

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
(Corpus Christi Division)**

In re	§	Case No. 07-20027
	§	
SCOTIA DEVELOPMENT, LLC, et al.,	§	Chapter 11
	§	
Debtors	§	Jointly Administered
	§	

**FEDERAL WILDLIFE AGENCIES’ COMMENTS ON AND LIMITED
OBJECTIONS TO PROPOSED PLANS OF REORGANIZATION**

The United States on behalf of the US Fish and Wildlife Service (“FWS”), Department of the Interior, and the National Marine Fisheries Service (“NMFS”), Department of Commerce, hereby files the below comments and limited objections with respect to the five Plans of Reorganization proposed in this case (Docket Nos. 2206, 2208, 2209-2211). The federal Wildlife Agencies have reviewed the proposed Plans and also heard presentations on each of the Plans. Based on the limited information conveyed through the proposed Plans and presentations, the federal Wildlife Agencies believe that the Mendocino/Marathon Plan is the most consistent with the existing Habitat Conservation Plan (“HCP”).^{1/} The existing HCP and Incidental Take Permits provide for the protection of endangered fish and wildlife on approximately 211,000 acres of forest lands in California while allowing compatible commercial timber production. The Mendocino/ Marathon Plan appears to provide the greatest certainty that the HCP, Incidental Take Permits, and Implementation Agreement will be fully implemented and that the benefits to the species through the HCP will be realized. While the other proposed plans may also be compatible with the existing HCP, the federal Wildlife Agencies do not have the same

^{1/} The federal Wildlife Agencies’ belief is subject to the incorporation of Confirmation Order language proposed in this filing.

certainty based on the information provided. For example, the Debtors' proposed Plans involve substantial transfers of property, and both the Debtors' Joint Plan and the Indenture Trustee's Plan lack detail that raises significant issues of uncertainty relative to the existing HCP and Incidental Take Permits. Regardless of which Plan is confirmed, the federal Wildlife Agencies will work with the successful Plan sponsor towards environmental compliance with the HCP and related Implementation Agreement.

In any event, as further explained below, the Court's Order confirming any of the Plans should clarify that: (1) the Plan does not authorize any transfer of regulated lands or permits by the Reorganized Debtor prior to obtaining applicable regulatory approvals; and (2) any post-confirmation issues about regulatory approvals must be decided in the nonbankruptcy forum(s) with jurisdiction. As this Court has held, plans of reorganization cannot restructure applicable environmental law for reorganized debtors.² Any provisions in the Plans to the contrary would be "forbidden by law" in contravention of 11 U.S.C. §1129(a)(3) (debtors may not propose plans that are "forbidden by law.").

Background

1. FWS and NMFS are jointly responsible for overseeing compliance with the Endangered Species Act of 1973, as amended ("ESA"), 16 U.S.C. §§ 1531 et seq.

2. Debtors Pacific Lumber Company ("Palco"), Scotia Pacific Company LLC ("Scopac"), and Salmon Creek Corp. ("Debtors") currently hold incidental take permits (ITPs or permits) issued by FWS and NMFS under Section 10(a)(1)(B) of the ESA and the California Department of Fish and Game (collectively the "Wildlife Agencies") under the California

² Memorandum Opinion and Order at 14 (Docket No. 665) (April 20, 2007).

Endangered Species Act. The permits cover the incidental take of federal and state ESA-protected and other sensitive species that may result from Debtors' logging-related (timber management) activities in California. The terms and conditions of the 50-year permits require the Debtors to implement the Habitat Conservation Plan (HCP) and the associated Implementation Agreement (IA) in California. The HCP and IA include an array of mitigation measures to offset impacts to wildlife and fish species covered under the permits.

3. The HCP is derived from the principles of the 1996 Headwaters Agreement and represents an extraordinary public and private commitment to the preservation of endangered wildlife and fish in old growth redwood and other forest lands in California.

