IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

In Re:	§	
	§	
Scotia Development LLC, *et al.*,	§	**Civil Action: 08-259**
	§	
Debtor-In-Possession.	§	**Bankruptcy Case: 07-20027**
	§	

APPELLANTS' OPPOSITION TO MOTION OF APPELLEES MENDOCINO REDWOOD COMPANY, LLC AND MARATHON STRUCTURED FINANCE FUND L.P. TO DISMISS APPEAL

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PRELIMINARY STATEMENT

Appellants respectfully submit this Opposition to the "Motion Of Appellees Mendocino Redwood Company, LLC And Marathon Structured Finance Fund L.P. To Dismiss Appeal" (the "Motion") filed by Appellees.[1] The Motion seeks to dismiss this Appeal on two grounds—first, for lack of subject matter jurisdiction because Appellants' 507(b) Claim was allegedly "part and parcel of the confirmation process" (Motion at ¶ 15); and second, because this appeal is "equitably moot" (Motion at ¶ 14). Both assertions are without merit.

This Court undoubtedly has subject matter jurisdiction to hear this appeal. The issue here—the disallowance of the 507(b) Claim—does not overlap with any issue in the separate appeal currently before the Fifth Circuit, which involves *only* the Confirmation Order. The 507(b) Motion created a separate and discrete contested matter and, accordingly, the Bankruptcy Court entered the 507(b) Order and the Confirmation Order as two separate orders.

This is not to say that the confirmation proceedings (including the pending Confirmation Order appeal (the "Confirmation Appeal")) cannot affect this Appeal. The 507(b) Claim exists because the Bankruptcy Court fixed the value of Appellants' Timberlands collateral when it confirmed the MRC/Marathon Plan. Thus, plan confirmation became the "endpoint" for determining the diminution in value of that collateral during the bankruptcy case, a predicate to quantifying the 507(b) Claim.[2] But this limited connection does not oust this Court of jurisdiction over this Appeal.

Appellees ignore several undisputed facts and basic principles of bankruptcy law that both highlight the separateness of the two appeals and destroy the underpinnings of their jurisdictional challenge. *First*, the hearing on the 507(b) Motion did not even begin until after

[1] All terms not otherwise defined herein have the same meanings as defined in the Motion.

[2] Hence, if the Fifth Circuit reverses the Confirmation Order, that reversal may moot this Appeal.

the Bankruptcy Court closed the evidentiary record on confirmation of the MRC/Marathon Plan. The two matters thus have separate evidentiary records. *Second*, the Bankruptcy Court entered separate orders for confirmation of the MRC/Marathon Plan and for the 507(b) Motion, rejecting Appellees' request for a single order on the two matters.[3] *Third*, the terms of the MRC/Marathon Plan did not make the disallowance (or limited allowance) of the 507(b) Claim (or of any other administrative claim) a condition to plan confirmation or to effectiveness. The Plan contained no cap or limitation on the allowed amount of administrative claims or the amount in which any such claim could be asserted. In addition, the Plan expressly permitted the filing of administrative claims for up to 30 days after that Plan's Effective Date. *Fourth*, throughout its provisions, the Bankruptcy Code maintains a fundamental distinction between the treatment of a claim under a plan of reorganization and the allowance of a claim. The issues that Appellants raised in the Confirmation Appeal with respect to the treatment of administrative claims under the MRC/Marathon Plan have no bearing on this Appeal, which focuses on the amount for which a particular claim should be allowed.

Appellees' equitable mootness argument also fails. *First*, as stated above, the MRC/Marathon Plan expressly permitted the filing of any administrative claims for 30 days after the Plan's Effective Date, and did not cap or otherwise limit any such claims. It is incongruous to assert that an appeal from an event that the MRC/Marathon Plan permitted to occur after that Plan's Effective Date could be equitably mooted by confirmation of such Plan.

