because they had a beginning cash
13 balance?

14 A. That's right.

15 Q. And what's that beginning cash balance?

16 A. It's approximately \$4 million.

17 Q. And it's also because the DIP that's provided,
18 right?

19 A. That's correct.

20 Q. Okay. And that's how that's being funded, and
21 that's why it comes down to under \$20 million and works?

22 A. Right.

23 Q. And when I say works, cash flow is during this
24 period, right?

25 A. Well --

1 Q. That's what I mean by works.

2 A. It ends with a positive cash balance, yes.

3 Q. And has anything changed your opinion that
4 these are conservative numbers and a conservative
5 forecast and are reliable for these purposes through
6 December 31, 2008?

7 A. I still believe these are reliable
8 projections.

9 Q. Now, Palco built up cash at the end of almost
10 \$4 million, right?

11 A. Yes.

12 Q. And so that's an additional cushion, true?

13 A. True.

14 Q. And you've indicated that Scopac expenses, you
15 believe, incorporate a cushion that can take care of any
16 concerns about foreseeable contingencies, such as, I
17 think, what Mr. Pascuzzi referred to?

18 A. I do. And largely based on looking at the
19 variance reports.

20 Q. Going through the testimony that Mr. Litvak
21 asked you about but didn't allow you to explain about
22 what is required to cash flow Scopac in any particular
23 period and what magnitude, do you recall that, where he
24 showed you your deposition from a while back?

25 A. Oh, yeah, yeah.

1 **Q. And you wanted to explain. He told you, no,**
2 **he didn't want you to explain. Can you explain to us**
3 **the context of those?**

4 A. I already have. I explained it earlier in my
5 testimony. That assumption was we were operating with a
6 great deal of uncertainty. I said multiple times in
7 front of this Court that you cannot operate Scopac on \$3
8 or \$4 million when your largest customer is
9 administratively insolvent. When you have a \$20 million
10 credit facility provided by the noteholders and you're
11 giving them logs, there is no -- there is no uncertainty
12 from your customer. You don't expect to collect the
13 money anyway.

14 **Q. Now, Mr. Hail, I guess -- Mr. McDowell talked**
15 **to you about some accrual of professional fees?**

16 A. I do.

17 **Q. And you don't know the proper classification**
18 **of those accruals in the bankruptcy context or whether**
19 **or not a legal issue is concerned as to whether there**
20 **are actual accruals in that context, I assume. That's**
21 **not your bailiwick?**

22 A. I'm sorry.

23 **Q. Whether they're going to be an admin claim**
24 **increase, an admin claim or not, you're not a bankruptcy**
25 **attorney?**

1 A. I am not a bankruptcy attorney.

2 **Q. Okay. But regardless, even if they are an**
3 **increase and some sort of accrual at the end, what is**
4 **the most in your mind that they could possibly be to add**
5 **on to any DIP facility or funding requirement or bond in**
6 **this matter?**

7 A. It's difficult for me to quantify that. I'd
8 like to, but I don't know the answer to that.

9 **Q. Do you think it's something less than \$6**
10 **million? I think you said \$12 million.**

11 A. I don't think the run rate for -- I don't
12 think the professional fees will run very high through
13 an appeal period based on what I've been -- based on
14 what I've learned of activities that take place during
15 an appeal period. So to assume a \$2 million a month
16 professional fee run seems extremely high to me. So I
17 have difficulty with the \$6 million number. And I
18 certainly would disagree with \$12 million number over
19 the course of a one-year appeal period -- or I'm sorry,
20 a six-month appeal period.

21 **Q. And we talked about -- they talked about**
22 **Marathon, what they do or don't get to do during the**
23 **appeal period. Do you recall that from -- those**
24 **questions from Mr. Neier?**

25 A. Yes.

1 **Q. They get interest, cash?**

2 MR. NEIER: I didn't ask any questions.

3 MR. KRUMHOLZ: I apologize.

4 MR. NEIER: I didn't ask him.

5 MR. KRUMHOLZ: For some reason -- fair
6 enough. Thank you for pointing that out. They all run
7 together at this point, Justin.

8 **Q. (By Mr. Krumholz) But they were talking**
9 **generally about what Marathon does or does not get. Do**
10 **you recall that?**

11 A. Yes.

12 **Q. And they get cash, first of all, \$400,000 --**
13 **approximately \$350- or \$400,000 per month on the DIP**
14 **facility, true?**

15 A. Correct.

16 **Q. They wouldn't get that under the MRC/Marathon**
17 **plan if it went effective, right?**

18 A. That's correct.

19 **Q. And the only thing Marathon doesn't get to do**
20 **is to foreclose during any stay, right? Something you**
21 **believe would be economic suicide?**

22 A. I wouldn't foresee why they would do it. I
23 can't -- I don't know what's going through Marathon's
24 head, but I -- that I could see why they would do that.

25 **Q. Do you --**

1 THE COURT: You don't think they can
2 foreclose their DIP during the stay pending appeal?
3 Because you think I wouldn't let them or is this -- or
4 do you think that the stay pending appeal should also
5 stay them?

6 MR. GERBER: I think what the testimony
7 is, Your Honor, is that -- not that they wouldn't have
8 the right to do it, but that it would be economic
9 suicide.

10 THE COURT: Okay. But I thought his
11 questions were based upon the assumption that the stay
12 stop them from --

13 MR. KRUMHOLZ: It was poorly worded.
14 It's not get to do, but --

15 THE COURT: It wouldn't.

16 MR. KRUMHOLZ: That it wouldn't stay it.
17 Thank you, Your Honor.

18 Q. (By Mr. Krumholz) You were asked about
19 retention lists. Do you recall that?

20 A. I do.

21 Q. Is Mr. Hail's suggestion consistent with your
22 understanding?

23 A. It is not.

24 Q. And tell us how that is.

25 A. It's my understanding that retention bonuses

1 are paid at the expected date; otherwise, they would
2 have been paid when the judge entered the order. I
3 mean, it's -- yeah, it's been my advice time and time
4 again that those are paid at the effective date.

5 **Q. There's been a lot made about Xroads getting**
6 **paid. You're serving as CFO as Scopac; is that right?**

7 A. I am.

8 **Q. Do you consider yourself a critical vendor for**
9 **Scopac?**

10 A. I do.

11 **Q. And what Xroads is doing for Palco and**
12 **Scopac --**

13 A. Absolutely.

14 **Q. -- to be a critical function?**

15 A. Yes.

16 **Q. And have you tried to pare down what gets paid**
17 **to be critical functions?**

18 A. Yes.

19 MR. KRUMHOLZ: Pass the witness, Your
20 Honor.

21 THE COURT: All right. You can step
22 down. We're going to break now for -- what?

23 MR. FROMME: I just wanted to point out,
24 as the witness steps down, is that the docket number for
25 the orders approving the incentive plans of both Palco

1 and Scopac. I know you've taken judicial notice of your
2 entire record, but just for your reference, Your Honor,
3 I think it's Docket No. 1275 approving the Palco plan
4 and docket No. 1259 approves the Scopac plan.

5 THE COURT: Does that solve the issue?

6 MR. FROMME: It solves the issue, Your
7 Honor. It's the effect --

8 THE COURT: It says effective date?

9 MR. FROMME: You can read it yourself.

10 THE COURT: Okay. All right. How many
11 more witnesses? Is that all your witnesses?

12 MR. KRUMHOLZ: Other than
13 Mr. Breckenridge by trial testimony, previous trial
14 testimony.

15 THE COURT: Okay. Well, it's admitted.

16 MR. KRUMHOLZ: And just to be clear on
17 that, they have not objected to Mr. Breckenridge's
18 testimony other than, I think, when we cut and pasted
19 the Q and A, there may have been some statements about
20 what each section said that's not actually Q and A, and
21 we've agreed to strike whatever is not the actual Q and
22 A from Mr. Breckenridge's proffer.

23 THE COURT: Okay. All right. So now how
24 many witnesses? Is Scopac calling anymore witnesses?

25 MR. FROMME: No, Your Honor.

1 THE COURT: All right. Now, how many
2 witnesses are you calling?

3 MR. NEIER: We have two witnesses, Your
4 Honor.

5 THE COURT: And they have proffers?

6 MR. NEIER: They do. They have been on
7 file since way before.

8 THE COURT: What are their names?

9 MR. NEIER: Mr. O'Brien and Mr. Johnston.

10 THE COURT: Johnston and O'Brien.
11 They're here?

12 MR. NEIER: Yes, Your Honor.

13 MR. HOLZER: Tab 1 and 2.

14 THE COURT: I have them. All right.
15 Well, we're going to break for lunch now.

16 MR. NEIER: Can we suggest a short lunch.

17 THE COURT: Yes, it's going to be a half
18 an hour. I'm not sure that is worth anything. I'll
19 tell you what, let's say -- it's now 12:54. How about 2
20 o'clock. I think you can theoretically get a lunch in
21 that time period.

22 MR. HOLZER: Your Honor, before you leave
23 the bench, in the Asarco matters from this morning, all
24 were passed till Tuesday except one we need to reset
25 until August, and I have an order on that one.

1 THE COURT: Thank you. Everybody is
2 excused. Stand at ease.

3 (A recess was taken for lunch.)

4 THE CLERK: All rise.

5 THE COURT: Be seated. Are you ready to
6 proceed?

7 MR. NEIER: Yes, Your Honor. Marathon is
8 calling -- I'm sorry, why don't you go first.

9 MR. FROMME: Eric Fromme from Gibson,
10 Dunn & Crutcher. Dr. Barrett is on a flight at 4
11 o'clock out of Corpus Christi.

12 THE COURT: You were going to call
13 Barrett?

14 MR. FROMME: No, we're not going to call
15 Barrett. He's already testified on the stand. And I've
16 announced to all the parties that he'll leave at 2:45.
17 I said 3:00, but 2:45 until anyone has an objection.

18 THE COURT: Any objection? Okay. He's
19 out of here.

20 MR. NEIER: I guess I should ask. The
21 indenture trustee is resting, correct?

22 THE COURT: Right.

23 MR. KRUMHOLZ: Yes.

24 MR. NEIER: We're calling Mr. Johnston.
25 We're just going to ask him if his proffer is his

1 proffer.

2 THE COURT: Raise your right hand to be
3 sworn.

4 JEFFREY JOHNSTON,
5 having been first duly sworn, testified as follows:

6 THE COURT: First of all, you are in
7 fact --

8 MR. NEIER: I guess I should say for the
9 record, Your Honor, that Mr. Gerber said that he didn't
10 have one of the documents that's footed in Exhibit B.
11 That was actually in a proffer from the debtors during
12 the confirmation hearing, and we have turned that over.
13 We also turned over a prior proffer, a prior appraisal
14 which we got also.

15 MR. GERBER: Your Honor, you have
16 indicated you're already going to let it come into
17 evidence, but I'll have some argument about the weight
18 of it.

19 THE COURT: Okay. But starting off, you
20 are Jeffrey Johnston?

21 THE WITNESS: Yes.

22 THE COURT: And this redacted declaration
23 took out the stuff from the 507 and left the stuff on
24 stay. Is that your proffer?

25 THE WITNESS: Yes, Your Honor.

1 THE COURT: And is it all true and
2 correct, to the best of your knowledge?

3 THE WITNESS: Yes, Your Honor.

4 THE COURT: Okay. It's your witness.

5 CROSS-EXAMINATION

6 BY MR. GERBER:

7 Q. Good afternoon, Mr. Johnston.

8 A. Good afternoon.

9 Q. I put your declaration up on the screen,
10 Mr. Johnston, at slide 1. You were engaged to determine
11 the amount of a bond required to pay for potential
12 damages that might be suffered by certain parties; is
13 that correct?

14 A. That's correct.

15 Q. And you formed an opinion as to the damages
16 that would result from the MRC/Marathon plan never going
17 effective, true?

18 A. No.

19 Q. I'm sorry. You formed an opinion as to the
20 damages that would be suffered in the event the plan
21 never went effective; is that correct?

22 A. No.

23 Q. What was your opinion basically?

24 A. I formed an opinion of the potential damages
25 that would flow to certain parties if the MRC/Marathon

1 plan did not go effective and the assets of the estates
2 were liquidated.

3 Q. Then you formed an opinion as to -- to
4 determine -- you determined the amount of a bond; is
5 that correct?

6 A. Yes, inasmuch as my understanding is that the
7 bond would be designed to cover those damages. So I
8 related the amount of those damages to a bond amount.

9 Q. You weren't engaged to consider any other form
10 of security other than a bond; is that correct?

11 A. The primary purpose of my retention was to
12 develop an opinion regarding a potential range of
13 damages, so that's what I focused on.

14 Q. Did you -- were you engaged to consider any
15 form of security other than a bond?

16 A. Not specifically.

17 Q. You weren't engaged to consider how the
18 parties in interest might be protected if the debtors
19 received adequate financing to continue operations
20 during the stay; is that true?

21 A. That's correct.

22 Q. And this is the first time you've ever
23 testified as an expert to help a court determine the
24 appropriate security in connection with the stay pending
25 appeal of a confirmation order, true?

1 A. That's correct.

2 Q. So your calculation is your opinion of
3 potential damages, what might happen if one first
4 assumes that a stay goes into place, secondly assumes
5 the Marathon/MRC plan does not go effective. And
6 thirdly, you assume that the assets are sold for
7 liquidation value; is that correct?

8 A. That's correct.

9 Q. So you assume the plan would never go
10 effective, but you didn't -- you didn't form an opinion
11 that the imposition of the stay pending appeal will
12 necessarily result in the plan never going effective,
13 correct?

14 A. That's correct.

15 Q. Okay. And you're not opining that if the plan
16 never goes effective the assets could only be sold for
17 liquidation value, true?

18 A. That's correct.

19 Q. Okay. And you're not opining that the
20 imposition of the stay would cause the assets to be sold
21 for liquidation value, true?

22 A. True.

23 Q. Does the opinion cover what potential damages
24 would result if the companies continued as going
25 concerns rather than selling their assets for

1 **liquidation value?**

2 A. Well, there are numerous possibilities of what
3 might happen. The purpose of my analysis was to
4 determine the range of potential damages.

5 MR. GERBER: Your Honor, I'll ask that
6 the witness only answer the question.

7 THE COURT: Just answer his question. So
8 be specific.

9 **Q. (By Mr. Gerber) Does your opinion show what**
10 **potential damages would result if the companies**
11 **continued as going concerns rather than selling their**
12 **assets for liquidation value?**

13 A. I believe it covers that possibility.

14 **Q. Okay. Have you delivered an opinion of the**
15 **cash losses of any of the debtors' businesses during the**
16 **time of the stay?**

17 A. I'm sorry. Could you repeat that?

18 **Q. Yes. Have you delivered an opinion of the**
19 **cash losses of any of the debtors' business operations**
20 **during the time of the stay?**

21 A. No.

22 **Q. Have you delivered an opinion of the cost to**
23 **insure any of the debtors' assets against catastrophic**
24 **events during the time of the stay?**

25 A. No.

1 Q. Have you delivered an opinion of the amount of
2 property taxes which would accrue and be payable with
3 respect to any of the debtors' assets during the time of
4 the stay?

5 A. No.

6 Q. Have you delivered an opinion of the amount of
7 the rental value of any of the debtors' assets during
8 the stay pending appeal?

9 A. No.

10 Q. Have you delivered an opinion of the amount of
11 interest which might be earned on distributions to
12 creditors during the time of the stay pending appeal?

13 A. No.

14 Q. Have you delivered an opinion regarding any
15 expense incurred by any party as a result of the time
16 delay caused by the stay pending appeal?

17 A. Well, I believe my opinion encompasses a
18 variety of different types of damages that might arise,
19 so I think to say have I covered any, the answer would
20 be yes.

21 MR. GERBER: That was not my question,
22 Your Honor. I move that the answer be stricken as
23 nonresponsive.

24 THE COURT: Okay. Try to answer just his
25 question that he asks.

1 Q. (By Mr. Gerber) Have you delivered an opinion
2 regarding any expense incurred by any party as a result
3 of the time delay caused by the stay pending appeal?

4 A. Singularly, no.

5 Q. Let's go to the next slide, please. I'm
6 showing you paragraph 5 of your declaration,
7 Mr. Johnston. It's your opinion that potential damages
8 that could be suffered by Marathon/MRC and other
9 creditors in interest as a result of the stay imposed
10 that would prevent the plan from going effective is \$404
11 million and change?

12 A. Yes.

13 Q. Now, you were not asked to determine MRC or
14 Marathon's risk that the -- -- for changes in interest,
15 were you, changes in interest rates, what Mr. Hail was
16 suggesting to Mr. Young?

17 A. That's correct.

18 Q. Okay. And you were not asked -- and you're
19 not going to testify to that either, I presume?

20 A. It's not part of my declaration, no.

21 Q. Okay. And you didn't testify as to -- your
22 opinion doesn't include and you were not asked to
23 evaluate the risk of fire damage or any of the other
24 risks that Mr. Hail suggested might be facing MRC; is
25 that correct?

1 A. That's correct.

2 Q. Were you asked to -- did you -- were you asked
3 to analyze Mr. Brilliant's request for \$100 million
4 bond?

5 A. No.

6 Q. This portion of your opinion says that the
7 damages were a result of the stay imposed that would
8 prevent the plan from going effective; is that correct?

9 A. Yes.

10 Q. Okay. Did you earlier just testify that
11 you're not saying that -- you're not -- you didn't make
12 any evaluation of -- you're not opining that the stay
13 itself would prevent the MRC/Marathon plan from going
14 effective; is that correct?

15 A. Well, we agree --

16 Q. I'm sorry, let me rephrase it. I'll withdraw
17 the question. You're not saying that imposition of the
18 stay and then modification of the stay would -- or
19 dissolution of the stay would prevent -- would
20 necessarily prevent the plan from going effective?

21 A. I'm not saying that the stay would forever bar
22 the plan from going effective.

23 Q. Okay. Do you know if MRC or Marathon -- the
24 MRC/Marathon plan provides any compensation to MRC or
25 Marathon if the plan does not go effective as you've

1 assumed?

2 A. I'm not aware of any.

3 Q. Okay. As far as you know, there's no break-up
4 fees or they're not entitled to any payments or
5 indemnifications from the estates or any of the
6 creditors if they decide not to take the plan effective;
7 is that correct?

8 A. That's my understanding.

9 Q. Let's go to the next slide. This is your --
10 part of your Exhibit B, correct?

11 A. Yes.

12 Q. Okay. Your Exhibit B does try to calculate
13 damages to Marathon and MRC as if they were unable to
14 purchase the timberlands as provided in the plan; is
15 that correct?

16 A. Not specific to Marathon and MRC, no.

17 Q. Okay. Well, who would -- who would be harmed
18 then -- your calculation shows the value of the
19 timberlands per the finding of the Court at \$510
20 million, then you deduct the liquidation value of the
21 timberlands which you say is \$260 million. Who would be
22 harmed by that drop in value if not Marathon and MRC?

23 A. These damages would enure to the benefit of
24 the estate. So in other words, these damages would be
25 damages to the estate. I have not attempted or sought

1 to allocate those among specific parties.

2 Q. Okay. So damage to the Scopac estate. Are
3 either MRC or Marathon creditors of the Scotia Pacific
4 estate?

5 A. Of Scotia Pacific?

6 Q. Yes, sir.

7 A. I don't believe so.

8 Q. Okay. Are either of them equity holders to
9 the Scotia Pacific Company?

10 A. I don't believe so.

11 Q. Okay. So you're not opining that either
12 Marathon or MRC are entitled to the protection of that
13 \$250 million difference in value; is that correct?

14 A. Could you repeat that?

15 Q. Yes. You're not opining that either Marathon
16 or MRC are entitled to the protection of that \$250
17 million difference in value between what the Court says
18 was the value of the timberlands and what you say is the
19 liquidation value?

20 A. Well, to be clear, I have not limited my
21 analysis to the Scopac estate.

22 Q. Well, does anyone else own an interest in the
23 timberlands other than the Scopac estate?

24 A. No.

25 Q. And you said it was the estate that would

1 **suffer as a result of that drop in value, correct?**

2 A. Yes. When I use the term estate, I'm
3 referring to the combined estates here.

4 **Q. Well, again, does any other estate other than**
5 **Scotia Pacific have an interest in the timberlands?**

6 A. I thought that one of the other estates owned
7 a small portion of the timberlands or perhaps timber
8 harvesting rights, but I may be mistaken about that.