Environmental Obligations Will Not Be Adversely Affected By The Plans

4. All of the proposed Plans state that notwithstanding any other provisions in the Plan, all environmental obligations relating to the HCP and IA shall be complied with in full in the ordinary course of business and shall not be adversely affected by the bankruptcy case. First Amended Joint Plan of Reorganization By Mendocino Redwood Company and Marathon ¶ 2.5; First Amended Indenture Trustee's Plan ¶¶ 6.6, 7.3; First Plan Supplement to First Amended Indenture Trustee's Plan Exhibits E, B; Debtors' Second Amended Joint Plan ¶ 2.9; First Alternative Plan for the Palco Debtors ¶ 2.8; First Alternative Plan for Scopac ¶ 2.5.

5. These Plan provisions are consistent with this Court's ruling that "A plan of reorganization cannot restructure the environmental laws and regulations of California and the United States." Memorandum Opinion and Order at 14 (Docket No. 665) (April 20, 2007).

6. The United States requests that the language in these paragraphs also be placed in the Confirmation Order in order to avoid any ambiguity or unintended consequences given that many of the Plans provide that the Confirmation Order takes precedence over terms of the Plan.

See, e.g., First Amended Joint Plan of Reorganization By Mendocino Redwood Company and Marathon ¶ 13.10; Debtors' Second Amended Joint Plan ¶ 13.10; First Alternative Plan for the Palco Debtors ¶ 12.10; First Alternative Plan for Scopac ¶ 12.10. Accordingly, the Confirmation Order should provide: "Treatment of Environmental Obligations. Notwithstanding any other provision in the Disclosure Statement, Plan, or this Order, as amended from time to time, the Debtors (including the Reorganized Entities, as of the Effective Date) shall comply, complete, perform, satisfy, and/or provide for satisfaction of any pre-petition, current, ongoing, executory, and future Environmental Obligations. Each Environmental Obligation shall be satisfied in full in the ordinary course of business of the Debtors, or, as of the Effective Date, the Reorganized Entities, at such time and in such manner as the Debtors and the Reorganized Entities are obligated to satisfy such Environmental Obligation under applicable non-bankruptcy law. Each Environmental Obligation shall survive the Effective Date of this Plan as if the Reorganization Cases had not been commenced, shall not be discharged under section 1141(d) of the Bankruptcy Code, and shall not otherwise be adversely affected by the Reorganization Cases."

The Mendocino/Marathon Plan is Most Consistent With the Habitat Conservation Plan

7. As noted above, the federal Wildlife Agencies have reviewed the proposed Plans and also heard presentations on each of the Plans. Based on the limited information conveyed through the proposed Plans and presentations, the federal Wildlife Agencies believe that the Mendocino/Marathon Plan is the most consistent with the existing HCP. The Mendocino/Marathon Plan appears to provide the greatest certainty that the HCP, Incidental Take Permits, and Implementation Agreement will be fully implemented and that the benefits to the species through the HCP will be realized. While the other proposed plans may also be compatible with the existing HCP, the federal Wildlife Agencies do not have the same certainty based on the

information provided. For example, the Debtors' proposed Plans involve substantial transfers of property, and both the Debtors' Joint Plan and the Indenture Trustee's Plan lack detail that raises significant issues of uncertainty relative to the existing HCP and Incidental Take Permits.

**Advance Regulatory Approvals of Future
Transfers of Property By Reorganized Debtor Are Required**

8. Sections 5.3.1 and 5.5 of the HCP IA require advance approvals by the Wildlife Agencies of any transfer of any property covered by the permits and underlying HCP and IA ("Covered Lands").³⁷ In order to obtain such approvals, the Wildlife Agencies will need to make a determination as to whether any land transfers and contemplated land management activities by third parties would compromise the effectiveness of the HCP. In addition, if any new activity is proposed on lands either transferred or retained under the Plans, the Wildlife Agencies will also need to determine whether the activity can be permitted in accordance with the Federal and State Endangered Species Acts and their implementing regulations, which will require