Second, even if the MRC/Marathon Plan's express terms did not already vitiate Appellees' equitable mootness argument, Appellees' theory that "reversal of the Bankruptcy Court's 507(b) Order would cause the MRC/Marathon Plan to unravel (Motion at ¶ 22) lacks any

[3] Nor have the Appellees at any time sought to consolidate this Appeal with the Confirmation Appeal.

basis in the record and is based on a false premise. Appellees wrongly suggest (Memo. at p. 5) that only one of two outcomes is possible on this appeal—either the administrative claim is completely disallowed, or it must be worth more than "$200 million."[4] In fact, there are a variety of other possible results, some of which are nowhere near the "200 million" the Appellees fear. For example, this Court should at a bare minimum award Appellants the $18 million for the diminution of their cash collateral through the payment of estate professional fees. There is no evidence that such an award would drive HRC—a self-described $500 million company—out of business. Equitable mootness requires that the appellate court be unable to grant *any* relief. It is not sufficient that there might be obstacles to granting *all* relief sought.

Moreover, both MRC and Marathon are substantial and well-financed entities. There is no evidence that HRC would be unable to satisfy the approximately $163 million in aggregate claims asserted by Appellants.

In addition, a reversal of the 507(b) Order would not affect the rights of any other creditor under the MRC/Marathon Plan because, under that Plan, HRC (wholly owned by MRC and Marathon) is solely responsible for the payment of any administrative claim that is allowed in the event of reversal. No other creditor who received a distribution under the MRC/Marathon Plan would be required to return a penny of that distribution. Hence, this Appeal is not equitably moot.

At bottom, the Motion is simply an element of Appellees' ongoing campaign to evade appellate review of difficult and troubling issues of secured creditors' rights in chapter 11 cases. As noted by Chief Judge Jones at oral argument on the Confirmation Appeal:

[4] As discussed below, the Appellants' 507(b) Claim consists of three sub-claims aggregating to at least $163 million.

> [Y]ou fellows [Appellees] have done about as speedy a job of trying to *undermine* our appellate review as I've ever seen in nearly 25 years on the bench. So what's equitable about that situation?

Fifth Circuit Oral Argument, Oct. 6, 2008, at 19:50 – 20:02 (Chief Judge Edith Jones) (emphasis added), *available at* http://www.ca5.uscourts.gov/OralArgumentRecordings.aspx?prid=280244.

Courts have recognized "the dangers associated with allowing the bankruptcy court to be the de facto final decision maker of a controversy merely by confirming a plan of reorganization and denying a motion for a stay." *In re Equinox Oil Co.*, Civil Action No. 00-3320, 2001 U.S. Dist. LEXIS 8165 at *32 (E.D. La. June 11, 2001) (rejecting argument that substantial consummation rendered appeal from order resolving conflicting claims to insurance proceeds equitably moot). These dangers simply reinforce Appellees' burden to show that there is no possible relief that this Court could provide—especially where, as here, the requested relief would affect only Appellees. The Motion should be denied.

FACTUAL BACKGROUND

1. Appellants' 507(b) Claim Consists Of Three Sub-Claims.

Appellees omit critical facts related to the nature of the 507(b) Claim. Appellants' superpriority administrative claim under 11 U.S.C. § 507(b), in the aggregate amount of at least $163 million, is not an "all or nothing" claim, but actually consists of three distinct sub-claims reflecting discrete diminutions in the value of their cash collateral during the bankruptcy case: (i) an $18 million claim for the depletion of Appellants' cash collateral to pay estate professional fees (from which Appellants received no benefit); (ii) an $8.9 million claim arising from the improper deduction of $8.9 million from the compensation to which Appellants were entitled for the Cash Collateral on hand on the Petition Date; and (iii) a claim for an amount not less than $136 million for the decline in the value of the Timberlands from the Petition Date to the

Confirmation Date, using the Bankruptcy Court's $510 million Confirmation Date valuation as the "endpoint." *See* Merits Brief at pp. 11, 44-45.

2. Appellees Omit Critical Facts Relating To Their Own Plan.

Appellees exaggerate the relationship between the confirmation of their Plan and the 507(b) Claim Appeal by ignoring several key elements of their own Plan. Their original plan provided that their newly created, wholly-owned entity (HRC) would pay all administrative claims in full. Appellant 134 at § 2.1. The MRC/Marathon Plan did not include any particular resolution of administrative claims or any "cap" or limitation on such claims among the conditions precedent to either the Confirmation or Effective Date of that Plan and did not otherwise seek to identify or resolve any particular administrative claims or dictate or limit the amounts of such claims. *See id.* at §§ 11.1.1, 11.1.3. To the contrary, the MRC/Marathon Plan expressly permitted administrative claims to be filed as late as thirty days *after* the Plan Effective Date, which itself could not occur until *well after* the Plan was confirmed. *Id.* at § 2.2; *see also id*. at Appendix A (definition of "Administrative Expense Claims Bar Date").