9 **Q. Well, is that value of the timberlands the**
10 **harvesting rights, do you know? Include the**
11 **harvesting -- never mind. We don't need to go there.**
12 **As you say, it's maybe small.**

13 **At what time -- in connection with your**
14 **calculation of the bond requirement, at what point in**
15 **time do you assume a sale of the timberlands would only**
16 **be able to generate liquidation value?**

17 A. I have not made an assumption about a specific
18 point in time.

19 **Q. Okay. Are you suggesting to the Court that**
20 **the moment the plan does not go effective that the only**
21 **value that could be received from the timberlands is the**
22 **liquidation value?**

23 A. No.

24 **Q. How much cash or other property is MRC**
25 **required to contribute in order for the plan to go**

1 **effective, do you know?**

2 A. Well, the plan has been amended, so I'm not
3 sure how much it is under the amended plan.

4 **Q. With respect to the damages that you calculate**
5 **on Exhibit B, have you made allowance for or deducted**
6 **for MRC not having to have put up any -- any money in**
7 **connection with those assets that are reflected there?**

8 A. No, I don't believe that would be relevant to
9 my calculation.

10 **Q. That's not my question. Have you allowed for**
11 **or considered any of that?**

12 A. I said no.

13 **Q. And you said that MRC and Marathon don't have**
14 **any interest in the timberlands. Let's go to the next**
15 **slide. Let's go to the going concern of the value of**
16 **the Palco town assets less the liquidation value of**
17 **Palco and selected subsidiaries. Do you see that?**

18 A. Yes.

19 **Q. What are those two numbers meant to reflect?**

20 A. The going concern value of the Palco town
21 assets is just that, the appraised -- an average of the
22 appraised values on a going concern basis or fair market
23 value basis of those assets. The liquidation value of
24 Palco and select subsidiaries is intended to represent
25 the liquidation value of those assets.

1 Q. Again, now, you have -- we'll come back to the
2 going concern value. But the liquidation, where did you
3 get that liquidation value?

4 A. That was derived from the joint disclosure
5 statement.

6 Q. So the liquidation value came from the debtors
7 numbers as far as liquidation value; is that correct?

8 A. Yes, from the joint disclosure.

9 Q. Joint disclosure of all the parties, including
10 MRC and Marathon, correct?

11 A. Correct.

12 Q. There's also a liquidation value on that chart
13 for the timberlands, correct, for Scopac?

14 A. Yes.

15 Q. Okay. And that's \$426 million, not the \$260
16 million you used, correct?

17 A. No, that's not correct.

18 Q. That's not the number you used in your
19 analysis. Go back to Exhibit B. You used \$260 million.
20 You didn't use the \$469 million, correct?

21 A. The 469 --

22 Q. I'm sorry. Did you use it or didn't you?

23 A. I don't know what number you're referring to,
24 469.

25 Q. Go back to the liquidation. I'm sorry. 426?

1 A. That is not the liquidation value of the
2 Scopac timberlands.

3 Q. It is the midpoint of net proceeds available
4 for distribution, correct?

5 A. I'm sorry. That -- that number is the
6 midpoint of net proceeds available for distribution.

7 Q. Okay. It is the same comparable number with
8 respect to the Palco and select subsidiaries number that
9 you did use, correct, same calculation?

10 A. No.

11 Q. Let's go back to going concern value. Were
12 you present during Mr. Breckenridge's testimony?

13 A. I believe I was.

14 Q. Okay. Did you hear him testify that on behalf
15 of Marathon -- and that's your client as well, too,
16 Marathon, right? Let's go to the -- keep going. Keep
17 going. Keep going. There it is. He testified to the
18 going concern value at about \$110 million, correct?

19 A. I don't know. I can't put that in context
20 from three line items.

21 Q. Well, let's go and see what your attorneys say
22 about it. Go to the brief of the response. Keep going.

23 Right there, the uncontroverted testimony --
24 this is page 22 of the brief your attorneys filed. Not
25 your attorneys, but the same attorneys who hired you

1 **said. "The uncontroverted testimony at confirmation**
2 **hearing was that the town assets are valued at \$110**
3 **million." Do you see that?**

4 A. Yes.

5 **Q. And you didn't use that number; is that**
6 **correct? You didn't use that number; is that correct?**

7 A. That is correct. I'm not sure that's an
8 apples and apples comparison. But I did not use that
9 number.

10 MR. NEIER: Town assets versus Palco.

11 **Q. (By Mr. Gerber) Okay. Well, your counsel**
12 **suggests that's the undisputed value of the Palco**
13 **assets, correct?**

14 MR. NEIER: No, that's not what I
15 suggest.

16 A. That sentence indicates it's the
17 uncontroverted testimony of the confirmation hearing was
18 of the town and the assets. Those are just a subset of
19 the Palco assets.

20 **Q. Well, let's look at Mr. -- well,**
21 **Mr. Breckenridge's testimony, the Court can look at**
22 **Mr. Breckenridge's testimony. I believe he looks at all**
23 **the assets. Those are his three components.**

24 **In any case, did you make any independent**
25 **determination of the value of the Palco town assets or**

1 **the Palco and select subsidiary assets either at fair**
2 **market value or liquidation value as of any particular**
3 **date?**

4 A. I relied on the experts or the appraisers that
5 were retained in this matter for that information.

6 **Q. I'm sorry. Did you make any independent**
7 **determination of the value?**

8 A. I would consider that to be my independent
9 determination based on that information.

10 **Q. So you just relied on other people's**
11 **valuations?**

12 A. Yes, experts.

13 **Q. Were any -- which experts?**

14 A. Cushman and Wakefield.

15 **Q. Okay. Was --**

16 A. And Richard Ellis.

17 **Q. Excuse me. Was the Cushman and Wakefield --**
18 **the Cushman and Wakefield evaluation that you relied on**
19 **ever offered into evidence?**

20 A. I don't know.

21 **Q. Was it ever given to the indenture trustee**
22 **prior to today?**

23 A. I don't know.

24 **Q. It's not published anywhere, to your**
25 **knowledge, is it? It's not any public document, is it?**

1 A. Well, it's certainly referenced in the joint
2 disclosure statement.

3 **Q. Is it really? Is the April 1st, 2008 opinion**
4 **that you relied on referenced in the joint disclosure**
5 **statement? It didn't exist at that time, did it?**

6 A. The Cushman and Wakefield appraisal is
7 referenced in the joint disclosure statement. I'm not
8 sure --

9 **Q. What you relied on was dated April 1st, 2008,**
10 **correct?**

11 A. I was just going to finish by stating it may
12 not be that same appraisal.

13 **Q. So the one you relied on was not published and**
14 **was not referenced in the disclosure statement, correct?**

15 A. You may be right.

16 **Q. Did you opine as to any other damages which**
17 **Marathon might potentially suffer if the stay is**
18 **imposed? Let's go back to Exhibit B, please.**

19 A. Well, as I testified, I have not allocated
20 damages to specific parties in this case, so not
21 specifically.

22 **Q. Okay. So you can't tell the Court who this**
23 **bond -- whether or not this bond protects Marathon, MRC**
24 **or anybody else in particular?**

25 A. I think I can tell the Court that it is

1 intended -- the calculation and the methodology is
2 intended to protect all of those parties.

3 Q. Okay. But you can't tell who or what damages
4 any one in particular might -- any party might suffer
5 regarding those amounts?

6 A. Well, I don't think that's true because with
7 respect to the creditors who -- the claimants who are
8 being --

9 MR. GERBER: Your Honor, if he could just
10 answer the question.

11 THE COURT: Well, you asked him he can't
12 tell and he said no, it's not true.

13 MR. GERBER: And then he started --

14 THE COURT: So it's not true. That's all
15 you want. Okay. Go ahead.

16 Q. (By Mr. Gerber) Now, you were engaged to
17 provide an opinion regarding potential damages that
18 could be suffered. You didn't indicate any probability
19 that they would be suffered; is that correct?

20 A. That's correct.

21 Q. So you don't know based -- you have not
22 attempted, based on the facts of the case, to consider
23 the probability that any of these damages might occur,
24 whether they're more likely than not or likely or just
25 not likely at all, correct? When you say potential

1 **damages, is that what you mean?**

2 A. I have not formed an opinion regarding
3 probability, that's correct.

4 Q. So you can't tell whether or not the
5 likelihood of harm as to any of those parties -- you
6 can't give the Court any help on the likelihood of harm
7 to any of the parties you were attempting to calculate
8 damages for? All you did was calculate the potential
9 damages if you assume those three things occurred. That
10 is, the imposition of the stay, the plan never, ever
11 going effective, and a liquidation sale, correct?

12 A. No. I think I can tell the Court that the
13 likelihood of these damages occurring under those
14 circumstances.

15 Q. Okay. And the likelihood is 100 percent those
16 will occur?

17 A. I think the likelihood that this range of
18 damages would occur is reasonably high under those
19 circumstances.

20 Q. Well, that's not in your opinion anywhere.
21 Are you saying to the Court that you did form an opinion
22 as to the likelihood of damages, that you're just now
23 telling us?

24 A. You just asked me a question, and I'm seeking
25 to answer a question.

1 Q. It's not part of your opinion, though,
2 correct?

3 A. I was not asked to render that opinion.

4 Q. Okay. And it's not in your opinion anywhere,
5 correct?

6 A. That's correct.

7 Q. Okay. Under your understanding, unless the
8 plan goes effective, do the administrative claimants or
9 other parties listed below the liquidation value of the
10 timberland have any right to payments from Marathon,
11 MRC, Newco or Townco?

12 A. Could you repeat that?

13 Q. Yes. Is it your opinion that unless the plan
14 goes -- well, let me put it this way. Unless the plan
15 goes effective, do the administrative claimants or other
16 parties listed here have any right to payments from
17 Marathon, MRC, Newco or Townco?

18 A. I don't have an opinion about that.

19 Q. And the same thing for all of these claims.
20 Is it your opinion that the amount of potential damages
21 that you've calculated is predicated on a liquidation
22 sale of all the Palco and Scopac assets, correct?

23 A. That is the assumption that I've made in my
24 calculation.

25 Q. In fact, even in the case of a liquidation

1 sale, it's possible that the PBGC claim would not be
2 payable, correct?

3 A. That's possible.

4 Q. And there are other parties liable for the
5 PBGC claim besides Palco and Scopac?

6 A. I'm not familiar enough with the PBGC's claim
7 to provide an answer.

8 Q. And since you assume that the plan would never
9 go effective and you only considered a liquidation sale
10 that would not yield enough to pay the secured creditors
11 at each estate, you concluded that the administrative
12 claimants and the unsecured creditors would never get
13 paid anything on their claims, correct?

14 A. I believe that's correct, yes.

15 Q. So by making the assumptions you made that all
16 these things, those three assumptions that you were
17 asked to make, you assured yourself that none of the
18 claims -- and these are all the claims that are called
19 for under the Marathon/MRC plan, correct?

20 A. Yes.

21 Q. Okay. By making those three assumptions, you
22 just determined at that point then, well, all those --
23 all those claims would never get paid, correct?

24 A. That would be the reality under the
25 circumstances.

1 **Q. No. Under the assumptions, correct?**

2 A. Assumptions or circumstances, yes.

3 **Q. And you gave no probabilities as to those**
4 **assumptions and you gave no probabilities as to whether**
5 **or not --**

6 THE COURT: You're now sort of
7 testifying. He's already said that. Move on.

8 MR. GERBER: Pass the witness.

9 THE COURT: Does anybody else have any
10 questions for this witness?

11 MR. FROMME: Your Honor, Scopac has no
12 questions.

13 MR. HAIL: I have one quick question,
14 Your Honor.

15 CROSS-EXAMINATION

16 BY MR. HAIL:

17 **Q. Mr. Johnston, earlier today you heard me and**
18 **Mr. Young discussing about the present value of an**
19 **income stream, right?**

20 A. Yes.

21 **Q. And that was the present value of 14 years --**
22 **14 years at 6.8?**

23 MR. GERBER: Objection, Your Honor,
24 outside the scope of the proffer, outside the scope of
25 the cross.

1 MR. HAIL: I'm just asking him to do some
2 math, Your Honor, what I did earlier today.

3 MR. GERBER: I don't think there's any
4 test of his math in his proffer or in my
5 cross-examination.

6 THE COURT: He is a CPA, isn't he?

7 MR. GERBER: Your Honor, but he's here to
8 testify --

9 THE COURT: So you'd prefer me to do the
10 calculations? I was a math major, but I'm not a CPA. I
11 was into pure math, all of the weird crazy stuff, not
12 anything that has any application.

13 MR. GERBER: Your Honor, I suspect
14 geometry would apply anyway, so we're in good shape.

15 MR. HAIL: Your Honor --

16 MR. GERBER: If Mr. Johnston's calculator
17 is working and Mr. --

18 MR. HAIL: I'm not going to ask him to do
19 it. I think he did it already. I just wanted to know.

20 **Q. (By Mr. Hail) What was the result of that**
21 **calculation?**

22 A. \$28.7 million.

23 MR. HAIL: Okay. That's all. Thank you.

24

25

CROSS-EXAMINATION

1 BY MR. NEIER:

2 Q. David Neier on behalf of Marathon.

3 Mr. Johnston, do you recall that Mr. Gerber asked you
4 questions regarding whether or not the joist disclosure
5 statement was based on Cushman and Wakefield's
6 appraisal?

7 A. Yes.

8 Q. Can you show the -- if I could direct your
9 attention to what's on the screen, you'll see a
10 reference to Cushman and Wakefield's estimate of orderly
11 liquidation value. Do you see that?

12 A. Yes.

13 Q. Do you see any date there?

14 A. No.

15 Q. But as far as you're concerned, the
16 liquidation value is based from the disclosure, it's
17 based on the Cushman and Wakefield estimate, correct?

18 A. That's correct.

19 MR. GERBER: Objection, Your Honor. The
20 point was that --

21 MR. NEIER: We don't need a speaking
22 objection.

23 MR. GERBER: Well, Your Honor, it's
24 important because it's extraordinarily misleading.

25 MR. NEIER: It's not misleading.

1 MR. GERBER: The joint disclosure
2 statement --

3 THE COURT: I think that it's fair for
4 him to try to rehabilitate his witness. And it's fair
5 for you to point out the other things. And then we
6 argue about which means what, but not while they're
7 questioning.

8 MR. GERBER: As long as I can recross
9 him.

10 MR. NEIER: No, Your Honor, there's not
11 recrossing.

12 THE COURT: There isn't any recross. But
13 I don't understand. You asked him about one thing and
14 he's asking about another thing.

15 MR. NEIER: Of course not.

16 MR. GERBER: That's what I'm saying, that
17 it's outside the scope of my cross. I asked him about
18 an April 1st Cushman and Wakefield appraisal that he
19 relied on. It was published long after this disclosure
20 statement. He admitted it. And now he's saying, oh,
21 but it was in the disclosure statement.

22 MR. NEIER: Actually, I think the witness
23 testified that he's not sure which appraisal -- which
24 dated appraisal was referenced in the joint disclosure,
25 but he believed it was one from Cushman and Wakefield.

1 I'm demonstrating that it is.

2 THE COURT: Let's move on.

3 MR. NEIER: Thank you.

4 Q. (By Mr. Neier) Now, if we could turn to
5 Exhibit B from your proffer. Now, is it your belief
6 that the damages that could be suffered as a result of
7 any stay could be less than this amount? Could it be
8 less than this amount?

9 A. Yes, it could be.

10 Q. It could be less than \$404 million?

11 A. That's correct.

12 Q. Could it be also be more than that amount?

13 A. Yes.

14 Q. If there was an earthquake or a fire and the
15 entire forest burned up, it would be more than that
16 amount, correct?

17 A. That's correct.

18 Q. But would you say that this is the foreseeable
19 damages that could result from the stay being entered
20 and the MRC/Marathon plan not going effective?

21 A. Yes, I believe this estimate is foreseeable.

22 Q. And would the damages that would be suffered
23 from from increased interest expenses, the failure of
24 Marathon to recover on its DIP, the loss of the benefit
25 of the bargain, would they all be the types of damages

1 **that are encompassed in this amount, this \$404 million?**

2 A. That was my intent.

3 **Q. And, in fact, when Mr. Gerber went through a**
4 **laundry list of specific type of damages, do you believe**
5 **that all those damages would be encompassed in this**
6 **amount?**

7 A. Yes, I believe this amount would cover those
8 types of damages.

9 **Q. And, you know, to the extent that --**

10 MR. NEIER: You know what, Your Honor, I
11 think I'm going to end on that. I don't think I have
12 any other questions.

13 THE COURT: Anyone else? Okay. Now, if
14 the debtor owned this outright and had a deal to settle
15 it for \$510 million with no security or anything like
16 that, I guess I could see how the difference between the
17 liquidation value and the value that I found under the
18 plan, though, this goes -- the cash for the amount of
19 the value of the forest goes to the noteholder.

20 So why is your calculation, to the extent
21 that you have added \$250,000 for the -- \$250 million for
22 the decrease from 510 down to the liquidation value, why
23 is that not really just protecting the IT's interest
24 rather than somebody else's interest?

25 THE WITNESS: Well, I'm not sure that I

1 make that distinction. I mean, if the -- if the debtor
2 had a deal to sell the assets for 510 and the proceeds
3 would be paid out in the order of priority, I think it's
4 the same an analysis. And maybe I'm not addressing your
5 question. But I don't make that particular distinction
6 in my estimate.

7 THE COURT: Okay. You can step down.
8 Next witness is Jeffrey Johnston.

9 MR. GERBER: That was Jeffrey Johnston.

10 THE COURT: George O'Brien.

11 MR. NEIER: Can we have one or two
12 minutes to see if we want to call the next witness?
13 We're going to talk to the debtor about that.

14 THE COURT: All right. We'll take a
15 five-minute break.

16 (A recess was taken.)

17 THE CLERK: All rise.

18 THE COURT: Be seated.

19 MR. NEIER: Your Honor, we're not going
20 to call any further witnesses. And I guess the debtor
21 does not want to call any further witnesses.

22 MR. McDOWELL: We do not, Your Honor.

23 THE COURT: All right. I received a
24 brief on continuing jurisdiction during the process of
25 the hearing. One wouldn't open and one finally did. So

1 that's been received, and I replied saying that I
2 received it.

3 MR. GREENDYKE: We saw it.

4 MR. KRUMHOLZ: Your Honor --

5 MR. NEIER: To answer Mr. Krumholz's
6 question, we rest.

7 MR. KRUMHOLZ: Does the debtor rest?

8 MR. McDOWELL: The debtor rests, Your
9 Honor.

10 MR. HERMAN: Your Honor, this is Ira
11 Herman at Thompson & Knight.

12 THE COURT: Yes, sir.

13 MR. HERMAN: As you know, we've been
14 appearing for the indenture trustee, along with the
15 Fulbright firm.

16 THE COURT: Yes, sir.

17 MR. HERMAN: We have received via e-mail
18 or written instructions and can confirm that we have
19 received them from the holders that are in compliance
20 with the indenture and the requirements of the TIA
21 whereby the indenture trustee has been instructed to
22 support the Lehman DIP and support the so-called
23 subsidized log or the subsidized log program that has
24 been outlined for Your Honor during the course of the
25 day today. I just confirm that to the Court because

1 that question has been raised again and again, and now
2 it has been reserved -- now it has been received.

3 THE COURT: Thank you.

4 MR. PENN: Your Honor, is that a document
5 that might be forwarded to the parties in the courtroom
6 so we might see the extent of those instructions?

7 THE COURT: Can you forward a copy to
8 everyone?

9 MR. HERMAN: Your Honor, we have
10 received, you know, e-mail instructions from the
11 holders, and I'm not sure that they are in a form to be
12 shared with the whole world. There will be a formal
13 agreement. But as far as the IT is concerned, the
14 indenture trustee is concerned, all the large holders
15 have said yes to those proposals. And I believe they're
16 all on the line as well, Judge. I'd rather -- if the
17 Court can't rely on my word, it can be ratified --

18 THE COURT: I was just sending a question
19 by one of the lawyers, whether they could get copies of
20 that.

21 MR. HERMAN: I understand, Judge.

22 THE COURT: I'm not asking you to get
23 copies. They just asked could they have a copy. And
24 you're telling me they can't.