³⁷ Section 5.3.1(a) provides in relevant part: "Palco's transfer of ownership or control of Covered Lands, or portions thereof, other than in the MMCAs, which transfer are addressed in Section 5.5 of this Agreement, will require prior approval by [the Wildlife Agencies] and an amendment of the Federal and State Permits in accordance with Section 7.2 of this Agreement" Section 5.5 provides in relevant part: "Palco may sell, exchange or otherwise transfer to a third person one or more of the MMCAs, or a portion thereof, so long as Palco demonstrates to the reasonable satisfaction of [the Wildlife Agencies] that the protection to be afforded by such third party (and its successors) to the marbled murrelet and the habitat of the marbled murrelet in such MMCA(s) and to the other Covered Species is equal to or greater than that afforded under the HCP for a period of 50 years from the Effective Date. . . . Without limiting the generality of the foregoing, for purposes of this Agreement, the sale, exchange or transfer to a third party for an MMCA with legally binding restrictions running with the land and reasonably approved by [the Wildlife Agencies], which limit the uses of the MMCA proposed for Transfer to those uses specified at Section 3.1.1 of this Agreement for a period of 50 years from the Effective Date shall be deemed to constitute protection afforded by such third party (and its successors) that is equal to or greater than that afforded under the HCP."

assurances of adequate funding to carry out applicable requirements.^{4/}

9. In order to avoid any future misunderstanding, any of the Plans, if confirmed, should be clarified to recognize that advance regulatory approvals of any transfers of Covered Property are required. The United States therefore requests that the Confirmation Order provide: “Nothing in the Plan or this Order authorizes any transfer of Covered Lands or permits by the Reorganized Debtor prior to obtaining any applicable regulatory approval. Covered Lands shall mean any property covered by the Debtors’ permits or the Habitat Conservation Plan and Implementation Agreement.”

10. While in bankruptcy, 28 U.S.C. § 959(b) requires debtors-in-possession to “manage and operate the property in [their] possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.”^{5/} Consistent with this

^{4/} Some of the proposed Plans propose new residential housing and potential other types of development or imply that land may be transferred for residential housing on Covered Lands containing commercial timberland. Residential housing is not a covered activity whose effect on the incidental take of species covered by the Endangered Species Act was analyzed as part of the HCP. Housing development can result in incidental take of covered species different than that analyzed in the timber-related HCP that the Wildlife Agencies would need to analyze based on the specifics of proposed uses. These impacts might include, but not be limited to: (1) increases in water withdrawal for domestic purposes from watercourses supporting wildlife and fish; (2) increases in road densities and usage that could impact sediment levels in streams which can affect wildlife and fish; (3) the risk of landslide activity that would impact streams, wildlife, and fish; (4) increases in the delivery of nutrients and pesticides to streams that would threaten wildlife and fish; (5) impact on wildlife and fish from increased human activity, including noise, light and domesticated animals; (6) conversion of foraging, nesting and resting habitat for wildlife at building sites; (7) attraction of nuisance species (e.g., corvids) thereby increasing predation on nesting birds (e.g., marbled murrelets); (8) introduction of invasive weed species; (9) conversion of rare plant habitat at building sites; and (10) increased fragmentation of older forest habitats.

^{5/} Debtors-in-possession are required to perform all the “functions and duties” of trustees. See 11 U.S.C. § 1107(a).

approach, 11 U.S.C. §1129(a)(3) requires that debtors may not propose plans that are “forbidden by law.” See In re Texas Extrusion Corp., 844 F.2d 1142, 1160 (5th Cir. 1988) (court reviews assertion that Plan was “forbidden by law” because it would violate antitrust laws); In re Cajun Electric Power Co-op, Inc., 150 F.3d 503, 519 (5th Cir. 1998) (Plan may not propose “independent illegality”); see also Collier on Bankruptcy § 1129.03[3][b][ii] (plan that would violate other regulatory law would be “forbidden by law” and would preclude confirmation even if no provision of title 11 was violated). Just as a debtor-in-possession must comply with applicable approval requirements relating to its property under environmental law, a fortiori, a reorganized debtor must comply with the same requirements, and any Plan that suggested otherwise would be “forbidden by law” and not confirmable. Indeed, the Fifth Circuit has emphasized the limited role of bankruptcy courts once a debtor emerges from chapter 11. See In re Craig’s Stores of Texas, Inc., 266 F.3d 388 (5th Cir. 2001).