Indeed, the MRC/Marathon Plan permitted Appellees to withdraw as plan proponents by refusing to enter into the operative transactions required by the Plan, thereby rendering the Plan void. *See id*. at §§ 11.1.2.4, 11.2. But once they decided to consummate their Plan, Appellees bore the risk of having to pay the administrative claims in full.

In its Confirmation Findings of Fact and Conclusions of Law (the "Confirmation Findings"), the Bankruptcy Court required that the MRC/Marathon Plan be amended to provide that Appellants be paid at least $510 million for the Confirmation Date value of the Timberlands. Appellant 113, pp. 5-6. This amendment would prevent Appellees from using the "Class 6 Distribution Adjustment" to reduce the distribution on Appellants' secured claim dollar for dollar by the amount of any allowed administrative claim, as their Plan originally provided. *See*

generally notes 5-6, *infra*. Although Appellees had the right to withdraw from their Plan, they elected to amend it to conform to the Confirmation Findings, leaving other terms of the Plan unchanged. The MRC/Marathon Plan, as amended, was confirmed. *See* Appellant 134. Thus, Appellees assumed the risk that their wholly-owned entity would be liable for all administrative claims, without limitation, and without deducting those claims from Appellants' distribution.

3. Appellees Omit Facts Concerning The Timing Of The Filing And Denial Of The 507(b) Motion.

The Indenture Trustee filed the 507(b) Motion on May 1, 2008, and brought it to the Bankruptcy Court's attention at the next day's session of the confirmation hearing. *See* Appellant 97; *see also* Appellant 201 at pp. 10:7-9, 76:5-15. But when asked by the Bankruptcy Court whether the 507(b) Claim needed to be determined immediately, counsel for Appellees answered in the negative. *See* Appellant 202 at pp. 147:5-11. On May 15, 2008, Appellees filed an objection to the 507(b) Motion, and on May 21, Scopac filed a "response" to that Motion. The Bankruptcy Court set July 18, 2008, as the hearing date on the 507(b) Motion. Except for the formality of filing an objection, the 507(b) Motion was ignored by Appellees until after the contested Confirmation Hearing (and after the presentation of all evidence thereat) had concluded.[5]

The Bankruptcy Court closed the evidentiary record on Confirmation on May 2, 2008. Appellant 201 at p. 79:21-24. One month later, on June 6, 2008, the Bankruptcy Court entered its Confirmation Findings, which included a requirement that, in order to be confirmed, the MRC/Marathon Plan must be amended to provide that Appellants would be paid a minimum of $510 million (i.e., the Confirmation Date value of the Timberlands found by the Bankruptcy

[5] The apparent reason for the Appellees' initial disregard of this claim is that Appellees structured the MRC/Marathon Plan such that any allowed administrative claims would, in substance, reduce the distributions on the Appellants' Class 6 secured claims on a dollar-for-dollar basis. *See* Appellant 134 at Appendix A (defining "Class 6 Distribution Adjustment").

Court) on account of their secured claims.[6] The effect of this requirement was that, notwithstanding the provision for the "Class 6 Distribution Adjustment," (*see* note 5, *supra*) the distribution on account of the Appellants' secured claim could not be reduced on a dollar-for-dollar basis, without any limit, based upon the allowance of administrative claims (including any administrative claim allowed to the Appellants). Only after the Bankruptcy Court required this change did Appellees assert, for the first time during the afternoon session on June 6, 2008, that the 507(b) Motion had to be resolved promptly.[7]

After closing the evidentiary record on Confirmation and entering the Confirmation Findings, the Bankruptcy Court began the separate hearing on the 507(b) Motion, which was held from June 30, 2008, through July 2, 2008. As set forth in the "merits" briefs in this appeal, the Bankruptcy Court determined that Appellants were entitled to an additional $3.6 million on account of their interest in the Cash Collateral in existence on the Petition Date, Merits Brief at p.15, but denied the 507(b) Motion. *See* Brief at p. 5, 12-13. Immediately, Appellees agreed to pay the additional $3.6 million, demonstrating their ability to pay administrative claims that they had not previously anticipated.