25 MR. HERMAN: Your Honor, I don't believe

1 what I have is in a form that should be released. But
2 I'm just confirming that the IT has received those
3 instructions and all of the holders are on the phone who
4 have given those instructions, and you can confirm.

5 THE COURT: Thank you.

6 MR. PENN: Your Honor, if we might have
7 some clarify about what percentage that represents.

8 THE COURT: Do you know what percentage
9 that is?

10 MR. HERMAN: Your Honor, it's far more
11 than a majority.

12 THE COURT: Is it less than two-thirds?

13 MR. HERMAN: I don't believe so, Your
14 Honor. I believe it's more than two-thirds. Based on
15 the most recent records that the IT has, it is much more
16 than two-thirds, substantially more.

17 THE COURT: All right. Ready to argue?
18 Yes, sir.

19 MR. GREENDYKE: This is Bill Greendyke,
20 also counsel for the indenture trustee. I confirm it is
21 more than the super majority.

22 THE COURT: Of course, I don't have any
23 idea what the indenture says. I have no idea. I am
24 relying on you to tell me what the indenture says. And
25 apparently it says that of more than -- or this amount

1 can do this DIP and log give-away or discount or
2 whatever you want to have. That's what your position is
3 on the DIP. But apparently it takes 100 percent to
4 subject your lien to being devalued by the whatever --
5 whatever actual damages occasioned by the -- by the --

6 MR. GREENDYKE: I'm not sure I understand
7 the question. If the question is a credit bidding
8 question --

9 THE COURT: Mr. Pachulski said that you
10 could not set your \$513.6 million against any damages
11 that might occur as a result of the deal.

12 MR. GREENDYKE: I understand.

13 MR. KRUMHOLZ: Non-monetary -- we can
14 waive non-monetary terms, but we cannot waive monetary
15 issues without 100 percent. You're exactly right, Your
16 Honor.

17 THE COURT: And you believe that you have
18 an opinion from your indenture trustee department that
19 this log discount program and \$20 million DIP, which may
20 be 25 -- and I'm not sure whether you agree to that or
21 not -- but you can waive that. That's something you can
22 just waive. That's non-monetary, even though it results
23 in either \$20 or \$25 million being taken off your debt
24 and it results perhaps on the other side in giving them
25 maybe it's \$3 million or something, a bunch of logs.

1 MR. KRUMHOLZ: Yes, Your Honor.

2 MR. GREENDYKE: The indenture is in
3 evidence, the deed is trust is in evidence and the new
4 master purchase agreement is in evidence. Those
5 documents indicate that --

6 THE COURT: Well, I'm going to rely on
7 your opinion about all of that unless somebody here is
8 going to try to say something --

9 MR. NEIER: Your Honor, we're going to
10 disagree with that, but I think we can save it for
11 closing arguments, if that's okay with you.

12 THE COURT: Okay.

13 MR. GREENDYKE: We think the answer to
14 the last question is a simple majority. I want to make
15 one more announcement before I turn the podium to
16 Ms. Coleman and Mr. Krumholz. He's going to be arguing
17 and closing for us. There is a lawyer on the phone by
18 the name of Laura McSaude, who is with and represents
19 the American and Securities Forum. And she would like
20 to make a statement at some point. I think in
21 connection with certification of the appeal. I just
22 wanted to introduce her and make you aware of that.

23 THE COURT: So she's going to be a friend
24 of the court statement.

25 MR. GREENDYKE: I think they have made a

1 statement. Yes.

2 THE COURT: So do you want to do that
3 now?

4 MR. GREENDYKE: Whenever the court deems.
5 I just want to introduce her before everything got
6 rolling.

7 THE COURT: I'm all ears, as they say.
8 Is she ready?

9 MS. McSAUDE: Yes, Your Honor, I'm here
10 on the phone.

11 THE COURT: Go right ahead.

12 MS. McSAUDE: Thanks so much, Your Honor.
13 As the gentleman said, I'm here on behalf of the
14 American Securitization Forum. I just want to make a
15 brief statement that the American Securitization Forum
16 supports the indenture trustee's request for a stay
17 pending appeal and for certification to the Fifth
18 Circuit. The ASF's main concern was the substantive
19 consolidation issue and its impact on the industry;
20 therefore, the ASF believes that a thorough review of
21 the substantive consolidation issue by a higher court is
22 appropriate under these circumstances. Thank you very
23 much, Your Honor.

24 THE COURT: Thank you. All right. Are
25 we ready to proceed? Are you going to argue both issues

1 right now? Ready to argue both issues?

2 MR. KRUMHOLZ: Both the certification
3 issue and the --

4 THE COURT: Right.

5 MR. KRUMHOLZ: I'd rather save the
6 certification issue for now.

7 THE COURT: For when?

8 MR. KRUMHOLZ: Immediately after, I
9 guess.

10 THE COURT: Is somebody else arguing
11 that? Is that what you're saying?

12 MR. KRUMHOLZ: No, I'm not. I'll argue
13 both. I'll argue both.

14 THE COURT: I mean, I agree that there's
15 two distinct issues. I'm not asking you in the same
16 breath or paragraph.

17 MR. KRUMHOLZ: May it please the Court.
18 To begin, Your Honor, you asked two very important
19 questions when we began the other day and they got cut
20 right to the chase. Of course, the very important
21 issues are how do we keep the status quo. And you asked
22 two questions. The first question, Your Honor, that you
23 raised was, okay, how do you keep it operational? And
24 there's been a lot of testimony about that. And we'll
25 get to that in a moment.

1 The second question is: Well, what if
2 some foreseeable or unforeseeable event occurs? And you
3 made certain analogies to, I guess, the stock market and
4 otherwise. But regardless of that, you asked what would
5 happen if the plan doesn't go through, they withdraw;
6 that is, Marathon or MRC somehow decide between now and
7 the end of the appeal we're backing out and somehow have
8 a right to do so. And we spent a lot of time on the
9 evidence and I wanted to cover those issues.

10 THE COURT: They have a right to back
11 out. I don't think you question that, do you?

12 MR. KRUMHOLZ: They have a right to back
13 out under a certain time period under the plan. But
14 regardless if they do or would back out, what would
15 happen whether or not we need to bond a fund or provide
16 a security for any damages that result -- as a result of
17 any such occurrence. And I want to address those one at
18 a time.

19 First of all, Your Honor, I want to talk
20 about the operations, okay. You have heard from three
21 witnesses during this trial as to operations. I want to
22 rely on the Court that these are the very people who run
23 it from day-to-day. And you never heard from
24 Mr. O'Brien. They pulled him down. The supposed CEO of
25 this company, Palco, you never heard from. And there's

1 a reason why. It's because he couldn't rebut anything
2 that Mr. Barrett said. He couldn't rebut anything
3 credibly with what Mr. Young said. And he couldn't
4 rebut anything about what Mr. Long said, his cohort and
5 his fellow officer at Palco. That is why you didn't
6 hear from him.

7 By the way, Your Honor, before I forget.
8 I spoke with Mr. Litvak and he said they have withdrawn
9 their proffer as well, is that right, as to Mr. O'Brien;
10 is that right?

11 MR. NEIER: You're talking to the wrong
12 person.

13 MR. McDOWELL: Yes, Your Honor, that
14 would be the testimony.

15 MR. KRUMHOLZ: I just want to make sure.

16 THE COURT: You can't not call the
17 witness and not withdraw the proffer. You get a chance
18 to question him if a proffer is in. Go ahead.

19 MR. KRUMHOLZ: So what did Mr. Barrett
20 say that's now uncontroverted by any witness at all? He
21 said that with the \$20 million DIP in place, he said if
22 Palco had 5 million board feet per month of logs and if
23 this discounted log program were put into place, then
24 there's no doubt in his mind that he could -- that Palco
25 could perform and maintain its operations through

1 December 31 of 2008. We now know that the DIP is not
2 \$20 million, it's \$25 million during that time frame.
3 So now there's a \$5 million cushion.

4 So there's no question about what
5 Mr. Barrett said. He was very clear about it. And he's
6 been the one who has run this company since day one.

7 THE COURT: Of course, he's also the one
8 who said that when -- in discussing matters with his
9 team, if it's really important, it's okay for him to lie
10 about things, too. Isn't that what he said? I'm not
11 sure if that's exactly what he meant, but that's
12 certainly what he said. I thought it was sort of
13 extraordinary testimony. But go ahead.

14 MR. KRUMHOLZ: Your Honor, if you're
15 talking about the e-mail that was presented -- and I'll
16 be happy to address that. We're talking about an e-mail
17 about certain levels -- a certain amount of wood that
18 was going to be delivered to Palco in the context of an
19 internal discussion. And he has committed to you and
20 you are going to require by order as to what needs to be
21 delivered. And he has committed to do that. And
22 Mr. Long, a Palco officer, said he has no doubt in not
23 only Mr. Barrett's credibility, but his ability to do
24 so. And frankly, Your Honor, given that context --

25 THE COURT: I'm not going to give that

1 much weight.

2 MR. KRUMHOLZ: -- of the testimony last
3 week and otherwise, I find it remarkable that frankly
4 that would be an impressive comment in the context of
5 these proceedings.

6 But regardless of that, you also heard
7 from Mr. Long who is the man at the mill. And Mr. Long,
8 their own employee, says exactly the same thing as
9 Mr. Barrett. Uncontroverted, no rebutting testimony
10 whatsoever. They consciously chose not to call
11 Mr. O'Brien, and we all know why.

12 THE COURT: I don't think there's any
13 doubt that we can continue to operate these two
14 businesses, especially -- you know, you keep giving them
15 \$20 million. Give them \$20 million and they can run for
16 a while. There's no question about that. And Palco,
17 give them free trees can run for some more, too. I
18 don't think's any question to that.

19 MR. KRUMHOLZ: And then, of course,
20 Mr. Young has testified about the forecast and how that
21 all works. And the only issue that came up at all that
22 I wish I had the opportunity to cross Mr. O'Brien about
23 was this midnight 13-week projection that all of a
24 sudden has some \$2 million a month in professional fees
25 that are accruing right after they get the forecast

1 which they know and have known for three weeks that
2 Mr. Young has been working on.

3 And what does this midnight 13-week
4 projection say? \$2 million of professional fees that
5 are accrued when they know after interviewing Mr. Young
6 the reason this discounted log purchase program was put
7 into place was so that there wouldn't be any accruals.

8 So what happened was, and it's clear, is
9 that they spent the last night and the last day, in my
10 opinion, worried about the fact that they couldn't rebut
11 any of that. And so they decided they need a 13-week
12 projection to show something far different that has
13 never been disclosed to anybody until just last night.
14 And I think it was about midnight. And they come up
15 with these \$2 million in fees for a Palco entity that
16 will not even be a party to an appeal. I think those
17 are absurd fees in the context of what will likely occur
18 during the appeal.

19 We've projected -- Mr. Young has
20 projected \$100,000 in fees. And we think that those are
21 reasonable. And we think that given the \$25 million
22 over the next six months and the DIP that any difference
23 will be made up through the funding through this DIP
24 facility.

25 But turning -- so I don't think there --

1 as Your Honor has now stated that there's much dispute
2 about the fact that they continue operating if we give
3 them \$20 to \$25 million. It's obviously the way that we
4 feel like we will get a fair appeal. And I'm not going
5 to rehash the importance, of course, of our getting that
6 fair appeal.

7 But the next turn, since that's their
8 best argument with respect to the operating costs and
9 whether or not we can maintain the status quo, to some
10 wild hypothetical and wild risk that somehow MRC or
11 Marathon are going to decide not to go effective with
12 the plan at some point.

13 THE COURT: Okay. I agree with you that
14 there's little likelihood that Marathon is going to
15 change their mind. On the other hand, Marathon has an
16 absolute right to -- once their DIP is due, to call it,
17 don't they? I mean, it changes the circumstances after
18 the DIP is due.

19 MR. KRUMHOLZ: Your Honor, what the case
20 law says is you need to fund or secure a bond. Whatever
21 is likely or is going to occur. I mean, it's not some
22 wild speculation. And the reason why I say that is
23 this. When I began speaking to you --

24 THE COURT: Let's assume Marathon is the
25 one and let's assume that Mendocino has had the interest

1 in buying this for a long time. They still have a
2 commitment for -- I mean, what is it, \$375 million
3 borrowing? Or is it 325?

4 MR. KRUMHOLZ: Your Honor --

5 THE COURT: That's outside their control.
6 They could lose that, too, couldn't they?

7 MR. KRUMHOLZ: Well, Your Honor, the
8 reality is you confirmed a plan based upon the
9 representation that it was going to be an all cash deal.

10 THE COURT: If they do it within 60 days.
11 But there's nothing -- I mean, I don't have to find that
12 their commitment will last through the appeal period.

13 MR. KRUMHOLZ: I think that one of the
14 other attorneys will address that very point and why
15 that's an absolute non-issue. Let me just say this for
16 the moment. We all agree it's very unlikely and wildly
17 speculative, I think, that Marathon would somehow back
18 out of the deal. Then the issue turns to MRC.

19 The truth is what the evidence before you
20 has established over the course of the last few weeks is
21 that these redwood forests are very unique, a very
22 unique commodity.

23 THE COURT: My English teacher would be
24 going crazy. You're either unique or you're not.
25 You're not very unique or less unique. It's a one of a

1 kind or it's not one of a kind.

2 MR. KRUMHOLZ: It's a one of a kind.
3 It's a unique property. And there's simply not
4 availability for redwoods throughout this country. They
5 don't come available very often. And that's why --

6 THE COURT: I should count the fact that
7 there is a 60 day time table on the contract.

8 MR. KRUMHOLZ: Your Honor, I believe that
9 under existing case law, the factors that you must
10 consider -- if you could turn to the second slide in the
11 PowerPoint. And the answer is yes to that. Are these
12 right here. The ones that the Fifth Circuit looks to
13 when we're talking about real estate companies, okay.
14 And that is -- go to the next slide. I'm sorry.

15 You should look at taxes, whether there's
16 insurance, whether the court costs have been covered,
17 whether the cash burn has been covered, whether there
18 was any lost income during the appeal is covered, and
19 whether the delayed distribution to the creditors has
20 been covered or not. Those are the factors the cases
21 suggest should be taken into account.

22 THE COURT: These are factors for stay
23 pending appeal of a confirmation order?

24 MR. KRUMHOLZ: These are -- these are not
25 factors of a stay of a confirmation order in this

1 specific context, Your Honor. But these are the factors
2 for these types of companies with large real estate
3 holdings that -- and how courts judge how to assess
4 exactly what should be secured. And so knowing this,
5 what do they do?

6 THE COURT: Are there any cases on the
7 specific issue of appeal of a confirmation order?

8 MR. KRUMHOLZ: Well, there are. And I
9 can't tell you off the top of my head. I have a feeling
10 that Mr. Pachulski will --

11 THE COURT: They don't say anything
12 different than this, is that what you're saying?

13 MR. KRUMHOLZ: I think this is the
14 applicable on the subject. And I think Mr. Pachulski is
15 probably in a better position to speak director to
16 appeals in the confirmation context.

17 But what I can speak to is Adelpia,
18 which is where they turn for the proposition that you
19 should consider that sort of thing. I said in opening
20 and I'll say again that was a situation where the
21 appellee was a buyer, a third-party. And they were the
22 ones that were asserting a contract right to be approved
23 by the court. And it wasn't the appellee in the case,
24 it wasn't a plan proponent. And it's wholly
25 inapplicable here. And so we don't believe there's any

1 support --

2 THE COURT: Who was suing the appellee?

3 MR. KRUMHOLZ: The appellant.

4 THE COURT: Well, I got that. Who was
5 the appellant? How's that? You can say it. You don't
6 have to tell him. You can just tell me.

7 MR. KRUMHOLZ: The debtor was the
8 appellee.

9 THE COURT: So the debtor was suing a
10 purchaser in Adelpia?

11 MR. PACHULSKI: Your Honor --

12 THE COURT: Yeah, go ahead.

13 MR. PACHULSKI: This is Isaac. I
14 apologize. But since I had the painful experience of
15 being involved in that case --

16 THE COURT: Go right ahead.

17 MR. PACHULSKI: This is what happened in
18 Adelpia and this is why it's different. A plan of
19 reorganization was confirmed. Before the plan was ever
20 confirmed, months before the plan, there was a sale of
21 substantially all of the assets of all of the debtors to
22 Time Warner. So that sale was done by the time you got
23 to the plan. Under the terms of the sale to Time
24 Warner, the consideration consisted primarily of
25 securities of Time Warner.

1 Now, under the terms of that contract
2 with Time Warner, which preceded confirmation of the
3 plan, Time Warner was not a party to the plan
4 proceeding, it was not an appellee, it was not involved.
5 Under the terms of that contract, because Time Warner
6 wanted a public market for its security, there was a
7 provision in the contract that said if the securities
8 that Time Warner provided to Adelphia were not
9 distributed under a plan by a day certain, then those
10 securities -- then Adelphia would be contractually
11 obligated to have an IPO for at least one-third of the
12 security.

13 And by the way, this was an absolute
14 deadline under the sole control of someone who was not a
15 party to the appeal pursuant to a previously approved
16 contract. And there was evidence that if the plan did
17 not go effective and if the securities were not
18 distributed, then the cost of the IPO between the
19 underwriter discounts and other things would be about
20 \$750 million.

21 Okay. So the important point is this
22 was -- no party to the appeal could control this. This
23 was a third-party. It was a drop dead date. The second
24 major -- there were two other major elements of damages,
25 both of which are actually covered by our proposal that

1 were a problem in Adelpia.

2 First, you had oversecured bank debt at
3 the subsidiary level in Adelpia that was accruing \$40
4 million of interest a month. That would have been
5 accrued at the expense of creditors of the parent. So
6 the court said, look, during the delay pending appeal,
7 there could be another \$280 million in inters being
8 accrued at the expense of creditors of parent who were
9 structurally junior creditors of the subsidiary.

10 The second -- and we don't have that
11 here, Your Honor. To the extent there is any interest
12 that accrues on the DIP or any interest on B of A. I
13 haven't seen the budget. So if I made a mistake, I'm
14 sorry. But I think it's in the budget.

15 The second thing that was covered in
16 Adelpia was prospective professional fees. And in
17 Adelpia, for whatever reason, because it was a hugely
18 complicated case, they were \$10 million a month. In
19 this case, once all this litigation is done and you have
20 a DIP in place and all you're doing is briefing an
21 appeal, you know, you're going to have some professional
22 fees. And those prospective fees are covered in the
23 budget.

24 But the key point of Adelpia is that the
25 appellees had no -- the appellees who wanted the bond

1 had absolutely no control over the contractual right of
2 a non-party of the appeal to enforce a contract that
3 would have imposed a \$750 million obligation or loss to
4 others if the plan had not gone effective. And I
5 apologize for taking so long. The facts are important.

6 THE COURT: So what did the court do?

7 MR. PACHULSKI: What the court did in
8 Adelphia, the court imposed a bond for the items that
9 were in control -- the bond basically covered three
10 items. And I don't know how the exact math worked.
11 Number one, it was a huge bond. And it was huge for
12 three reasons. It was huge first because -- actually,
13 there were four reasons that I think about it. I'm
14 sorry.

15 First, you had the contract right of a
16 non-party to the appeal who had no incentive other than
17 to enforce that contract right. Time Warner wasn't a
18 party to the appeal. The bond also had to cover the \$40
19 million a month. The bond also had to cover the
20 prospective professional fees, which are covered by our
21 DIP proposal here, but we don't have something like that
22 \$40 million in interest. And there was another point
23 that I think was important to the court.

24 In Adelphia -- you were talking about
25 securities of Time Warner. Time Warner was a cable

1 company, and it happened at the time that those
2 securities were at an all time high. And you were
3 dealing with securities, publicly traded securities,
4 which are inherently volatile. The one thing that's
5 clear, Your Honor, is that you can't possibly compare
6 these timberlands to publicly traded securities.