**Any Environmental Law Disputes About Transfers of Property
Must Be Determined In the Non-Bankruptcy Forums Having Jurisdiction**

11. Various provisions in the Plans might be misconstrued or misunderstood to suggest that the Bankruptcy Court has some future role relating to regulatory approvals under environmental law for any proposed future transfers of property or permits. See, e.g., First Amended Joint Plan of Reorganization By Mendocino Redwood Company and Marathon ¶ 12.1.15; First Amended Indenture Trustee’s Plan ¶¶ 7.2.3, 19.1.1; Debtors’ Second Amended Joint Plan ¶ 12.1.15; First Alternative Plan for the Palco Debtors ¶ 11.1.15; First Alternative Plan for Scopac ¶ 11.1.15. To the contrary, plans of reorganization cannot restructure applicable environmental law for reorganized debtors including the jurisdictional provisions of

environmental law.⁹ Environmental law issues relating to any proposed future transfers of property or permits must be decided in the nonbankruptcy forums with jurisdiction.

12. The United States therefore also requests that the Confirmation Order provide that: “Notwithstanding anything to the contrary in the Disclosure Statement, Plan or this Order, any disputes involving the Environmental Obligations, regulatory approval of any transfers of property contemplated by the Plan, or the amendment or issuance of any environmental permit shall be resolved in the appropriate non-bankruptcy forum.”

13. Without such clarification, the United States believes such provisions in the Plans would be “forbidden by law” in contravention of 11 U.S.C. § 1129(a)(3).

14. Likewise, any provisions of the Plans purporting to confer jurisdiction on the United States District Court for the Southern District of Texas over any environmental matters regarding property in California are inappropriate and forbidden by law. First Amended Joint Plan of Reorganization By Mendocino Redwood Company and Marathon ¶ 12.2; Debtors’ Second Amended Joint Plan ¶ 12.2; First Alternative Plan for the Palco Debtors ¶ 11.2; First Alternative Plan for Scopac ¶ 11.2. A Plan cannot confer jurisdiction on a court that does not otherwise exist. See In re Resorts International, 372 F.3d 154, 161 (3d Cir. 2004). The Confirmation Order should clarify that these provisions do not apply to any environmental liabilities to governmental entities with the following language: “Paragraph ____ of the Plan does not apply to any environmental liabilities to governmental entities.”

The Wildlife Agencies’ Partial Security Interest Should Pass Through The Bankruptcy

15. Debtors’ liability for HCP/IA requirements is partially secured by an at least

⁹ Memorandum Opinion and Order at 14 (Docket No. 665) (April 20, 2007); In re Resorts International, 372 F.3d 154, 161 (3d Cir. 2004).

LARRY LUDKA
Assistant U.S. Attorney
U.S. Attorney Office
Southern District of Texas
800 North Shoreline Blvd, #500
Corpus Chrsti, TX 78476-2001
361-888-3111

OF COUNSEL:

LYNN COX
United States Department of the Interior
Office of the Regional Solicitor
2800 Cottage Way, Suite E-1712
Sacramento, CA 95825-1890

DEANNA HARWOOD
United States Department of Commerce
National Oceanic and Atmospheric Administration
Office of General Counsel
501 W. Ocean Blvd., Suite 4470
Long Beach, CA 90802

CERTIFICATE OF SERVICE

I certify that, on April 4, 2008, a true copy of the foregoing Federal Wildlife Agencies Comments on and Limited Objections to Proposed Plans of Reorganization was served on all parties on the service list entitled to notice through the Court's electronic filing system.

_____/s/_____
Alan S. Tenenbaum