Following the Bankruptcy Court's ruling on the 507(b) Claim, Appellees sought to have only one order—the Confirmation Order—entered. Appellants objected, and the Bankruptcy Court agreed that two orders were appropriate—an order confirming the MRC/Marathon Plan,

[6] Even in the face of this change, however, the provision of the Plan that permitted the filing of administrative claims in *unlimited* amounts for 30 days *after* the Effective Date was not changed.

[7] The Appellees seek to obfuscate the fact that they were the ones who (i) initially convinced the Bankruptcy Court to ignore the 507(b) Motion for more than one month after the Indenture Trustee's counsel specifically brought it to the attention of the Bankruptcy Court (as well as to MRC/Marathon), and then (ii) decided that it was important to resolve. At page 7 of the Memorandum, the Appellees state: "During a status conference later in the day [June 6, 2008], it was brought to the Bankruptcy Court's attention that until the Indenture Trustee's 507(b) Motion was resolved, the MRC/Marathon Plan could not be confirmed." Notably, the Appellees do not disclose who brought it to the Bankruptcy Court's attention and who previously told the Bankruptcy Court that there was no need to resolve it quickly. In both instances, it was the proponents of the MRC/Marathon Plan.

and a separate order disallowing the 507(b) Claim. Appellant 214 at pp. 154:11 - 159:24. The Bankruptcy Court entered both orders on July 8, 2008. The next day, July 9, 2008, Appellants filed notices of appeal from the Confirmation Order and separate notices of appeal from the 507(b) Order. Appellants directly appealed the Confirmation Order to the Fifth Circuit but, consistent with the separateness of the two proceedings, moved forward in this Court with the appeal from the 507(b) Order. In the Confirmation Appeal, Appellants challenge the MRC/Marathon Plan's *treatment* of the 507(b) Claim, but did not (and could not) challenge the Bankruptcy Court's disallowance of the 507(b) Claim. Appellees never sought to consolidate the two appeals.

4. Appellees Have Failed To Provide Any Evidence That This Court Is Unable To Award Any Relief Whatsoever To Appellants.

Appellees repeatedly assert (Memo. at p. 18) that the allowance of the 507(b) Claim "would result in unraveling the MRC/Marathon Plan." But there is no evidence in the record to support this assertion, and, in fact, the MRC/Marathon Plan would stay firmly in place. Appellees did not present any evidence to the Bankruptcy Court that demonstrates that they cannot: (i) pay $8.9 million relating to the improper deduction of an undisputed $8.9 million from the compensation to which Appellants were entitled from the Cash Collateral on hand on the Petition Date; (ii) pay $18 million relating to the depletion of Scopac's Cash Collateral to pay estate professional fees (from which Appellants received no benefit); and/or (iii) pay $136 million (or at least some portion thereof) relating to the decline in the value of the Timberlands from the Petition Date to the Confirmation Date. Nor do Appellees offer any such evidence

now.[8] In fact, the record shows that HRC will generate more than enough cash flow to pay the 507(b) Claim over time, even if it is allowed in full. *See* Appellant 243.

ARGUMENT

A. This Court Has Subject Matter Jurisdiction Over This Appeal Because It Is Separate And Distinct From Appeal From The Confirmation Order.

This Court has jurisdiction to hear appeals from bankruptcy court orders pursuant to 28 U.S.C. § 158(a)(1). Appellees argue that the pending Fifth Circuit appeal from the Confirmation Order divested this Court of subject matter jurisdiction over this Appeal. Appellees essentially contend that the subject matter of the direct appeal from the Confirmation Order to the Fifth Circuit, and that of the appeal of the 507(b) Order to this Court, are the same.

The record flatly belies this claim. Only the Confirmation Order is before the Fifth Circuit. The 507(b) Motion was denied in a separate order that is *not* before the Fifth Circuit but *is* the order from which all of the issues in this Appeal arise. Appellees' attempt to shoehorn the issues involved in this Appeal into the Confirmation Appeal ignores both this record and the fundamental distinction between the Bankruptcy Code's treatment of a claim under a plan (which is the subject of a plan and plan confirmation proceedings) and the allowance of a claim (which is the subject of separate claims allowance proceedings).