7 So everything, everything that the court
8 in Adelpia required bonding against isn't present here
9 or is already covered in the DIP proposal. And the
10 reason I say that is I'm sure at some point the other
11 side is going to say, Your Honor, look in Adelpia,
12 Judge Sheindlin, even though she talked about the
13 importance of an appeal and how it's a fundamental right
14 and imposed a huge bond. Yes, because there were huge
15 amounts outside of the control of the parties that
16 weren't covered.

17 So the point of this -- and it was really
18 important because you have to get granular. The things
19 that were covered there don't apply here, not in concept
20 and certainly not in amount. And I'm sorry to have
21 interrupted Mr. Krumholz. He wasn't lucky enough to be
22 involved in Adelpia.

23 THE COURT: Thank you.

24 MR. KRUMHOLZ: So that's why, Your Honor,
25 from a legal perspective we believe that you should not

1 consider the second question that you've been asking;
2 and that is, what are the damages if Mendocino somehow
3 decides that they want to back out. But factually
4 speaking, you have no evidence before you, not even this
5 self interested -- the interested testimony of Mr. Dean
6 who has been staying at the hotel or anyone else from
7 Mendocino testifying that that's what they would do or
8 what conditions would have to happen for that to occur.
9 You have zero evidence before you, Your Honor, that
10 indicates or suggests that they're going to do it other
11 than the testimony, I guess, of lawyers.

12 THE COURT: Well, do we have any evidence
13 that the deal will last any longer than 60 days that's
14 in the deal?

15 MR. KRUMHOLZ: I'm sorry?

16 THE COURT: Do we have any evidence to
17 suggest that the deal will last any longer than 60 days
18 within the deal? The deal requires they close in 60
19 days. Everybody has a right to back out after 60 days.
20 I mean, it will have to be renegotiated, I guess. I
21 mean, maybe you can just extend it kind of like --

22 MR. KRUMHOLZ: It can just be waived,
23 Your Honor. All they have to do is get up on the stand
24 and raise their hand and say, Mr. Dean, under what
25 circumstances will you not waive the 60-day period? And

1 he would give you a litany. And then you would have
2 certain conditions that you would have to consider; are
3 they foreseeable or not? Is it probable or it's not.
4 But they didn't even do that. There's no evidence
5 before you that they wouldn't do what we say. All of
6 the evidence suggests is reasonable which, of course, is
7 to close, is to move forward with the plan. How do we
8 know that? Because he's been pursuing it for years.
9 How do we know that? Because they've been saying the
10 value has been rising for 18 months.

11 THE COURT: You're giving them the
12 opportunity to close after about six months and actually
13 pay less. I mean, you're giving them that opportunity
14 because of the deals that you're doing. I mean, so --
15 so I mean, I think there's an incentive to close. But
16 there are lots of things outside the control of the
17 parties that are the proponents of the plan. There are
18 lots of things outside their control that could cause
19 this deal to not close.

20 MR. KRUMHOLZ: The interest rates, Your
21 Honor, have been coming down for a long time because of
22 the economy. And they've held steady because of
23 inflation, of course. There's no reason or no evidence
24 before you that interest rates are going to go up.
25 There's no evidence for you to rely upon that there's

1 going to be some nuclear attack or terrorist attack or
2 some unforeseen or foreseen condition that is going to
3 suggest that Mendocino back out.

4 And, of course, how do we know that it's
5 unlikely? Because you didn't hear from any witnesses
6 describe under what conditions it might occur or what
7 concerns they may or may not have about what would
8 occur. You had hypothetical testimony from
9 Mr. Johnston. They admitted on cross it was all
10 conjecture and didn't even put probabilities to his
11 assessment. That's all you've heard, which is
12 meaningless, unless you tie it to some reality.

13 And, of course, they had an opportunity
14 to put any number of people on the stand and didn't to
15 describe the reality or at least describe the subjective
16 intent, which we still would have said is wildly
17 speculative and without probative value. But at least
18 it would have been something. But what you've been left
19 with isn't even that. They haven't even given you a
20 record to rely upon to determine or assess in any
21 reliable fashion what the risks are, under what
22 conditions they would walk. And every piece of evidence
23 that you have heard -- and, frankly, every finding that
24 you've made is inconsistent with the notion that they
25 would walk. That's the reality that we sit in today.

1 Mr. LaMont couldn't even come up with
2 comparables of redwoods in northern California. Or for
3 that matter, in Oregon or Pacific northwest in
4 Washington. And the reason is because these are unique
5 properties; not very unique, but unique.

6 And so what we know here is you have a
7 buyer that's spent millions and millions of dollars
8 trying to purchase these properties for years and years
9 and years who still think it's a wonderful deal and has
10 gone up since he's purchased it and has gone up in the
11 18 months during the pendency of this bankruptcy, during
12 the worst economic times since arguably the depression.
13 And somehow, without any testimony from that witness
14 stand, Your Honor is supposed to wildly speculate that
15 they're going to back out.

16 And I just don't think that's even
17 reasonable or rational for them to suggest that you do.
18 And I think that's what it comes down to. So at the end
19 of the day, what do they next turn to? They next, of
20 course, turn to the fires. We heard a lot about the
21 fires. And you even saw a website. And I didn't know
22 what kind of evidence that was. But regardless, we saw
23 all of these fires that might take place.

24 And the reality is what we heard from
25 Mr. Barrett are hard numbers, real numbers. And that

1 is, there's been 35,000 acres over decades of running
2 and operating this forest. That's the truth. And we
3 heard from Mr. Young -- from Mr. Long that indeed they
4 have fire protection policies that they think are
5 effective. That's what we heard. And that's from
6 Palco's own witness.

7 And so relying on Palco's own witness and
8 Dr. Barrett, who has run these forests for a very long
9 time and who everybody finds is always found to be
10 credible has told you exactly that. And so I think
11 fires is a non-issue.

12 Now, the next issue is -- and you touched
13 on this a moment ago, was \$513.6 million. And why can't
14 you just post all your claim and any damages that result
15 will just come right out of that. And as we said, first
16 of all, the indenture doesn't allow for it; and
17 therefore, it becomes impossible to do.

18 THE COURT: You've convinced me of that.
19 So that's not a possibility. But in addition to that,
20 there's nothing I can do if something happens and this
21 doesn't close at the end of the appeal. I can't --
22 there's no doctrine under which I can equitably
23 subordinate your lien because you appeal the loss.
24 That's not grounds for equitable subordination, correct?

25 MR. KRUMHOLZ: I'm sorry. Can you repeat

1 that, Your Honor?

2 THE COURT: It's not grounds -- I mean,
3 you don't have to answer that. But there are no grounds
4 for equitable subordination of a lien because you've
5 lost your appeal?

6 MR. KRUMHOLZ: That's right.

7 THE COURT: I have no authority to do
8 that?

9 MR. KRUMHOLZ: That's right.

10 THE COURT: And the net result could be
11 that at the end if we have no plan, if the value goes
12 up, they can't even sell it at this amount because you
13 get a higher value because they'd have to have the value
14 be the value at confirmation if somebody were to confirm
15 a plan. So you'd get a better deal after your appeal,
16 if it goes up. If it goes down -- if the liquidation
17 value goes down, you might be entitled to an
18 administrative claim by the virtue of the fact that it
19 goes down. So, you know, again, it's more difficult for
20 the debtors to confirm a plan after the appeal. And
21 there's nothing I can do about that; isn't that true?

22 MR. KRUMHOLZ: Your Honor, if we win, all
23 bets are off.

24 THE COURT: If you win, you're entitled
25 to win and there is a whole new case.

1 MR. KRUMHOLZ: And if we lose --

2 THE COURT: I assume that somebody else
3 will have to do something. And I don't know where we'll
4 go, whether it will be a Chapter 7 trustee or whether
5 we'll give you the property back. I don't know. If you
6 win, it depends on what they say. It depends on what
7 the board says if you win. But we're not talking about
8 that possibility. If you win, you ought to win. If you
9 lose, how can we make certain that the debtor and
10 everybody else is not in a worse condition at that time
11 if you lose?

12 MR. KRUMHOLZ: This is how -- and we
13 believe the answer to your question is to allow the
14 operations to continue such that in six months, at the
15 end of December of 2008, these are going concern
16 entities that can -- that if we win -- obviously all
17 bets are off if we lose -- they can close and there will
18 be no harm. And I don't -- we don't believe that you
19 should bond against or secure against the wild notion
20 that it's not supported by any evidence at all before
21 you that MRC may walk.

22 I mean, that's -- that's our position.
23 We don't think Adelpia stands for the notion that you
24 should. And so going through these factors, which we
25 think are the Fifth Circuit factors that you should

1 apply -- let's go to the next screen. The
2 non-controversial elements, Your Honor, are taxes,
3 insurance and court costs. I don't think there's going
4 to be any testimony that that's now covered by the
5 forecast of Mr. Young. And, of course, the cash burden
6 entity is going to be appealed, we've talked about.
7 We've gotten the board approvals, we've gotten approvals
8 of the IT, we've gotten all the necessary approvals.
9 And I don't believe that there's any dispute about that.

10 Now, whether there's income lost during
11 the appeal, the MRC business plan -- you might want to
12 take that one off. What we do know is they get to keep
13 the \$225 million and the interest. And the bridge loan,
14 they don't have to pay the interest on the bridge loan,
15 which is, of course about 4.75 percent on some 3 plus
16 million dollars. And Marathon gets \$400,000 per month
17 in cash. And they don't get any cash if it goes
18 effective, they just get equity. So we don't believe
19 that there's anything lost during the course of the
20 appeal. Move forward, please.

21 Now, we've also done an analysis through
22 Mr. Young of what it would -- what the delay
23 distribution to creditors would be. If you go to the
24 last page of the proffer of Mr. Young, he goes through
25 all of the administrative claims of the creditors. And

1 he applies the federal rate, federal adjustment rate.

2 We thought that was a fair rate because that's what the

3 statutory basis is. And that's what the law says it

4 should be in that context. And that's essentially what

5 we're talking about here, an adjustment rate. So

6 \$700,000 to Scopac, \$300,000 to Palco, both of which can

7 come out of the \$25 million through December 31, 2008.

8 Next slide. Now, we talked about MRC

9 walking. And this is sort of the summary bullet point

10 of why we think it's the incorrect legal standard that

11 they used in Adelpia. MRC sought this timberland for

12 four years. They almost bought it in 2006 after a six

13 to seven months, if not longer, due diligence period.

14 They spent millions and millions of attorneys and other

15 costs associated with this. The redwood forest is

16 unique. And Sierra Pacific is ready, willing and able

17 and a very credible buyer of the mill.

18 So if for some reason it doesn't close

19 and if for some reason that you need a buyer of the

20 mill, we have someone ready, willing and able that

21 Mr. Longs has told us is a credible buyer. And, of

22 course, I don't think there's been any dispute in that

23 regard. And Hughey Long has confirmed that. So we

24 don't believe that that's a credible issue. And we

25 think it's wildly speculative based on, frankly, no

1 evidence on the record.

2 So Your Honor, in closing, I would just
3 suggest that as to the stay pending the appeal, I have
4 gone through the four factors you must consider in terms
5 of whether a stay should be granted in opening. I won't
6 bore you with that discussion again. And I think you're
7 well aware of those factors. And then the only question
8 becomes the amount of the bond. And we believe it
9 should be the DIP and the discounted price of the logs
10 as testified to by Mr. Young, and based upon
11 Mr. Barrett's -- Dr. Barrett's and Mr. Long's testimony
12 in that respect.

13 And with that, I'll just turn to the
14 direct certification issue. And again, Your Honor, it's
15 just -- as the Court will recall, the Fifth Circuit has
16 previously took and decided a direct appeal essentially
17 in this case. It took five months to be completed. But
18 regardless, you did consider these various particular
19 factors and only one of these factors or circumstances
20 must be present to mandate --

21 THE COURT: Does anybody know what the
22 time period for the Fifth Circuit to act on an emergency
23 matter is?

24 MR. KRUMHOLZ: Your Honor, I think it's
25 speculative at this point.

1 THE COURT: Not the time to act upon an
2 appeal, but on an emergency matter?

3 MR. KRUMHOLZ: I think it's the same
4 answer. At least it is as to me.

5 THE COURT: What's a reasonable time
6 period for you to go to the Fifth Circuit, in other
7 words?

8 MR. KRUMHOLZ: To go to the Fifth Circuit
9 for purposes of the entire --

10 THE COURT: On the issue of stay pending
11 appeal. Do you have any idea what that is?

12 MR. KRUMHOLZ: I personally don't, but I
13 can get that answer to you shortly. In fact, if Ray
14 Rodriguez is on the phone, I encourage him to pipe up if
15 he has an answer.

16 THE COURT: He's either asleep or not on
17 the phone.

18 MR. KRUMHOLZ: I think that's probably
19 right. It better not be the former. But, Your Honor,
20 only one of the three --

21 THE COURT: Does anybody know that? Is
22 there anybody in the courtroom that happens to know for
23 a fact what it takes to go to -- who's filed a writ? A
24 mandamus? I mean, isn't that the same kind of thing?
25 You've got to go ask them for an immediate act?

1 MR. KRUMHOLZ: Well, when a mandamus is
2 requested, Your Honor, it's very quick. It's very
3 quick.

4 THE COURT: How much time are we talking
5 about?

6 MR. KRUMHOLZ: I just don't know in this
7 circuit, Judge. I think it's -- I know the reason
8 you're asking, and I'm very reluctant to say because I
9 don't know if it's going to be enough time. And I don't
10 think it's fair --

11 THE COURT: The only thing I could do is
12 I could ask the chief how much time is a reasonable time
13 for them to review that issue. I don't know. But I
14 don't know that it's appropriate for me to -- I mean, I
15 couldn't ask Judge Jones a question like that without
16 permission from Judge Head and maybe Judge Steen, our
17 chief judge. I don't know. You don't just fire off
18 questions like that.

19 MR. KRUMHOLZ: Let me commit to you that
20 if I can find out the answer -- and I think we've tried
21 to. But if I can find out the answer for you, we'll do
22 that.

23 THE COURT: Which of the three does this
24 one fall in?

25 MR. KRUMHOLZ: It falls under all three,

1 actually.

2 THE COURT: You think it's under all
3 three?

4 MR. KRUMHOLZ: I do.

5 THE COURT: So go over that quickly.

6 MR. KRUMHOLZ: The order involves a
7 question of law, as to which there is no controlling
8 decision or involves a matter --

9 THE COURT: No controlling decision.

10 MR. KRUMHOLZ: -- involving public
11 importance.

12 THE COURT: Well, public importance --

13 MR. KRUMHOLZ: There are a lot of
14 unique -- many unique issues that came up during the
15 confirmation hearing. I think that was admitted by
16 almost all parties until MRC's counsel said otherwise,
17 as far as I could tell, in the opening statement, that
18 it involves not only unique issues that you had not
19 considered previously, but that some -- many courts had
20 not considered at all or courts had not considered it at
21 all. Not only that, there was certain a gray area --

22 THE COURT: Firstly, you don't have any
23 billion dollar cases, to start with. And then you don't
24 have cash offers of a half a billion dollars. So those
25 kind of issues rarely come up because it's just not

1 likely to happen. But go ahead.

2 MR. KRUMHOLZ: So the bottom line is that
3 we believe that it's a question -- there are many
4 questions of law as to which there is no controlling or
5 many controlling decisions on many of the 11 points of
6 appeal. But it also involves a matter of public
7 importance. And I've talked to you about. And I won't
8 get into that discussion yet again. But the credit
9 markets have been watching. And I'll leave it at that.
10 The order involves a question of law concerning
11 resolution of conflicting decisions as the second
12 factor.

13 THE COURT: Do you think that there's
14 some conflict in bankruptcy law that two affiliated
15 cases, one of which is a special purpose corporation,
16 filed bankruptcy that under no circumstances may they be
17 joined into one corporation and come out emerged from
18 bankruptcy?

19 MR. KRUMHOLZ: Your Honor, I don't know
20 that I would say it exactly that way. What I would
21 suggest is this. We do not believe that you can take
22 the collateral of a separate purpose entity which
23 creditors have -- for which creditors have relied upon
24 documents stating that they must be kept separate,
25 absent a piercing and a substantive consolidated of some

1 sort or a showing of that nature. And even then, I'm
2 not sure if it could happen. And then tap into value,
3 what we believe to be value of that collateral and hand
4 it off to the creditors of another entity, both secured
5 and unsecured.

6 THE COURT: There's no question you can't
7 do that if you're tapping into the so-called value. I
8 mean, if there's extra value going to the other side,
9 you can't do it. I agree with you. I didn't rule that,
10 though.

11 MR. KRUMHOLZ: We also think there are
12 public policy issues that arise that come under that
13 first factor.

14 THE COURT: Okay.

15 MR. KRUMHOLZ: The order involves a
16 question of law requiring resolution of conflicting
17 decisions. At minimum, it stretches. And at a maximum,
18 it contravenes decades of what we believe is well
19 settled jurisprudence and overlooks the flaws and legal
20 inadequacies inherent in what we believe to be in the
21 MRC and Marathon plan, which the IT believes creates
22 conflict on several key issues of law.

23 And finally, a decision from the Fifth
24 Circuit will instill a sense of confidence, and that's
25 the third prong, an immediate appeal in order to

1 materially advance the progress of the case, which I
2 think is undisputed here that we need a sense of
3 confidence here and in the rulings and the law that has
4 been cited upon. And we believe that there is a cloud
5 of uncertainty. And certainly serious questions of
6 error that need to be addressed by the appellate courts
7 before there is finality and before there is, you know,
8 true closure to the case.

9 So we believe all three prongs -- and I
10 believe that the only entity that has objected to the
11 direct certification is the State of California. I'm
12 not sure of that. But that was the case at the
13 beginning. Is that true?

14 MR. SCHWARTZ: We objected.

15 MR. KRUMHOLZ: But I didn't get -- I
16 didn't understand the State of California suggesting
17 that we didn't want this to move forward quickly. I
18 don't get that. They've always said since day one they
19 want to move forward quickly. So I'll leave it at that.
20 But regardless, Your Honor, I appreciate the time. And
21 to the extent I have additional time, I'll reserve it
22 for others.

23 THE COURT: Thank you.

24 MR. PACHULSKI: Good afternoon, Your
25 Honor. Isaac Pachulski of Stutman, Treister & Glatt on

1 behalf of certain noteholders. I'd like to start with
2 the basics. All this discussion of a bond has to do
3 with a question of whether the appellee will suffer
4 irreparable harm. Now, it's basic that when someone is
5 trying to establish an affirmative, the burden is on the
6 person trying to establish the affirmative. In other
7 words, if somebody wants to say that we have to bond
8 against risk, it's their burden to show that that risk
9 actually exist.

10 In Adelphia -- and I just went through
11 it. That burden was met. It was very clear that Time
12 Warner had a right it was going to excise. And the
13 various numbers I talked about was clear. The problem
14 here is that the other side hasn't met -- there's been a
15 total failure of proof.

16 To begin with, it's clear, and I believe
17 this Court recognizes that a liquidation isn't going to
18 happen between now and the end of the year because of
19 the combination of the DIP proposal and the discount log
20 program. So the other side is saying, well, wait.
21 They're all trying to pile on bond after bond amount on
22 the basis that MRC or Marathon may walk. There is no
23 evidence to support that, Your Honor.

24 The mere fact that they have a right to
25 walk does not give the Court any basis -- there is no

1 basis in this record to support an inference that they
2 will walk. Mr. Dean could have gotten on the stand.
3 They didn't put a single witness up. Moreover, all the
4 evidence in the record absolutely rebuts the inference
5 that they would walk. And the best way to highlight
6 that is to talk about the two arguments, not evidence.
7 These are arguments of counsel. And arguments of
8 counsel from the podium are not evidence. You have on
9 this record no evidence to support any inference that
10 there's any possibility that MRC will walk. And let me
11 explain why.

12 First, people talk about alternative
13 investment opportunities. Well, MRC, the name is
14 Marathon Redwood Company. They're a redwood forest
15 company. Not only is there no evidence of alternative
16 investment opportunities, but the clear record before
17 Your Honor from the confirmation hearing on is that
18 there are no alternative investment opportunities like
19 this.

20 Your Honor was rather surprised when
21 Mr. Fleming did not do what appraisers usually do, which
22 is have a comparable sales approach. Why? Because he
23 couldn't find any. Mr. Fleming couldn't find a sale of
24 redwood forest in California. Mr. LaMont had to go to
25 or Oregon and Washington. And I don't know if those

1 were redwood forests or not because I wasn't involved at
2 the time. But Marathon -- MRC isn't looking for forest
3 in Oregon and Washington. And one reason we know that,
4 Your Honor, is because there was live testimony about
5 synergies. And you heard today about how they're going
6 to take logs from the Palco plant and have them
7 processed in Ukiah.

8 Now, how it is that Palco survives when
9 you take some of its logs that it's been processing and
10 move them to Ukiah. And when you reduce Scopac's
11 harvest rate, all these three can roll over some other
12 time. But there is no alternative to this. There is no
13 alternative because there were no comparables. There is
14 no alternative because there is no evidence of any
15 alternative. And there is no alternative because
16 there's no way they could get the synergies.

17 The second evidence that destroyed any
18 inference that there is any chance that these people
19 would walk is that they have been stalking this
20 particular asset for years. And there's no evidence
21 they stalked any asset like it because there isn't any.
22 You heard evidence -- and I don't know if this was in
23 '05 or '06 about how there was an offer where MRC was
24 looking at buying Palco, and thereby buying Scopac.
25 There was arguments about what that means to value. One

1 thing is clear, that they have been talking this asset
2 for many years.

3 So you start with the fact that there is
4 absolutely no basis in the record to find that a there
5 is any risk of harm. And absent a factual evidentiary
6 predicate in the record, which you do not have and will
7 never have because the other side decided not to put on
8 a witness, you can't find, with all due respect, that
9 there is a risk that we have to bond against or that we
10 have to protect against.

11 Going beyond that, on top of that, Your
12 Honor, you've asked -- you've asked about various ways
13 to provide protection. And there is a particular
14 problem with requiring any of these in the face of not
15 having any evidence of a risk to MRC. And that is this.

16 Whether you were to have an escrow or a
17 set aside of some amount of the distribution under a
18 plan and forget about whether that thing is technically
19 possible. Or whether you require a bond or whether you
20 require some other mechanism, the mechanisms have the
21 following in common: No matter what number you order as
22 protection, because it will have to be backed by cash or
23 cash equivalents, even if at the end of the day the
24 appellees suffered not a penny of damages on appeal, it
25 will cost the noteholders 15 to 20 percent of whatever

1 you order.

2 In other words, if we lose at the appeal
3 and it turns out there are no damages, it will still
4 have an effective cost of 15 to 20 percent of the amount
5 put up. Now, I'm sure you're saying, how can that be if
6 there are no damages? How can you suffer?

7 What people have overlooked, Your Honor,
8 are two things. First, when you get a bond or whatever,
9 you have to put up cash. That's capital you can't
10 redeploy. That's capital that's tied up. It's earning
11 market rates. And the second thing that people have
12 completely overlooked is that this issue of damages will
13 not be determined instantaneously. If an appeal is
14 lost, people will have time to file claims against the
15 bond. I don't know if it's a complaint or what. So
16 there will be a trial. And we know that there's nothing
17 more creative than a lawyer left alone with an adding
18 machine, a complaint and the funds to go after.

19 I mean, just to give you one example.
20 When Mr. Brilliant was asked what kind of a bond do you
21 want? He said \$100 million. Yet when it came to
22 actually producing any evidence of any damage to MRC, by
23 speculating that interest rates would go up 1 percent in
24 six months, which hasn't happened, and T-bills aren't
25 that volatile, they put it that to the side and they

1 came up with a fraction.

2 So what's going to happen is whatever
3 number you order, we're going to have to explain to the
4 Circuit for that number. Now, given the fact that this
5 is just a money complaint, this isn't going to be
6 expedited like a confirmation hearing. And we're not
7 going to go a direct appeal to the Fifth Circuit. And
8 nobody is going to expedite the appeal.

9 So you'll have discovery, you'll have a
10 trial. That takes time. The court calendar is busy
11 with really important matters, so it gets continued.
12 Then we go to the district court, then we go to the
13 court of appeals. Meanwhile, the money is tied up for
14 two and a half to three years. And now, we can all talk
15 about what kind of rates of return these funds look at,
16 but let's assume -- and I think any distressed debt fund
17 will tell you that this is low. Let's assume it's 8
18 percent. And let's assume that while the people are
19 getting 2 percent on these tied up funds.

20 So basically if you take the difference,
21 6 percent, and you multiply it by two and a half years,
22 you've got a 15 percent loss. And the real problem with
23 that, Your Honor, is by creating that construct, you
24 will enable the FLE, even if they suffer no damages, to
25 hold money, to hold capital of these funds hostage and

1 view that as leverage to get damages to which they're
2 not entitled.

3 Now, it's one thing to say that you're
4 going to expose people to that, to that real economic
5 problem to deal with the real risk. It's quite another
6 thing to say, well, since MRC could leave, you know,
7 we're going to -- we're going to force people to suffer
8 this.

9 And there's another point I should have
10 mentioned before. And I'm sorry, but the argument as to
11 why MRC might walk in the next six months is that the
12 value of the timberlands go down. And I do have to
13 repeat what was said before because we have to adjust
14 that against the record in this case. The Court has
15 already recognized that given the nature of this advent,
16 there is no meaningful risk that it can decline in value
17 over the next six months. The trees grow. In fact, it
18 will be more valuable in six months.

19 Over the past few months, MRC and
20 Marathon convinced the Court that at 18 months, not six
21 months, when we had a drop in residential housing, we
22 had a drop in residential construction, when we had a
23 crisis in the capital market, when discount rates went
24 up, when financing became harder, through all of that,
25 the timberlands were impervious and didn't go down in

1 value. That's what the Court found, despite all of
2 these events.

3 In light of the record in this case,
4 there is no evidence to support an inference that the
5 value will go down.

6 Well, then MRC also has to speculate
7 about something else. They say, we could lose our loan.
8 No evidence, Your Honor. You need evidence, not people
9 arguing about speculation. Even though there was some
10 argument without an evidentiary foundation that interest
11 rates might go up 1 percent, there was no evidence that
12 the financing would become unavailable. And there's a
13 reason for that. What's being financed? The
14 timberlands. You finance timberlands, you look at the
15 value of the timberlands. It's real estate financing.

16 As we've already discussed, based on Your
17 Honor's findings, there is no basis to find any
18 realistic possibility that the value of the timberlands
19 will go down. Well, if the value doesn't go down, then
20 why on earth is the lender going to walk? The lender is
21 in the business of lending money. So, again, they ask
22 you to speculate. So you add all of that together, and
23 they're asking you to make a finding without an
24 evidentiary basis to require protection against an
25 irreparable harm, to which there is no evidence.

1 Now, there was one other sort of
2 contradictory request made by MRC. And that's this.
3 Not only are people asking us to bond against the
4 possibility that MRC walks, MRC also wants to bond
5 against the possibility that they don't. So we're being
6 asked to bond two mutually exclusive possibilities.

7 And MRC's theory was, well, if the
8 interest rate goes up, interest goes up by 1 percent,
9 therefore, you know, we could suffer \$27 million based
10 on present value discount. Number one, there is no
11 evidence to support an inference that treasury bills are
12 that volatile. And if anyone looked, they would find
13 that they have not been that volatile in a recent six
14 month period. But honestly, we don't know because
15 there's no evidence. And that was their burden.

16 But there's another point that's been
17 ignored, and I think the Court has to take this into
18 account. Unlike their speculation, it is absolutely
19 clear that what the -- what the indenture trustee
20 proposes to do will result in a \$10 million -- in more
21 than \$10 million windfall to MRC if we lose the appeal
22 and they close. And there has to be some protection
23 against that. Let me explain what I'm talking about.

24 There are two components. The first is,
25 Your Honor, what we'll call under the MRC plan. They

1 are required to pay the administrative expense accrued
2 to the effective date. And because of the floor Your
3 Honor set, they can't use the Class 6 distribution
4 adjustment to knock us below \$513.6 million.

5 Now, I believe there was testimony that
6 part of the funds will be used to pay roughly \$4 to \$5
7 million in Scopac professional fees that are
8 pre-effective date professional fees. That if we
9 close -- if they close the plan today, MRC would have to
10 pay. So basically, thanks to the DIP, \$5 million in
11 fees would have to be paid will not -- by MRC will
12 instead be paid by the estate.

13 I'm sorry, Your Honor, I was interrupted.
14 The second -- the second issue, Your Honor, is that
15 you've heard a lot about the roadwork, about deferred
16 roadwork. If the -- if MRC took over the property
17 today, they would have to do all that work. The
18 projections showed that over \$6 million is going to be
19 spent on deferred roadwork. That means if we lose the
20 appeal and they close, they take up \$6 million. So
21 there is over \$10 million in amounts that they would
22 have had to pay if they close today that are going to be
23 paid functionally as a result of the DIP and the
24 arrangements that are made possible.

25 Unlike all the speculation you've heard,

1 that's real; that's real money, those are really their
2 obligations. And there needs to be a mechanism that
3 even if we lose the appeal and we pay that amount and
4 they close, we ought to get that back. The purpose of a
5 bond arrangement or security arrangement isn't to deter
6 windfall in winters. And so that has to be taken into
7 account. And we should be made whole for that. But at
8 any event, that's not speculative. And their claim is
9 completely speculative.

10 I'd like to deal briefly with the
11 certification issue, Your Honor, because there are a
12 number of legal issues that have not been addressed by
13 the Fifth Circuit, and they're important ones. And I
14 don't remember all of them offhand, but let me start
15 with a couple. One issue -- and I think it's only been
16 addressed by one bankruptcy court outside of the Fifth
17 Circuit -- is whether if you have a sale free and clear
18 of liens that fits within Section 1129(b)282, you can
19 use the indubitable equivalent standard of Roman Numeral
20 III. Now, I don't want to reargue that. But that's a
21 legal issue. There is no controlling authority. And
22 that's an important issue that needs to be resolved.

23 The second issue that we have raised is
24 whether the absolute priority rule prohibits a
25 distribution to unsecured creditors in a greater

1 percentage amount that is going to a secured creditor
2 where the secured creditor is secured by all of the
3 assets of the debtor. Here, basically noteholders are
4 secured by all the assets of Scopac. And the unsecured
5 creditors are getting something anyway, even though
6 Scopac's secured creditors aren't being paid in full.
7 There's no circuit level authority directly on point.
8 If there was something, we would have cited it. There
9 isn't. Again, that's a legal issue.

10 The third legal issue that no one has
11 ever addresses and no circuit court has addressed at
12 all. Can the 1129 A-9 requirement that administrative
13 claims be paid in cash be satisfied by a mechanism like
14 a Class 6 distribution adjustment which does not provide
15 for the payment of Scopac intercompany claim against
16 Palco in cash.

17 The fourth legal issue is where assets of
18 two separate estates are sold to a single purchaser, is
19 there an improper substantive consolidation where a plan
20 does not clearly demonstrate or set forth which estate
21 assets are being used to pay which estate creditors.
22 These are among the legal issues we will raise. What
23 they have in common is that they have not been addressed
24 by the Fifth Circuit and they important legal issues.

25 Finally in terms of the fact that some

1 people oppose this, this is another installment in the
2 mootness game, Your Honor. The only reason they don't
3 want an expedited determination is because an expedited
4 determination reduces the period of time in which the
5 noteholders collateral funds losses through debtor in
6 possession financing. This is really amazing for people
7 who have talked about the need for a prompt resolution,
8 they talk about the need to remove uncertainty. Yet
9 these same people -- these same people just in general
10 say, oh, let's take our time, let's put it in district
11 court first, let's put it in Fifth Circuit first. We
12 don't have to expedite. Your Honor knows what's going
13 on. And I'm not going to spend a lot of time on it.

14 The fact is given the importance of this
15 case, given the fact that we're dealing with a legal
16 issue that has never been address by the Fifth Circuit,
17 and given the fact that an expedited appeal is the best
18 way to ensure the integrity of our appellate rights,
19 there's every reason for this Court to certify this
20 matter for direct appeal to the Fifth Circuit. Thank
21 you, Your Honor.

22 THE COURT: All right. Mr. Gibbs. Are
23 you going to be short?

24 MR. GIBBS: Yes, Your Honor.
25 Mr. Pachulski has demonstrated an ability to speak

1 quickly and also to speak from the telephone very
2 quickly when there's a avoid. It takes me a while to
3 unfold out of a chair and walk up to the mic, and he
4 beat me to the podium. The benefit of that, Your Honor,
5 is that ten or 15 minutes that I had of comments that
6 might have been in addition to the comments that
7 Mr. Krumholz made, Mr. Pachulski very completely and
8 very eloquently covered. So I'm not going to burden the
9 record with repetitive arguments in favor of the stay
10 pending appeal and in favor of the bond within the
11 construct that the indenture trustee has proposed.

12 What I do want to do is to hand up to the
13 court and hand up to the parties present something that
14 I just received about two minutes into Mr. Pachulski's
15 closing argument. It is responsive to the Court's
16 questions. And I think instructive to the parties about
17 the validity of any risk of MRC being unable to close
18 should this appeal last beyond the 60-day expiration
19 that's built into the plan. With the Court's
20 permission.

21 THE COURT: All right.

22 MR. GIBBS: As an officer of the court, I
23 will advise the Court and the parties present what this
24 is. This is a binding commitment letter from Beal Bank
25 Nevada, my client. This is an identical commitment to

1 the one that Newco or MRC is presently in possession of
2 from American Ag, their bridge lender under the plan for
3 \$325 million. That bridge loan -- commitment letter had
4 an expiration of, I believe, the end of August within
5 their current 60-day period by which they with walk if
6 the plan is not effective.

7 One of the arguments of counsel for the
8 plan proponents as to why there's a risk to the parties
9 here that the parties won't close is that they may not
10 have financing. This eliminates that risk. This is a
11 commitment for the same amount of money on the exact
12 same financial terms to the exact same plan proponents
13 to fund their obligations under this plan. And this
14 commitment runs until January 31 of 2009.

15 I would have had it to the Court before
16 the close of evidence, but for technical problems in
17 getting it printed and getting it over to the
18 courthouse. It was done in response to a concern raised
19 that their existing bridge financing would be expired
20 and there might be evidence that even though they didn't
21 bring it, that the parties were unable to get an
22 extension of that bridge financing. Well, we didn't
23 hear any such testimony from the plan proponents who
24 were opposing the stay.

25 But even if the Court is swayed by

1 argument that that's a risk, we've eliminated that risk.
2 The only difference in the commitment that they
3 currently have and the one that I've handed up and
4 handed out to the parties are the beneficiaries on that
5 commitment are the following: "This commitment runs
6 until January 31, 2009. It will be for the same
7 six-month term on the same economic conditions." It
8 also does not contain the \$1 million -- it's a little
9 more than \$1 million that the plan proponents would have
10 to pay American Ag should they use a different permanent
11 financier other than American Ag.

12 If they take this bridge loan from my
13 client and get a permanent financing from a different
14 party, they don't owe my client \$1 million. So they're
15 \$1 million to the good, \$1 million plus to the good if
16 they actually close under this bridge financing because
17 their existing bridge financier walks and doesn't extend
18 their present commitment beyond the current expiration
19 date. So I wanted the Court to have that as you're
20 evaluating the risk of harms to the -- harm to the
21 parties occasioned by Marathon, Mendocino not going
22 forward with their plan should they succeed on appeal
23 after the appeal has been concluded.

24 There is simply no economic impediment
25 related to financing that would cause them to walk.

1 They have put on no evidence that they have -- that they
2 have any intention of not closing this deal. And to
3 build into a cost for us to appeal this ruling some risk
4 that they might is based on pure speculation and a
5 complete absence of evidence on the record.

6 As I said, I don't want to burden the
7 Court with too many arguments and the legal reasons why
8 and the summary of the evidence. But I wanted the Court
9 as the Court equity to have this. And I think the
10 parties behind me should be pleased because I think I've
11 solved one of their problems to closing. Thank you.

12 MR. KRUMHOLZ: Your Honor, we just move
13 that that be marked as Exhibit 201 and be admitted into
14 evidence.

15 THE COURT: You're asking me to reopen
16 the evidence --

17 MR. KRUMHOLZ: Yes.

18 THE COURT: -- to introduce this?

19 MR. KRUMHOLZ: Yes, Your Honor.

20 MR. NEIER: There's no witness, Your
21 Honor.

22 MR. PENN: We object. There is no
23 sponsoring witness.

24 THE COURT: Okay. You've made your
25 argument. Now you-all make your argument. And I'll

1 rule on everything.

2 MR. GIBBS: Your Honor, if you need a
3 witness in order to consider the admission of that
4 document, there is a witness available by phone. He
5 tried to get on a plane to come down, there were no
6 seats on any of the planes to get him here to testify
7 live. But he's here to answer to the Court or any
8 attorneys' questions.

9 THE COURT: All right. Now we're ready
10 for somebody else. Is Scopac going to argue?

11 MR. FROMME: Yes, Your Honor. Just a few
12 comments, a few minutes, Your Honor. The protection --
13 Eric Fromme from Gibson, Dunn & Crutcher on behalf of
14 Scopac. The protection which the appellees are entitled
15 from Scopac's perspective is to compensate them for the
16 inability to effectuate the confirmation order that is
17 being stayed. In this case, in case they win the
18 appeal. And then as Your Honor is aware, the most
19 analogous cases in the Fifth Circuit are the cases that
20 deal with a stay of an order where a sale of property is
21 being appealed.

22 And those courts have -- what those
23 courts have done is require that the potential seller be
24 protected for the cost it incurs as a result of having
25 to wait to sell the property. And usually those

1 elements are taxes, accrued rent or rental value during
2 the appeal period and any expected proceeds. And that's
3 what -- that is -- that does not include the speculative
4 risks that the other parties have raised. And the Court
5 has expressly recognized at this point there is no need
6 to ensure, for example, against the possibility of an
7 earthquake to hit.

8 So the speculation about fluctuation of
9 interest rates is just that, speculation. And that is
10 not what -- that is not what we try to do by preparing
11 the log for -- I guess logs for discount or logs for
12 less program. What we tried to do was preserve what
13 Mr. Young called the status quo. We tried to achieve
14 that with this log discount and the DIP financing. And
15 how did that work? The point of the cash flow forecast
16 is that it keeps both debtors operating. It maintains
17 the status quo, maintains the going concern value, and
18 it keeps the people in Scotia employed.

19 As to Scopac's ability to provide a
20 sufficient amount of logs, I know Dr. Barrett testified
21 that he could do it. And I know Your Honor remembers
22 the e-mail as he calls the terminator e-mail. And
23 Dr. Barrett explained that that came up in the midst of
24 an argument and he did not provide an accurate number.
25 But the harvest number that he used was sufficiently

1 accurate to prove his point. And no one at the debtors
2 questioned his ability to provide the accuracy of his
3 forecast. And most importantly, the person that must
4 rely on that forecasts, Mr. Long, believes those
5 forecasts can be met and has no doubt in that. And he
6 plans his operations accordingly to the debtor.

7 MR. NEIER: You're the debtor.

8 MR. FROMME: I believe it. And the Palco
9 debtor believed it, too, because Mr. Long testified to
10 it. So it maintains a status quo of the debtors, but
11 how does it affect the creditors? And let's go down the
12 list of creditors that are there.

13 First of all, MRC, they're not a
14 creditor. Marathon, under its plan, it would have to
15 put in \$25 million. It would get the town and the cogen
16 plant. Now, so the delay in having those things happen
17 is what needs to be compensated for. The maturity of
18 Marathon's DIP loan is irrelevant. Marathon is not
19 going to get \$75 million under its plan. It gets equity
20 and it gets the assets. So Marathon should give
21 assurance that the town and the cogen plant will
22 continue to be operated under current terms. That's
23 what they're getting. That's what they get under the
24 proposal that Mr. Young and Mr. Barrett came up with.