1. The Confirmation Process And The Hearing On The 507(b) Motion Were Separate Contested Matters.

Contrary to Appellees' position (Memo. at p. 14), the 507(b) Motion was not a "reconsideration" of the Confirmation Findings.[9] The 507(b) Motion proceeding was completely

[8] Appellees even failed to attach a declaration in support of the Motion filed with this Court. All Appellees attach (Motion at Exs. "A"-"C") is their motion to dismiss filed with the Fifth Circuit, the opposition thereto, and their reply, none of which even to cite to 11 U.S.C. § 507(b).

[9] The Bankruptcy Court never said that the 507(b) Order was a "reconsideration" of its Confirmation Findings, as Appellees contend (Memo. at p. 14). In the passage Appellees quote, the Bankruptcy Court questioned whether the 507(b) Motion *ought* to be a "reconsideration" of its Confirmation Findings, for purposes of determining whether the Court should order a separate order for the 507(b) Motion. Appellant 214 at pp. 18-19. The Bankruptcy Court

separate, as evidenced by several undisputed facts. *First*, the hearing on the 507(b) Motion did not even *begin* until the Bankruptcy Court closed the evidentiary record of the confirmation hearing and entered the Confirmation Findings. *Second*, the 507(b) Motion was a separate "contested matter" under Bankruptcy Rule 9014, with a separate briefing schedule, separate evidentiary hearings, and, most importantly, entry of separate orders. *Third*, the MRC/Marathon Plan specifically provided that any administrative claim could be filed within 30 days after the Effective Date. Thus, that Plan itself contemplated that proceedings for the allowance of administrative claims would be separate from the confirmation proceedings and from the Plan itself. *Fourth*, the Bankruptcy Court denied Appellees' request that the Bankruptcy Court combine its ruling on the 507(b) Motion and the Confirmation Order in one order, without entering a separate 507(b) Order.

What is more, Appellants filed separate notices of appeal from the Confirmation Order and the 507(b) Order. The appeals are before separate courts, and no attempt was ever made to consolidate them. Appellants' notices of appeal respecting their direct appeal to the Fifth Circuit sought *only* review of the Confirmation Order, Appellee 135, and invoked the Fifth Circuit's jurisdiction *solely* for issues resolved in the Confirmation Order. *See* FED. R. APP. P. 3(a)(2). The Fifth Circuit cannot exercise jurisdiction over issues resolved in orders that are not brought to it in the notice of appeal. *See e.g., Quave v. Progress Marine*, 912 F.2d 798, 801 (5th Cir. 1990) (holding that Fifth Circuit did not have jurisdiction to review a fee award in an appeal from a judgment because the notice of appeal made no reference to the fee award order).

Appellees cannot seriously contend that the Fifth Circuit would have jurisdiction over the separate 507(b) Order that was never brought before the Fifth Circuit. In fact, even if Appellants

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answered this question in the negative when it decided to issue a separate order. Appellees have taken the Bankruptcy Court's statement completely out of context.

had sought to bring issues related to the Bankruptcy Court's disallowance of the 507(b) Claim in the Confirmation Appeal—which, as explained below, they did not do—the Fifth Circuit would have refused to consider them, just as it did in *Quave*.

Appellees' contention (Memo. at p. 17) that the Fifth Circuit has jurisdiction over the issues in the 507(b) Motion simply because they voluntarily amended their Plan to accommodate the $3.6 million increase in distributions to Appellants that the Bankruptcy Court ordered also fails. Appellees' voluntary action cannot vitiate the separateness of the two appeals; nor can it bring the whole 507(b) Order appeal before the Fifth Circuit. Regardless, none of the issues in this Appeal relate to the manner in which their administrative claim was treated under the MRC/Marathon Plan; they related only to the issue of disallowance.

Similarly, Appellees' protests notwithstanding (Memo at p. 20), a reversal of the 507(b) Order will not compromise the MRC/Marathon Plan or "interfere with" or "circumvent" the Confirmation Appeal pending before the Fifth Circuit.[10] Although the Confirmation Appeal and this Appeal may concern related facts,[11] some factual overlap between different proceedings and

[10] Appellees cite (Memo. at p. 16) *In re Whispering Pines Estates, Inc.*, 369 B.R. 752 (1st Cir. B.A.P. 2007), in support of the proposition that a lower court should not exercise jurisdiction over issues that might "interfere with or effectively circumvent the appeal process." *Whispering Pines* concerned a debtor's plan of liquidation that provided a certain window of time for the debtor to market and, hopefully sell, a certain piece of real estate and that, failing a sale during the period, the property could be foreclosed upon. The *Whispering Pines* court held that an appeal from the order confirming the liquidation plan prevented the lower court from considering the mortgage lender's application for relief from the automatic stay, in which the lender requested the right to *immediately* foreclose on the same property (before the marketing period had expired). The court held that the lower court lacked jurisdiction to grant the relief sought because, if granted, an immediate foreclosure would "directly affect the outcome of the appeal" by undermining the entire plan. *Id.* at 761.