25 And they don't get to -- they can

1 continue to use their \$25 million. And importantly,
2 under the discounted log program, the forecast in
3 Mr. Young's declaration provides for the interest
4 payments on the DIP loan going forward. Marathon is not
5 getting those payments currently. As to Bank of America
6 under the MRC plan, B of A will get paid in full. So
7 it's entitle to its interest payments. Under the
8 forecast, they get the interest payments; B of A gets
9 its interest payments.

10 Administrative creditors. Marathon, the
11 DIP lender, have prevented Palco from paying
12 restructuring fees of Palco, including professionals
13 since March of this year. Now, they have built up a
14 substantial --

15 THE COURT: Let's go to what happens in
16 the event that the deal craters. If the deal craters
17 during the appeal, what's the status of everybody at the
18 end?

19 MR. FROMME: Well, the status at the end
20 of the day is that the debtors continue to operate.
21 They maintain that going concern. And we know that the
22 value of the timberlands, which is a substance value of
23 both of those debtors, is going to be maintained. And
24 it's not going to go down.

25 THE COURT: The value -- I agree with you

1 the value is not going to go down. But the ability to
2 realize the value maybe well go down. Who else is going
3 to buy it?

4 MR. FROMME: Your Honor, Scopac has
5 prepared a backup 363 sale motion. And we have evidence
6 that Red Emerson and Sierra Pacific Industries is ready
7 to buy the Palco assets.

8 THE COURT: Do we have left that the
9 timber noteholders then get the property and Red Emerson
10 buys Palco.

11 MR. FROMME: No, Your Honor. Scopac
12 proposes that Scopac, the debtors, go forth on a 363
13 sale with certain protections for administrative
14 creditors and credit bid limitations.

15 THE COURT: 363 sale of what?

16 MR. FROMME: Of the Scopac timberlands.
17 And if the Palco debtors want to go forward with the 363
18 sale on their own, they have -- we've identified a
19 willing buyer.

20 THE COURT: What is a 363 sale going to
21 do? I mean, they have to bid 100 cents on the dollar of
22 their claim.

23 MR. FROMME: Well, they --

24 THE COURT: They haven't agreed to do
25 anything.

1 MR. FROMME: They haven't agreed to limit
2 their credit bid. This Court can limit their credit
3 bid.

4 THE COURT: How?

5 MR. FROMME: It's within your discretion
6 to limit the credit bid, Your Honor.

7 THE COURT: Oh, well, you mean -- you
8 mean, in other words, the provision in the code that
9 says that unless the code orders otherwise and yet --
10 which I think Colliers has recognized, I don't know why
11 corporate would ever do that, but under that sale
12 process, you agree with me, that unless -- if they don't
13 object, they can be limited. But if they object, then
14 we have that issue going forward. And if we don't worry
15 about that issue, they're going to bid their whole
16 thing.

17 MR. FROMME: I agree with that obviously.
18 And Your Honor, if they don't agree, Your Honor has
19 only --

20 THE COURT: So they go from one appeal to
21 another?

22 MR. FROMME: That's a possibility, Your
23 Honor. I don't deny that.

24 THE COURT: So the 363 is just another
25 appeal process?

1 MR. FROMME: Well, that's assuming that
2 they would appeal, but that's a possibility, Your Honor.
3 I don't deny that.

4 Well, Your Honor, what we have provided
5 for, though, for -- as for the bond for all the
6 creditors is what they would be entitled to if the
7 appeal loses and the deal doesn't crater. I think
8 that's what we're -- that's all that -- that's all that
9 we're really required to do, and that's what the debtors
10 tried to present.

11 THE COURT: So the legal terms of the
12 deal do not exist at the time when the appeal reasonably
13 will be over. Now, I don't understand why it is that we
14 somehow have to say that, okay, even though the
15 deadline -- I mean, the actual term of the deal is over.
16 And even though it's over, somehow it's their burden to
17 say, yeah, it's over, but we're going to do this deal
18 anyway. Why would we go with that? Why is it more
19 reasonable to believe that if the terms of the deal are
20 over, maybe it's a good idea to buy it. It would have
21 been a good idea for Harvard to buy it maybe. They
22 didn't do it. I don't understand what about a contract
23 that says it lasts 60 days means that it probably is
24 going to last 120 or six months.

25 MR. FROMME: I don't think that the

1 contract is saying that it's going to last beyond the
2 60-day period. That shouldn't impair -- that shouldn't
3 impair the indenture trustee's and the noteholders'
4 right to appeal. However, if there are conditions.

5 THE COURT: I'm saying -- I mean, they
6 have a right to appeal, but why shouldn't we protect --
7 be protecting the creditors from the possibility that
8 the terms of the contract will be enforced? And how are
9 we to say that that is somehow speculative? It's the
10 terms of the contract. We can speculate on whether
11 they're going to continue on. We can speculate on
12 whether they're a lender. We have another lender that
13 apparently is willing, if we believe this, but -- all
14 right. Go ahead.

15 MR. FROMME: Well, Your Honor, we're left
16 to speculate whether MRC would back out of the deal
17 based on the contract terms because MRC didn't come on
18 and tell us under what conditions it would back out of
19 the deal or that it would at all. We're left to
20 speculate that. There's no reason to think that they
21 would just because the contract period -- because they
22 pursued these assets for over four years.

23 THE COURT: Okay.

24 MR. FROMME: And importantly, Your Honor,
25 if MRC does announce that it's going to walk after 60

1 days, you have the authority and the discretion to
2 revisit the bond issue and address those damages and
3 whether those damages --

4 THE COURT: It will be too late then.

5 MR. FROMME: Well, I think that you can
6 address that issue if, in fact, they actually do.

7 THE COURT: Okay.

8 MR. FROMME: Your Honor, importantly,
9 under the forecast we provide for payments of
10 administrative fees going forward. There's been some
11 comment about the PBGC claim, just to be sure, just to
12 be clear. That's a contingent claim. It only arises if
13 the Marathon plan -- I'm sorry, the pension plan is
14 not -- is terminated by Palco. Again, the forecast
15 provide for payment of those payments throughout the
16 forecast period. I think it's important to note that
17 the effect of the noteholders' offer --

18 THE COURT: If the -- if the property is
19 sold to Red and on a 363 sale or whatever, does the
20 pension plan debt get paid?

21 MR. FROMME: You know, Your Honor, I'm
22 not familiar with that. That was --

23 MR. NEIER: Your Honor, there's no asset
24 purchase agreement from Mr. Emerson, so we don't know
25 the answer.

1 THE COURT: Okay. Go ahead.

2 MR. FROMME: Sure, Your Honor. It's that
3 they -- the noteholders' offer, including the Lehman
4 offer, offers to protect the continued operations.

5 THE COURT: Now, but Red Emerson was
6 going to buy Palco?

7 MR. FROMME: He's going to buy Palco, the
8 mill assets only.

9 THE COURT: But not the forest.

10 MR. FROMME: Not the town assets, not the
11 forest.

12 THE COURT: Right. So basically the
13 security for the stay pending appeal is the plan that
14 they could have proposed some time ago. Red Emerson
15 buys Palco. They do a 363 sale. It's their asset.

16 MR. FROMME: That's right, your Honor.

17 THE COURT: That's the plan, so we would
18 be giving them -- what they could have done if they
19 wanted to, as the bond pending appeal, plus the \$25
20 million and the free logs.

21 MR. FROMME: That's right, Your Honor,
22 yes. Importantly, I mean, Your Honor, Scopac came up
23 with this -- the idea of this log discount idea and,
24 frankly, we didn't think it was going to work in the
25 middle of the night either. We ran the numbers, and it

1 does. It preserves the status quo. It keeps the
2 debtors operating. Surprisingly, it does. The math
3 works out.

4 THE COURT: So there's really no question
5 that absent free logs and a free DIP, these debtors are
6 cratering; isn't that true?

7 MR. FROMME: No, I don't think that's the
8 testimony. Not these debtors. Absent the free logs,
9 Palco may crater if Marathon doesn't support that.

10 THE COURT: Well, and Scopac runs out of
11 cash?

12 MR. FROMME: Well, Scopac -- I'm sorry to
13 interrupt, Your Honor.

14 THE COURT: That's all right. Palco
15 craters and Scopac runs out of cash.

16 MR. FROMME: Scopac runs out of cash.
17 Scopac with debtor in possession financing could find
18 third-party buyers for its logs and continue to operate
19 it.

20 THE COURT: If they got financing.

21 MR. FROMME: If they got financing, yes,
22 Your Honor. The risk is -- just to be clear, the risk
23 is that Marathon walks in that scenario for Palco.

24 Quite frankly, as I said, we were
25 surprised, but it works and the math works out. And

1 critically under their scenario, whether they win or
2 lose, the noteholders, they put their money where their
3 mouth is. Under any scenario, they take a reduction.

4 THE COURT: I need to give the other side
5 some time, so close.

6 MR. FROMME: Thank you, Your Honor.

7 THE COURT: All right. This table.

8 MR. FIERO: Your Honor, John Fiero. I'll
9 go first. I need to do one quick calculation, and I
10 need to bring this board over before I get started. I
11 don't need the screen.

12 John Fiero for the committee, Your Honor.
13 I'm not going to touch on every element of the test.
14 I'm going to move real quickly to the real question,
15 which is what is the expected harm, what is the harm
16 that needs to be protected against, and how much of that
17 is directly attributable to my constituency, the
18 committee, and what are we worried about here today.

19 I want to start just by talking about the
20 question of likelihood of success very briefly, Your
21 Honor. You've ruled on every issue in this case. They
22 were all presented. They were all fully argued. You
23 didn't hear any new evidence here today or yesterday.
24 And while we may have serious issues, the committee
25 would commit that they're not substantial. They -- you

1 know, just take the biggy, all right? Can cash be the
2 indubitable equivalent? Well, it better be because
3 there's nothing better.

4 Moving on to the question of immediate
5 and irreparable harm and harm to others. They're stated
6 separately, but they're really the same question. It's
7 just a balancing test. Your Honor, if you confirm this
8 plan, the noteholders will get \$513.6 million. And on
9 account of their junior lien on the forest, right, B of
10 A is ahead of them, B of A is also getting paid \$36
11 million. And they will get their share of the
12 Headwaters litigation if they can prove they have a lien
13 on it.

14 If you impose a stay and for some reason
15 this plan is not confirmed, although you found that it
16 should be confirmed, the mill could shut down. There
17 will be people who will be unemployed. There will be
18 unsecured claims which go unpaid. And there will be
19 pensioners to the tune of \$28 and a half million whose
20 recoveries will be at risk. That, Your Honor, is
21 substantial harm. And that's why the committee is here
22 today.

23 Now, when Mr. Pachulski was talking,
24 he -- he said: Your Honor, a liquidation is not going
25 to happen because there's no evidence that anyone is

1 going to walk here today.

2 You don't need evidence that someone is
3 going to walk. The question is could they walk. And
4 the evidence in front of you, as you've pointed out, is
5 absolutely they could walk.

6 Your Honor, all you have to do to see how
7 close this deal is to being too much money, too much
8 trouble, too difficult a deal to do, all of the reasons
9 why MRC might throw up its hands and say, hey, the 60
10 days are over, I'm moving on. You know, the Fisher
11 family can invest its capital in something other than a
12 redwood forest.

13 It was right here before you in this
14 court when Harvard came in with a big to do, here's
15 Harvard, and MRC came in with its new number at 539.
16 Harvard went out in the hall, took a break, was never
17 seen from again. So we know that at least one other
18 investor active in the timber market, interested in
19 owning these unique timberlands -- and, yeah, we'll
20 agree they're unique -- saw this and said, we're not
21 going any higher than that. That's more than we're
22 willing to pay. And you have to assume from information
23 like that that where this deal sits and where MRC is in
24 terms of its investment in this deal is right at that
25 edge.

1 I'm sure that no one at MRC expected when
2 they got into this process that they would have devoted
3 as much time and energy to it as they have so far; or,
4 would you have been able to get them to believe you if
5 you told them that that was the case.

6 You know, the next issue we heard about
7 from Mr. Pachulski was, you know, we're the appellees
8 and this bond is really expensive. And if we put it up,
9 there -- it's going to be at risk. It's going to be a
10 shooting target, and people are going to go after it,
11 and it's going to be -- you know, our money is going to
12 be tied up for a long time.

13 Well, Your Honor, bonds do cost money.
14 And the reason they -- and that's -- and that's just the
15 price of being the loser, you know. If you are the
16 loser and you want to go forward and you want to take
17 another crack at it, it's going to cost you something.
18 And you don't get to say there should be no bond because
19 if I put one up, it will be inconvenient to me.

20 Well, the failure to cause this plan to
21 go effective will be inconvenient to one heck of a lot
22 of people and affect an entire county. And that is not
23 reason enough to order that there be no bond in this
24 case.

25 Your Honor, I'd also like to talk about

1 this notion of a six-month period. What we've heard is
2 that for six months as long as they feel like appealing,
3 there will be a free log program. But there's no
4 evidence that a six-month period gets us anywhere. If
5 we get three quarters of the way down the road and a
6 free log program is ended and the appeal is not over and
7 any condition has changed in a way that affects the
8 willingness of any party to close or the distribution
9 that a party might expect to receive, then the six
10 months was an inadequate proposal.

11 And in imposing conditions here today,
12 you shouldn't simply take what they're willing to offer
13 and say, okay, I'll start with your six-month offer. If
14 there's going to be a free log program, it should be
15 indefinite. And that's because appeals are uncertain
16 just like everything else. And the period could be
17 significant.

18 There's no reason, Your Honor, for the
19 appellees to take any risk. And that's why the
20 six-month period just doesn't make any sense.

21 Lastly, Your Honor, at the very beginning
22 of this hearing you asked two questions. The first was
23 can the business continue in a way that satisfies the
24 administrative expenses of the status quo? And it's
25 real easy to say free logs cover most of the expenses.

1 And I'll let someone else go through the specific line
2 items of Mr. Young's budgets and the deficiencies, and
3 we've heard a lot about that during Mr. Hail's
4 cross-examination. I think it's pretty clear that there
5 were some items that were missed and that perhaps free
6 logs are not going to do it here. Maybe another \$5
7 million with the DIP financing would, but that was an
8 offer that was made around lunchtime, and you didn't
9 hear evidence about how that would change the situation.

10 The second question you asked was: Well,
11 what if Mendocino or Marathon back out? That's a
12 perfectly reasonable question. And as you pointed out,
13 they have every right to do so. And that is the risk
14 that free logs and a DIP can never, ever replace.

15 Your Honor, I would just like to put on
16 the board here the elements of the harm to unsecured
17 creditors and, you know, likely -- similarly situated
18 constituencies, so that we can start running a total of
19 the harms that are likely to occur.

20 The first, Your Honor, is the dividend to
21 general unsecured creditors in this case to be paid by
22 Marathon or MRC. It's 10.6 million. This money would
23 not go to unsecured creditors. I'm sorry, you know, if
24 you -- if you think back to the chart that Mr. Krumholz
25 had on the board, he had -- he had six items. They were

1 the things that he thought that the noteholders needed
2 to account for. And they were taxes, insurance, court
3 costs, cash burn -- we've talked about that -- income
4 lost during the appeal, and the last was delayed
5 distribution to creditors.

6 Your Honor, if the transaction blows up,
7 it won't be a delayed distribution to creditors. There
8 will be no distribution to creditors. General unsecured
9 creditors will receive zero. That's \$10.6 million.

10 In addition to that, Your Honor, the
11 unsecureds are getting half a million dollars to
12 administer their estate. Your Honor, you can't pass up
13 10.6 unless you've got some money to use to compromise
14 the claims and reconcile the claims, so you've also got
15 a half a million dollars there of real benefit to
16 unsecured creditors.

17 Next, Your Honor, is the most obvious and
18 the most glaring and the most difficult one for the
19 noteholders to respond to. That's \$25 million. And
20 that's the pension. Your Honor, if you were to ask one
21 of my committee members, Steve Will, about the
22 pensioners of this company, the first words out of his
23 mouth -- he said it many times to me -- there are people
24 who have given their lives to this company. And that's
25 true. They lived in that town. They worked there. You

1 know, their whole lives retired, and they counted on
2 this money. And this is the PBCG's projected shortfall.
3 It's an element of the disclosure statement, and it's
4 not to be paid under any other proposal that's been put
5 forward. This is an extremely valuable proposition.
6 And the committee is proud to have delivered this into
7 the plan that's going forward here today.

8 The last, Your Honor, I'll put it in
9 here, are the admins at Palco. These are the -- this is
10 both what's accrued and what was projected to be accrued
11 over the six-month period if it were only to last six
12 months in this case for an appeal. If you put all these
13 together, Your Honor -- and this is just for the
14 unsecureds -- you come to \$55.6 million.

15 But, Your Honor, as you pointed out at
16 the beginning of this case and as is common, you don't
17 just bond for what you think is going to happen, you
18 throw a little extra in there to make sure. You
19 multiply by 1.25 percent. And if you were to do that in
20 this case, that number grows.

21 THE COURT: 69 million.

22 MR. FIERO: Yes, Your Honor, it's \$69 and
23 a half million. I don't want to make a mistake. And,
24 Your Honor, I think it's appropriate that this go here
25 because unless this is paid, we can't get that.

1 So just for the unsecureds, the harm here
2 is \$69.5 million. And if the Court is inclined to enter
3 any sort of stay, we would ask that the bond be in at
4 least this amount to begin with, in addition to the free
5 logs, in addition to the Lehman DIP.

6 THE COURT: Okay.

7 MR. NEIER: David Neier on behalf of
8 Marathon. Your Honor, even contrary to the fact that
9 this discount log program preserve the status quo, which
10 I don't think it does, the status quo is very, very bad.

11 THE COURT: Very, very what?

12 MR. NEIER: Very, very bad. The status
13 quo is not good. Palco has been living on fumes for,
14 you know, the better part of six months in this case.
15 And it's not like these operations are running the way
16 they should. It's not like this company is getting
17 better. It's getting worse.

18 So, you know, I think the math with
19 Mr. Young on the stand proved that, you know, one and
20 one is three because what he did is he took all the bad
21 things out of his spreadsheet, left all the good things,
22 and then said, oh, Palco is profitable after you get \$20
23 million of financing. But it wasn't true, and Mr. Hail
24 walked him through it. So the status quo DIP didn't
25 work. But even if it did, the status quo is really bad.

1 It doesn't account for the accrued administrative
2 expenses. It doesn't account for anything.

3 But the real problem is whether it's a
4 six-month \$20 million deal or 12-month \$25 million deal,
5 which seems to indicate that the next six months will
6 only be a \$5 million deal doesn't sound very healthy.
7 The fact is it was like nailing Jell-O to a wall. Every
8 time we raised a problem, they said we'll modify it,
9 we'll do a little thing here, we'll do a little thing
10 there, it will get better.

11 Okay. Where is the document that was put
12 in front of our financial experts that they could look
13 at and say, well, you've got this issue, you've got that
14 issue, can you solve these issues?

15 This hearing was well-known to all the
16 parties in this case. Did anybody put down on a piece
17 of paper that we could all look at and discuss and model
18 out and have a sign -- you know, a signature by the
19 indenture trustee that talked about this discount log?
20 No, they didn't. What they did is they presented some
21 half-baked, middle of the night idea in front of the
22 Court and asked everybody to buy it. And every time we
23 said, well, there's this problem and that problem, we
24 don't know what's really there because you haven't put
25 it in writing, they said, oh, we'll fix this, we'll fix

1 that.

2 That's just like the Beal offer. Okay.
3 It expired the next day, so they could argue about it,
4 make a record about it, use that record on appeal, but
5 it doesn't really exist. They haven't never put it in
6 an asset purchase agreement. It's just like all the
7 other people that came to this court that didn't have
8 anything in writing when they surely knew how to do it
9 in writing.

10 And now we have the latest from
11 Mr. Gibbs. This is a wonderful bridge commitment. This
12 bridge commitment -- if you look at Roman Number II is
13 expressly conditioned on the following: The
14 effectiveness of the plan must be stayed pending appeal
15 and such plan must not be put into effect, and the bond
16 or other security required to be made and deposited in
17 order to affect such stay pending appeal must be
18 approved by Beal Bank, its sole discretion. This is not
19 a commitment. This is a noncommitment. This is a joke.

20 Even this joke makes it clear that if
21 it -- if it goes out more than six months, they have the
22 right to raise the interest rate by 50 basis points.
23 Well, gee, that just sounds like what Mr. Brilliant has
24 been talking about, that 50 basis points every six
25 months, you have an increased expense. That's 100 basis

1 points for the year. That's Mr. Hail's \$28.7 million in
2 increased expenses as a result of delay in getting the
3 financing into place.

4 Can you put up the indenture. Your
5 Honor, you heard from Mr. Pachulski that they can't
6 agree to put their claim at risk so that we can offset
7 their claim downwards so that we can protect creditors
8 in this case in the event there's unsuccessful appeal
9 and there's damages. And they said to do that would
10 require a 100 percent or unanimous vote of all the
11 affected noteholders. Can you go to Section 10.2, sub
12 6, I think is, what, page 62.

13 We've seen this provision before. This
14 is -- this is the section -- this is the section that
15 talked about those things that need unanimous consent,
16 the consent of each noteholder affected. And then there
17 are six categories, and it's reducing the rate,
18 extending maturity, all those things. But No. 6 is
19 impair the right to institute the enforcement of any
20 payment on or with respect to any timber note. And what
21 this is, is if you impair the payment of the timber
22 notes, you obviously need the consent of those affected,
23 okay?

24 Now, the indenture trustee tells you that
25 they've got majority consent, okay, but they're giving

1 away collateral for free. They're giving away their
2 collateral. And what's more, they're impairing the
3 payment of the timber notes by the Lehman DIP, and
4 they're saying they don't need unanimous consent. I
5 suspect, Your Honor, that's because it's not a real
6 offer. It expires tomorrow. It's just a joke. It's to
7 make a record before this Court, but never to go into
8 effect. That's why they're doing this. They know they
9 need unanimous consent, and there's going to be some
10 bondholder who shows up if this program ever went into
11 effect and says, gee, I didn't agree to this, and this
12 isn't authorized, and, therefore, you can't tear my
13 bond. And then the Court is going to have to protect
14 that person.

15 Now, there will be a bunch of people who
16 have speculated from the microphone, gee, Marathon won't
17 back out. Okay. Well, I can absolutely assure you
18 Marathon is going to act in its economic best interest,
19 and we have every intention of moving forward because
20 that's in our economic best interest. But if there's a
21 stay, if there's a stay and Mendocino, which has \$200
22 million of capital sitting on the side and has agreed to
23 put up its own property to allow us to get the bridge
24 facility, if they walk, of course, we're walking. We're
25 going to exercise our rights under the DIP. We have no

1 choice because we're going to act in our economic best
2 interest. And if a lengthy stay is entered, we are
3 absolutely going to make the calculation. Which is
4 better for Marathon right now? Do we continue as is,
5 which is absolutely horrendous? Do administrative
6 claims keep on accruing? Do professional expenses keep
7 on accruing? Do we allow that to happen or do we
8 exercise our rights and remedies? If we see a lengthy
9 stay happening, we're going to act in our economic
10 self-interest. Much as we hate to do so, that's our
11 job.

12 And Mr. Pachulski says, oh, you know,
13 Your Honor, if there's a big bond, that creates leverage
14 for Marathon and MRC. Well, the opposite is also true.
15 A lengthy stay creates leverage for the noteholders.
16 They'll say well, gee, you know, we'll drop our appeal
17 if you'll do X. That's leverage.

18 Mr. Pachulski says capital is tied up for
19 months or maybe two and a half to three years in a bond.
20 Well, our capital is tied up. Our capital is standing
21 by. We're bearing that cost. Of course, we're going to
22 act in our economic self interest. This is not a plan
23 that can stay in effect just on the sidelines not
24 being -- not being able to be consummated for all time.
25 Of course, we cannot do that. And the Court does not

1 expect us to do that. And creditors and other parties
2 in interest need the assurance of a healthy bond to
3 ensure that their rights are protected. That's the only
4 way this case can be appealed. That's the only way this
5 case should be appealed. And the bondholders know that.

6 And then there's been this incredible
7 burden shifting by Mr. Krumholz and by Mr. Pachulski.
8 They seem to think it's our job. It's our job to show
9 what our harm is. No, it's their job to show there's no
10 irreparable harm. The harm is presumed from the fact
11 that our plan has been confirmed. It's their job to
12 show there's no irreparable harm, and they haven't met
13 that burden. And they think that this is somehow about
14 witnesses. It's not about witnesses. Your Honor said
15 this is like a TRO hearing.

16 You don't need witnesses to confirm up.
17 You don't need to continue the scorched earth litigation
18 when every party gets on the stand. We can hear the
19 experts opine on what the amount of the damages should
20 be. We can look at all the evidence in the record and
21 determine whether a stay should or should not be granted
22 and whether or not if a stay is granted, on what
23 conditions. That's what Your Honor does on a TRO.
24 That's what Your Honor does on a stay pending appeal
25 hearing.

1 And a bond is for all reasonable and
2 foreseeable circumstances. It does include -- it does
3 include perhaps alternative outcomes. It can include
4 the outcome that the bond -- that the MRC/Marathon plan
5 never goes effective because too much time has passed,
6 because the parties can no longer close on that plan,
7 because the world has shifted. It can also include
8 things like increased -- increased expenses, but we do
9 close. That's not unreasonable for a bond. A bond
10 protects all reasonable and foreseeable circumstances,
11 even if they're alternate ones.

12 Now, Mr. -- Mr. Fiero did a great job of
13 talking about the unsecureds, but he didn't list what
14 the administrative creditors -- can we put up
15 Mr. Johnston's chart? Now, with respect to the
16 administrative expenses --

17 THE COURT: You have 17, but he has 16.

18 MR. NEIER: We didn't include the
19 professional expenses. I'm sorry, I was thinking about
20 the professionals in that number. I think the number is
21 actually a lot higher than \$7.5 million, even as of
22 today. And I think we saw a prediction through
23 Mr. Young, through Mr. Hail that the number is going to
24 grow to about \$16 million, okay, because only \$100,000
25 per month is going to be covered during the appeal

1 process. And I assume that's going to be another
2 scorched earth process.

3 So, you know, I would estimate there's
4 probably another \$16 million of professional fees that
5 are going to get accrued. And those are just
6 professional fees. Those don't include the lender
7 expenses in terms of the appeal. I would estimate at
8 least another \$10 million to go forward.

9 So we're not -- we're not just talking
10 about the administrative expenses of Palco. We're also
11 talking about the professional fees, which are the
12 last -- which are the last calculation there. So to my
13 way of thinking, the appeal not only protects Marathon
14 and -- with respect to Marathon, how can it be argued
15 with respect to the calculation of going concern less
16 liquidation value. If we liquidate, we're likely to get
17 liquidation value. That was the liquidation value that
18 is the average of the two experts that opined or that
19 did an appraisal of the town. So we have \$75 million
20 DIP, okay. We have an \$85 million term loan. We're
21 owed 160 million plus fees to about 170 million. And
22 the town is going to liquidate at 69 million. So what
23 we have is \$100 million from the term loan and the DIP
24 loan that we're going to be short on, after you take out
25 the liquidation value.

1 THE COURT: Did you just double count the
2 administrative fees?

3 MR. FIERO: I've got \$16 million of admin
4 already in there.

5 THE COURT: It may be just 90.

6 MR. NEIER: You mean on the DIP in the
7 term? You're right. I agree. We already have -- I
8 believe it was \$5,290,000 of accrued professional lender
9 fees in addition to the professional fees, and that's a
10 sensitive issue for me. So perhaps I was double
11 counting because I really want to get paid.

12 So, Your Honor, we haven't even thought
13 of things like what about the auction rate securities?
14 What happens to the value of the auction rate
15 securities? That's \$26 million that may go to zero.
16 Okay. So we have the auction rate securities as well.

17 And, you know, we haven't talked about
18 the benefit of the bargain. This plan obviously has
19 value. It's now a confirmed plan, and we're entitled to
20 the benefit of that bargain. The Court has found that
21 of the competing plans, our plan was the plan that
22 should win. And we're entitled to that benefit of the
23 bargain, and that is a recognized damage. I don't know
24 how to put a number on that. Mr. Brilliant says \$100
25 million. That may be a good number.

1 So when you -- when you add up what's
2 happening, a bond that should protect us is clearly in
3 the neighborhood of a \$400 million bond. But putting
4 that aside, we're using the logic of Trans Texas, and
5 that's going concern less liquidation value to protect
6 all circumstances, all reasonable foreseeable
7 circumstances. No, it does not protect from a
8 devastating forest fire or earthquake or what have you,
9 but it is the reasonable and foreseeable.

10 And Your Honor asked a question, well,
11 you know, with respect to the timberlands, you have --
12 you have \$510 million, and then you have \$260 million.
13 Well, wouldn't some of that come out of the bondholder's
14 hide? Not if they don't impair their claim. Not if
15 they don't agree to impair their claim. The bond has to
16 cover that. Could certain noteholders that didn't agree
17 to the appeal, could certain noteholders also, you know,
18 have to recover on the bond? I don't know the answer to
19 that. Maybe the bonds trade and maybe the new
20 bondholders have a right to that money. I don't know.

21 But the fact of the matter is that a
22 reasonable and foreseeable way of going at all different
23 circumstances, including the benefit of the bargain,
24 including the auction rate securities, including the
25 shutdown of Palco, and everything else that we've put

1 forward on this chart is to do going concern value, less
2 liquidation value, like this court did in Trans Texas,
3 and that I understand did go up to the Fifth Circuit,
4 and the Fifth Circuit did approve that methodology and
5 did approve that bond. Or at least did not reverse it.

6 And you know, finally, Your Honor, the
7 noteholders somehow think that it was our burden to show
8 what would happen to the community and what would happen
9 to the environment and what would happen to the
10 employees and the residents in the community. It was
11 not our burden. It was their burden to show that there
12 would be no irreparable harm to those people. And their
13 own witnesses, Dr. Barrett and Mr. Long, proved exactly
14 the opposite. There will be a problem. There are
15 already losses of employees. That's already affecting
16 operations. It's going to continue. There's going to
17 be a human cost in this town.

18 They admit fully that if the mill is
19 shutdown, there will be a devastating impact in that
20 community. So I don't know how the noteholders can
21 argue there was no evidence. It was their own witnesses
22 that presented that evidence, and there was no need to
23 call additional witnesses. And the noteholders wanted
24 to hear from Mr. O'Brien. He was on their witness list,
25 and they could have called him themselves, but they

1 chose not to. Thank you, Your Honor.

2 THE COURT: Mendocino. I would like you
3 to try to be as brief as possible.

4 MR. BRILLIANT: I will, Your Honor.

5 MR. NEIER: I did not touch the
6 certification issue because I understand Mr. Brilliant
7 will handle that as well.

8 MR. BRILLIANT: I'll try to be brief,
9 Your Honor. I guess the first thing, I agree with my
10 colleagues in advance. You know, before you even get to
11 the bond, they have the burden on the four elements. We
12 don't think they have met it, and there shouldn't be a
13 stay at all. But if there -- you know, there is going
14 to be a stay, Your Honor, the stay has to be, you know,
15 bonded. And the legal test is to whether it should be
16 bonded.

17 And, you know, look at the Adelpia case
18 which Mr. Pachulski spoke about at length. And to quote
19 Judge Sheindlin, and she says there's no good reason --
20 excuse me, she says -- this is on page 22 of the
21 decision. It says: "To the contrary as outlined above,
22 stay pending appeal is likely to cause harm by
23 diminishing the value of an estate or engender the
24 nonmoving parties -- endanger the nonmoving parties'
25 interest in the ultimate recovery, and there is no good

1 reason not to require imposing a bond, and the court
2 should set a bond at or near the potential harm to the
3 nonmoving parties." At or near the full amount of the
4 potential harm to the non moving parties.

5 And that, Your Honor, is the standard in
6 Chapter 11 cases. It's not, you know, as you heard, you
7 know, in real estate cases, real estate taxes and other
8 things. It's all of the harm that potentially could
9 arise to all of the nonmoving parties. And here all the
10 potential harm is huge.

11 Now, with respect to the issue of
12 interest, Your Honor will recall Mr. Young testified
13 that he understood that it was Mendocino's intent to
14 have a bridge loan which would be a variable rate loan
15 and then to replace that as soon as possible with a
16 fixed rate loan. And there was a question as to what
17 would happen with interest rates. And there was a
18 calculation that was done if there was just a 100 basis
19 points, so a one point change in the amount of interest
20 that Mendocino would have to pay over the life of that
21 loan, how much would it be? And the testimony was \$28.7
22 billion would be the present value of that.

23 Mr. Young did the calculation. He had a
24 higher number, but Your Honor probably remembers that
25 Mr. Johnston had also done a calculation. He got the

1 lower number. We're willing to live with the lower
2 number, which \$28.7 million. And that's just a one
3 percent increase in the fixed amount of -- in the
4 interest on the fixed rate loan, which Mendocino would
5 like to get as soon as possible after the closing in
6 order to have permanent financing for the 14 years after
7 the transaction. And that's \$28.7 million.

8 THE COURT: We've heard arguments this is
9 the worst economic time in the history since the
10 depression. I mean, that's somewhat hyperbole, I
11 suspect. But if you believe the other side of that, I
12 mean, the interest rate, if we're moving into a new age
13 of Jimmy Carter, the interest rate could be 18 percent
14 in the future.

15 MR. BRILLIANT: That's right, Your Honor.
16 We would say to Your Honor that, you know, the full
17 range of potential harm for us here is not just 100
18 basis points or one percent move, but it would be a 300
19 basis point move.

20 Now, you know, counsel has told you,
21 well, T-bill rates have been coming down, which probably
22 you remember from Mr. Radecki's testimony, the issue is
23 not T-bill rates because Mendocino is not borrowing at
24 T-bill rates. Mendocino is borrowing is at real estate
25 loan rates or timberland rates. And Mr. Radecki did no

1 analysis on timberland rates, but he talked about how
2 the risk premium for loans had increased. And, you
3 know, to some extent, although he was no timberland
4 expertise, he was not wrong about that point, which as
5 Your Honor is saying is that the economic environment
6 we're in now is that risk premium has changed over the
7 last period of time. And it could change dramatically
8 here. And to the extent it does, that alone could be a
9 huge amount of money for Mendocino. If it was 300 basis
10 points, that would be \$86.1 million just for changes in
11 interest rates.

12 Now, Your Honor, Mr. Neier talked about
13 the auction rate securities and the potential that that
14 could diminish in value, and I think that that's
15 unrefuted. Now, other issues that are less tangible
16 would be loss of key customers, losses of key employees.
17 We heard testimony today about Mr. Carter who was a very
18 valuable employee in connection with the roads that had
19 left. And the testimony was interesting that you heard
20 today, Your Honor. It was that they can manage. You
21 heard from Dr. Barrett, they could imagine by
22 outsourcing functions or through cross-training. They
23 could keep things going. But there was not the
24 testimony that there wouldn't be harm or loss to the
25 plan proponents because of the loss of key employees.

1 In addition, Your Honor, the
2 cross-examination of Dr. Barrett in connection with the
3 change in the forest. They are not going to be managing
4 the forest the way that Mendocino would manage the
5 forest.

6 THE COURT: Well, how many feet, board
7 feet have they cut so far this year? That was in the
8 testimony. Was it 34?

9 MR. NEIER: Your Honor, they cut about 50
10 percent of what they have to cut. And they're cutting
11 about the same this year as they cut last year, so they
12 cut --

13 THE COURT: They're only delivering 5
14 million per month here on out under this plan. So how
15 many more months have we got? We're in --

16 MR. NEIER: We're in July, Your Honor.
17 Another six months.

18 THE COURT: So that would just be 30
19 more, so that would be a total of -- if they've done
20 25 -- have they done 35 so far?

21 MS. COLEMAN: The testimony is 30.

22 MR. McDOWELL: They've done 29, Your
23 Honor, of redwood.

24 THE COURT: Plus 30 would be 69.

25 MR. BRILLIANT: I believe the testimony

1 from Dr. Barrett is they were going to do 75 for the
2 year.

3 THE COURT: So they're going to cut some
4 that they're not going to give to Palco? Okay.

5 MR. BRILLIANT: That's right.

6 THE COURT: Go ahead.

7 MR. BRILLIANT: But Dr. Barrett
8 acknowledged they're going to cut more than the 55
9 million that Mendocino would have cut, so they're going
10 to cut more. And he also acknowledged that he doesn't
11 know what Mendocino's business plans are with respect to
12 the harvest on a go-forward basis. And by cutting down
13 trees today that Mendocino may have wanted to leave in
14 the forest to grow, it may be affecting Mendocino's
15 future harvest plans. And that may devalue the business
16 to Mendocino.

17 Your Honor, when Mr. Young testified with
18 respect to his spreadsheets, and he talked about the
19 loss of income for Mendocino. And he said that -- if I
20 recall, he said that the amount of losses were negative.
21 The cash flow for Mendocino in the first year was
22 negative. Mr. Hail on cross-examination got Mr. Young
23 to point out that he was mistaken about that and, in
24 fact, Mendocino will lose money by not closing. In the
25 first year, you know, they will lose in excess of \$9

1 million from not closing.

2 In addition, the stay will keep Mendocino
3 from being able to upgrade the mill the way they want to
4 and to transition the distribution business onto
5 Mendocino's distribution business. Now, how much loss
6 in value that will be because of a six or 12-month
7 delay, don't know, but it could be substantial.

8 In addition, Your Honor, most courts that
9 look at these issues also look at, you know, total loss,
10 you know, to the estate. If you look at Judge Lifland's
11 recent decision in the Calpine case where he denied the
12 stay but said that he would require a very large bond if
13 he granted one. And there he denied it because of
14 concerns like here about Mendocino not being obligated
15 to close after a certain date. The exit lenders would
16 have been able to get out of their commitment letter to
17 close and concerns that Calpine wouldn't have be able to
18 get its financing.

19 But in addition to just the possibility
20 of looking at that, the court also added up all the
21 professional fees, the inconvenience and loss of value
22 by being in bankruptcy, and all these other soft costs.
23 And there he came up with a \$900 million bond as well.

24 Also, Your Honor, you know, other value
25 here that has been talked about is that Mendocino would

1 be required to have its money tied up. Now, the
2 indenture trustee's counsel has a strange idea that at
3 any time they can just say no mas, no more.

4 THE COURT: The financing in that case
5 was \$7.6 billion, wasn't it?

6 MR. BRILLIANT: That's correct, Your
7 Honor.

8 THE COURT: So if you went by percentage,
9 that would only be \$37,000 compared to \$325 million.

10 MR. BRILLIANT: I don't know that, Your
11 Honor, that that's really a relevant way to compare it,
12 but the only point being the fact that the -- I mean,
13 we're not asking for a \$900 million bond here, Your
14 Honor. But I think the point is the fact that they may
15 not have financing, may not be able to close the plan
16 because of the occasion of the stay require a large
17 point. That's the point, not necessarily the amount of
18 it.

19 Your Honor, the indenture trustee has
20 this idea that any time they can just, you know,
21 terminate the appeal and that we would have to close
22 immediately, you know, to avoid, you know, Palco mill
23 closing. Well, it doesn't work that way. Your Honor
24 knows that, you know, right now parties have been
25 spending a lot of time getting all the title work taken

1 care of, getting all the financing work taken care of,
2 getting all the regulatory approvals and permits to
3 close. It's not as if, you know, people can
4 continuously update that so at a moment's notice people,
5 you know, would be prepared to close.

6 Also, the ability to do a transition to
7 make sure that a value of MRC, that doesn't dissipate,
8 you know, also is lost by having, you know, an appeal go
9 forward where you just don't know when, you know, the
10 other courts, you know, might rule.

11 THE COURT: Move on to the stay if you're
12 going to cover that, unless you've got a few things you
13 want to say very quickly about --

14 MR. BRILLIANT: No, Your Honor, but
15 that's how we get to the \$100 million, you know, for
16 Mendocino we talked about in the opening.

17 Now, Your Honor, with respect to the
18 automatic -- or the certification to the Court of
19 Appeals, you know, there's three possible tests. We
20 don't believe they meet any of them. You know, we don't
21 believe that, you know, there is a -- this is not about
22 a legal issue that, you know, like the --

23 THE COURT: If the issue is whether they
24 get a stay at all, or if they do, a bond that they may
25 think is too high, if we go to the district court and he

1 goes along with me, they're going to appeal that to the
2 Fifth Circuit immediately anyway, aren't they? Why
3 would we want to wait? Why wouldn't this issue -- I
4 mean, both of those courts are going to give them time
5 to at least argue that they should have a stay and
6 perhaps even the amount of the bond, if there is a bond.

7 MR. BRILLIANT: If there is a bond, Your
8 Honor, I don't believe there would be jurisdiction in
9 the Fifth Circuit to even, you know, hear an appeal. In
10 the Adelpia case, I was also involved in the Adelpia
11 case. Unlike Mr. Pachulski, I was on the winning side.
12 But there the -- Judge Gerber did not require a bond,
13 Judge Sheindlin did grant a stay, but subjected it to a
14 \$1.3 billion bond. The descending bondholders then
15 appealed to the Second Circuit and also sought a
16 mandamus on the amount of the bond.

17 And the Second Circuit, under what I
18 believe is well-settled law, which is even good here in
19 the Fifth Circuit, said that in circumstances like this
20 where there's a bond that's been issued, we have no
21 jurisdiction, you know, to determine whether or not, you
22 know, the bond was too much. It left open the
23 possibility if the bond was at such a great level that
24 it created a legal impossibility to bond it, but they
25 said that wasn't, you know, the case in that situation.

1 So we don't believe on the bond issue
2 this makes its way to the Fifth Circuit. But the reason
3 we want to go to the district court, just the practical
4 reason, Your Honor, is at its heart, at its base, you
5 know, this appeal really is about facts. It's about a
6 very large record. And it's about facts.

7 Now, they try to cast some of these
8 things as legal issues and as open legal issues or
9 conflicting legal issues, but I think Your Honor having
10 written the opinion knows better than that. And
11 factual-oriented appeals should go to the district court
12 first. And in fact, we cite in our brief on this point,
13 you know, two decisions on this that say that, you know,
14 it's not that all cases are supposed to bypass district
15 court. It's only cases that are primarily legal issues
16 like the SAR case was.

17 And where there's a really contested
18 factual record, it is helpful to the Court of Appeals to
19 have the district court, you know, go through the record
20 and determine a lot of the fact issues in the first
21 instance. And we believe that that is the better
22 process here, that it will serve all the parties, you
23 know, best here and would make for, you know, the
24 appropriate, you know, appellate review.

25 Your Honor, I take it you've read our

1 papers. You probably saw our response on all three of
2 the issues. We just don't think it's, you know,
3 appropriate here.

4 THE COURT: All right.

5 MR. McDOWELL: Your Honor, Palco has
6 about three minutes.

7 THE COURT: Make it two. Go ahead.

8 MR. McDOWELL: If you tell me you don't
9 need to hear them, I'll sit down.

10 THE COURT: I'll let you have two
11 minutes.

12 MR. PASCUZZI: Your Honor, can I have a
13 few minutes?

14 THE COURT: You can have two also.

15 MR. PASCUZZI: Thank you.

16 MR. McDOWELL: Your Honor, Dr. Barrett
17 testified that if the mill closed, there would be a
18 domino of bad effects that would happen. That part was
19 not contested. I wanted to respond a little bit to why
20 you didn't hear Mr. O'Brien. His proffer, again, was
21 drafted two weeks ago before we had the true midnight
22 filing of the free log program.

23 The gist of his proffer was substantiated
24 by Mr. Barrett -- or Dr. Barrett, and if the mill closes
25 bad things are destined to happen. And now the

1 situation is, will the mill close? And we're left -- or
2 Palco at least is left in a really difficult situation
3 here if the stay is issued because they've gotten --
4 they've come a long way, but they haven't quite crossed
5 the line.

6 I liked the analogy of nailing Jell-O to
7 the wall. We asked the CEO of Palco under what
8 circumstances -- the CEO of Scopac, under what
9 circumstances would Palco have to repay this? This is
10 yesterday, and they didn't know. He said someone else
11 was the ultimate authority on that. Eventually that
12 issue -- every issue we raised was slowly answered a
13 little bit verbally.

14 We still have to parse through some words
15 because we don't have anything that's on paper. But
16 we're left with our arguments and statements that we're
17 going to be able to fund everything. And everybody can
18 keep on going under the status quo. And again, I
19 brought out, I believe, in Mr. Young's testimony that
20 you can't really fund everything. Palco's still a
21 debtor who cannot fund its administrative expenses on a
22 going concern -- on a going forward basis.

23 The Marathon DIP, even if it decides, you
24 know, to extend it and roll it forward after the
25 termination date cannot afford to really continue to pay

1 those or at least bring it current because they have \$11
2 million today, \$11 million in accrued administrative
3 expenses today that are due, have not been paid. And
4 they do not take care of those at all. They do not
5 address those at all. So the decision that the Palco
6 board is going to be facing is what does Palco do when a
7 debtor can't pay its administrative expenses and has no
8 prospect of being able to pay its administrative
9 expenses in the immediate future.

10 Now, we've had a similar question in the
11 last several months, except that second prong has always
12 been answered, well, we have a prospect of being able to
13 pay these administrative expenses. We've come here --
14 I've told you every time I've been in front of you,
15 Judge, we're running out of money, we're deferring. But
16 we've always been on the verge of having a plan
17 confirmed. We've been on the verge of having this issue
18 resolved. The stay pulls that rug out from underneath
19 our feet. All of a sudden now we can't bear
20 administrative expenses, and we have no prospect of
21 being able to pay them in the immediate future. And
22 absent a -- you know, the free log program doesn't solve
23 that, doesn't address that. It addresses it at the
24 Scopac level, not for Palco.

25 THE COURT: All right. Last point.

1 MR. McDOWELL: The last 30-second point,
2 Your Honor, is something to consider. If MRC walks in
3 two months, yes, the noteholders have said we will keep
4 this free log program for as long as the appeal is
5 going. What's their incentive to keep the appeal going
6 if MRC walks? Hasn't this always been a waiting game?
7 Once MRC is gone, we have a 363 backup sale, don't they
8 win if they withdraw their appeal at that point? Isn't
9 there a foreclosure, and they can credit bid a 363?
10 Isn't that another alternative? I just wonder if this
11 free log program -- the way they structured it so cutely
12 isn't a mirage at the end of the day.

13 THE COURT: Okay. California.

14 MR. PASCUZZI: Thank you, Your Honor.

15 Paul Pascuzzi for the California State Agencies. Your
16 Honor, throughout this bankruptcy case, the California
17 State Agencies have been the voice of the public
18 interest. The governor of the State of California
19 outlined principles before any of the plans were filed
20 that stated what the public interest here was. After
21 the plans were filed, the governor supported the
22 MRC/Marathon plan as in the public interest. Not only
23 and in my clients as well, and not just us but state and
24 federal legislators, county officials all supported the
25 MRC/Marathon plan as in the public interest. We believe

1 that that's met here by allowing the MRC/Marathon plan
2 to go forward. And the risk that the MRC/Marathon plan
3 might not go forward we think is enough to meet the
4 element of the public interest. And it's actually to
5 refute the indenture trustee burden to show that the
6 public interest would be served by a stay. It will not.

7 Addressing the Adelpia decision, Your
8 Honor, that's a public interest issue as well. They
9 say, well, the MRC/Marathon folks have a self-interest
10 here. They can stay. They can pull out. But we're
11 affected by that as well. We don't have any control.
12 The creditors don't have any control. The federal
13 agencies don't have any control, nor do the people of
14 Scotia or Humboldt County.

15 Your Honor, you heard evidence about the
16 environmental compliance. I think Your Honor and
17 Scopac's counsel acknowledge without further funding
18 both Scopac and Palco cannot continue to operate. That
19 puts in jeopardy the environment and their compliance.

20 Even with the DIP, we heard that the
21 \$500,000 potential fines for cleanup and abatement
22 orders, not in the budget. Maybe there's enough cushion
23 in there. Maybe there's not.

24 Another public interest or harm issue,
25 Your Honor, is the roads issue, the backlog in the

1 roads. Again, that's \$14 million. I can put that up on
2 the chart here as an interest that needs to be
3 protected. Dr. Barrett testified they're going to do
4 the minimum legally required during this six-month
5 period, not a bit more. What about the ground work for
6 the stuff that's required in January and February of
7 next year?

8 Your Honor, we heard a lot about the
9 mill. We have a buyer for the mill, but there's no
10 buyer for the town. What happens to that? What happens
11 to the power plant? What happens to the sewage
12 treatment plant? The water plant? Those are things you
13 can't bond around.

14 The DIP is offered as the solution. It
15 was a six-month DIP initially. Your Honor recognized
16 that six months was probably not enough time for an
17 appeal like this, so now it's, I guess, extended for a
18 year. But there was no budget for a year. There was no
19 testimony about a year, and it's \$25 million. They
20 added another \$5 million for another six months.
21 There's no evidence that that will be sufficient to fund
22 the debtors' operations.

23 Finally, Your Honor, the trustee is not
24 likely to succeed on the merits. It's a factual
25 question. You found so in your findings. And with

1 respect to questions of fact, the movant usually does
2 not satisfy this element. And as the Court noted in the
3 closing arguments, the indenture trustee is arguing a
4 lot of legal issues that really weren't made in your
5 decision. So this element isn't met as well.

6 Mr. Neier caught that counsel for the
7 noteholders switched the burden on the irreparable
8 injury. It's not our burden to show that we will be
9 irreparable harmed if a stay is issued. It's the other
10 way around. And the only way irreparable injury the
11 indenture trustee can show is the loss of its appeal
12 rights potentially. And, sure, those are important
13 rights, but the majority of the courts hold that that is
14 not enough alone to meet this element, nor is a
15 financial interest irreparable injury.

16 Your Honor, we believe that no stay
17 should issue. Given the time constraints, I'll join in
18 all of the other arguments. Your Honor, if you do
19 consider a stay with a bond, we'd ask that you require
20 environmental compliance with all of the obligations and
21 perhaps add the \$14 million of roadwork and the \$500,000
22 of the cleanup and abatement orders to the bond.

23 We also join in opposition to the direct
24 certification motion because it doesn't meet the
25 standards. That's why we join. Thank you, Your Honor.

1 THE COURT: Okay.

2 MR. PACHULSKI: Your Honor?

3 THE COURT: Yes.

4 MR. PACHULSKI: I'm sorry, I thought the
5 other side was done. I'll let them finish first.

6 MR. TENEBBAUM: Your Honor, this is Alan
7 Tenebaum.

8 THE COURT: Go ahead, Mr. Tenebaum.

9 MR. TENEBBAUM: Yes, this is Alan
10 Tenebaum.

11 THE COURT: Very briefly.

12 MR. TENEBBAUM: Yeah, very briefly. We
13 recognize, Your Honor, that you're sort of in a very
14 difficult no-win situation if you deny the stay. But if
15 you grant the stay, then the plan itself may well be
16 lost.

17 Finally, that would not be in the public
18 interest, and that is one of the four factors that are
19 required to be considered. I'm going to focus on the
20 public interest factor on behalf of the federal wildlife
21 agencies. We've always said from the beginning of the
22 plan proceedings that the Mendocino/Marathon plan was
23 the most consistent with the HCP and, therefore, in the
24 public interest. We are concerned about environmental
25 compliance during the period of any stay. When a

1 company is in as dire straights as these debtors are,
2 that's always a grave concern. There's already
3 testimony that Scopac is seeking to reduce the amount of
4 environmental monitoring, although Dr. Barrett says
5 that's not until next year. But that would be within
6 the one-year stay that they're seeking.

7 And there's also testimony that the
8 roadwork -- roadwork backlog may not be provided for.
9 But the bigger concern, Your Honor, is not during the
10 stay. It's after the stay because if the plan is lost,
11 the -- we and the public will have lost the best hope
12 for long-term compliance with the HCP. The prospect of
13 the joining 363 sales is very discomfoting to us
14 because we think they're ripe with problems for
15 compliance and approval under the HCP regulatory
16 authorities.

17 So, Your Honor, in conclusion, we think
18 that the public interest counts for as short a stay as
19 possible and as protective a bond as possible
20 particularly given the absence of any showing of
21 likelihood of success for the reasons that Your Honor
22 indicated in his original ruling. Thank you.

23 THE COURT: All right.

24 MS. CULLER: Good afternoon, Your Honor,
25 this is Emily Culler with O'Melveny & Myers on behalf of

1 Bank of America. May I just take a couple of minutes?

2 THE COURT: All right.

3 MS. CULLER: Bank of America doesn't bear
4 any ill will to any particular party, and they actually
5 voted in favor of competing plans. But we found
6 opposition based on the general concern about the
7 harmful effect on the estate of creditors, including B
8 of A and the public interest. Nothing we've heard in
9 the past few days has alleviated those concerns. This
10 case has been pending for 18 months, and the emergency
11 Marathon plan is the only confirmable plan that has been
12 proposed.

13 While the noteholders of Scopac seem to
14 believe that an auction may produce a better result, no
15 viable buyer came forward in the past year and a half.
16 And there's no certainty about when another sale could
17 take place or whether the proceeds received in an
18 auction would be higher than under the plan.

19 The indentured trustee of Scopac have
20 argued that they can maintain the status quo of Scopac
21 and Palco through the end of December 2008 through the
22 discount log program and the DIP. There's been no
23 indication about what happens if we get to January and
24 the appeal is still pending. All of the evidence
25 presented by the indenture trustee and Scopac assume the

1 appeal is resolved within the next five months.

2 It is also unclear that the discount log
3 program actually works. I believe someone else already
4 brought up this point, but my understanding from
5 Mr. Pachulski is that the indenture requires 100 percent
6 of the noteholders to compromise the claim. I just
7 don't understand how the indenture trustee can
8 compromise \$20 million under the discount log program
9 with merely the approval of the majority of the steering
10 committee, or I think as Mr. Herman brought up, the
11 majority of the noteholders voting in favor. There just
12 seems to be some dispute about what's required under the
13 indenture, which I provide some cloud as to whether the
14 discount log program is actually plausible.

15 The program also leaves Scopac completely
16 cash strapped by the end of December. According to the
17 budget we can expect with the log program, Scopac would
18 only have \$300,000 by the end of the year. Based on the
19 evidence presented, the only conclusion I can reach is
20 that the best result of the proposed program is that it
21 may delay liquidation of the two companies until January
22 while continuing to improve considerable administrative
23 expenses against both estates to the detriment of the
24 creditors.

25 The evidence presented by Mr. Johnston

1 and Scopac further ignores the fact that the
2 Marathon/MRC plan goes away by its terms if the stay is
3 granted. They cannot reasonably believe that MRC as an
4 independent investor or even Marathon should sit around
5 and wait for an unspecified amount of time while someone
6 else runs the company and then pick off where they left
7 off once the appeal is resolved. Not only do the
8 companies change, but the market changes, the parties
9 needs change and financing changes.

10 As others have pointed out, the expense
11 of B of A remaining in the case is substantial. B of
12 A's interest and fees will continue to accrue as the
13 appeals process drags out. And B of A has to remain
14 involved in the case to protect its interest. While B
15 of A is generally objects to a stay, B of A is
16 supportive of any plan to pay B of A's claims in full as
17 part of the bond as suggested by the Court during
18 opening statement. We believe this payout makes evident
19 economic sense for the stay and creditors.

20 Just one last thing on the Lehman DIP,
21 we've reviewed the papers, we conferred with counsel,
22 and we've heard counsel speak about the proposal today,
23 and we think it's clear that the DIP does not prime B of
24 A and that B of A's interest in these will continue to
25 be paid out even if a stay is entered. But because

1 there have been some last minute changes to the DIP, we
2 just want to make clear for the record that we object to
3 the extent that our understanding on the treatment of B
4 of A's claim is incorrect. Thank you.

5 THE COURT: All right. Thank you. All
6 right. I'm going to ask now that the parties submit to
7 me by Monday morning anything in writing that they wish
8 to submit on this issue. However, what I'd like is for
9 the parties to on this table, to submit to me in writing
10 what it is that they're proposing. And what I'd like
11 for someone from this table to do is submit to me what
12 they think, if there is a bond in this case, what they
13 think it should be and why, in other words, focusing on
14 those terms.

15 In other words, in essence, I'm asking
16 for you to just analyze the four distinct factors that
17 you look at in giving a stay pending appeal. And
18 specifically since you-all have proposed this discount
19 log or whatever you want to call it, DIP in discount,
20 and we're not real sure exactly -- I'm not real sure yet
21 exactly what it says. I want to know exactly what it is
22 that you are proposing in writing. And I'd like for
23 you-all to address the same four issues in writing and
24 what you think the records shows with respect to why
25 there shouldn't be a stay, or if there is, how much it

1 should be.

2 MR. PACHULSKI: Your Honor.

3 THE COURT: Yes.

4 MR. PACHULSKI: This is Isaac Pachulski.

5 And the Court has been extremely accommodating, but I
6 have one request. There is a suggestion that I've
7 spoken to one of my clients about that I'd like the
8 parties to consider. Haven't spoken to anyone else
9 about it, but I think it's something that was not
10 available in Adelpia, and it's a way to solve the
11 problem Mr. Tenebaum raised. And if you'll just let me
12 lay it down for about two or three minutes, we don't
13 have to debate it. It's just that if the Court thinks
14 it's totally ridiculous, you can shoot me down, and that
15 way --

16 THE COURT: Tell me real -- I'll give you
17 30 seconds. What is it?

18 MR. PACHULSKI: All right. Instead of a
19 stay through December, there's a 60-day stay with a
20 mechanic to come back to the court within the 60-day
21 period and find out if MRC is going to walk or not so
22 that Your Honor doesn't have to speculate. If MRC says
23 they're going to walk, we either post a bond or they can
24 close. But if we post the bond, they have to walk. The
25 Court then continues with a similar program every 30

1 days, so instead of having to speculate if they're going
2 to walk and instead of our having to post a prohibitive
3 bond based on speculation, either they'll say they're
4 going to walk, and at that point you say we put up a
5 bond before they close or --

6 THE COURT: Let me stop you right there.
7 You don't have a judge who isn't willing to be creative
8 about solutions. And I encourage all lawyers to be as
9 creative as possible, and that sounds creative.
10 However, you can have a plan A and a plan B, but it
11 needs to be in writing.

12 MR. PACHULSKI: I understand. I just
13 wanted to know if I would be shot down.

14 THE COURT: I'd like to have it -- what's
15 reasonable? Can you get it to me by, say, 10 o'clock on
16 Monday morning?

17 MR. PACHULSKI: It's up to the Fulbright
18 lawyers.

19 THE COURT: Yeah, I know. 10 o'clock.

20 MR. GREENDYKE: Yes, Your Honor.

21 THE COURT: Okay. Because I think we
22 have to move forward. We've got to decide this, and
23 we've got to move forward deliberate speed and get this
24 decision made Monday or Tuesday. So if you can get it
25 to me, everybody get their stuff in at 10 o'clock. And

1 if there's something so startling that somebody thinks
2 they need to reply, they're going to have to do it
3 Monday. But they're going to have to let me know
4 they're going to do it by letting everyone else know,
5 too.

6 MR. GREENDYKE: You don't want us here at
7 10 o'clock?

8 THE COURT: No. I just want you
9 e-mailing me the -- filing your whatever you want to
10 call it, your brief or findings or whatever it is, and
11 getting it to me by 10 o'clock on Monday.

12 MR. GIBBS: Judge, I would like to
13 suggest that you move the 10 o'clock to 1 p.m. so the
14 people at least are in their offices and the final
15 perhaps -- I know that we're going to seal --

16 THE COURT: You don't work on the
17 weekend.

18 MR. GIBBS: Correct. I haven't worked a
19 weekend since last weekend.

20 THE COURT: Okay, 1 p.m. That will be
21 fine. Thank you.

22 MR. NEIER: Thank you, Your Honor.

23

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1 THE STATE OF TEXAS:

2 COUNTY OF NUECES:

3

4 I, SYLVIA KERR, Certified Court Reporter in and for
5 the State of Texas, do hereby certify that the above
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