Whispering Pines is, however, inapposite here. As shown above, unlike the situation in *Whispering Pines*, the resolution of the present Appeal will have no effect on the Confirmation Order or the MRC/Marathon Plan. All of the transactions and distributions under the MRC/Marathon Plan would remain intact, which would not have been the case in *Whispering Pines*, where the relief requested by the secured creditor would have eliminated the marketing period that was the cornerstone of the debtor's plan there.

[11] For example, the Bankruptcy Court's confirmation-related finding that the value of the Noteholders' Timberlands collateral was $510 million is a factual predicate for the 507(b) Claim, to the extent that this confirmation valuation is the "endpoint" value by which the diminution in the value of the Appellants' Timberland collateral from the Petition Date is determined.

orders is common, especially in bankruptcy cases. Just because the issues in this Appeal relate, in part, to facts established by the Confirmation Order (such as the "endpoint" collateral value) does not mean that this Appeal will have any legal effect on the pending Confirmation Appeal. Indeed, in bringing this Appeal, Appellants assume (but do not concede) that the Confirmation Order will be not be reversed on appeal.[12]

Appellees cite (Memo. at p. 16) case law for the proposition that an appeal divests a lower court of, variously, "issues before the Circuit Court," "aspects of the case involved in the appeal," or "the same issue" involved in a circuit appeal, and that a lower court should not "intrude itself in the appellate decision process." While generally true, however, none of these statements affects this Court's jurisdiction over this Appeal, because there is no overlapping of the *legal* issues between this appeal and the appeal before the Fifth Circuit.

Appellees' reliance on *In re TransTexas Gas Corp.*, 303 F.3d 571 (5th Cir. 2007), is particularly puzzling, because, if anything, that case actually *supports Appellants'* position. There, the debtor filed a reorganization plan that provided for a 10% interest rate on the tax claims of the State of Texas. The taxing authorities appealed the bankruptcy court's confirmation order, challenging the 10% interest rate. After the notice of appeal was filed, the bankruptcy court issued two further orders that "clarified" the interest rate to be 10%—the same rate as in the plan, which the taxing authorities also appealed. *Id.* at 574. The district court dismissed the appeal of the confirmation order and the first "clarifying" order as moot, and then affirmed the second subsequent order. *Id.* at 576.

The taxing authorities then appealed again, but *only* from the affirmance of the *second subsequent order*. The Fifth Circuit dismissed the appeal for lack of jurisdiction. It determined

[12] If the Confirmation Order is reversed, it is possible that this Appeal would be moot because the factual predicate for the "endpoint" value will presumably have been eliminated.

that the appeal of the confirmation order divested the bankruptcy court of jurisdiction to issue the two subsequent orders, because those orders determined the *same* issues as that on the confirmation appeal (i.e., the interest rate). *Id.* at 578. The Fifth Circuit held that it could not issue effective relief because the only proper and effective order—the confirmation order—had never been presented to it. *Id*. Thus, the Court determined that it *did not* have jurisdiction over orders that had not been presented in the notice of appeal even though the issues on appeal from the second supplemental order were identical to those raised by the confirmation order.

TransTexas plainly does not support Appellees' jurisdictional challenge here, because the issues in this appeal are not the same as those before the Fifth Circuit on the Confirmation Appeal. In fact, *TransTexas* actually supports this Court's jurisdiction, because it suggests that the Fifth Circuit in the Confirmation Appeal took jurisdiction only over issues raised by the Confirmation Order, the only order listed in the notices of appeal for the direct appeal to the Fifth Circuit.[13]

This Court's jurisdiction finds further support in *In re Enron Corp.*, Civ.A. 01-16034, 2006 Bankr. LEXIS 4294 (Bankr. S.D.N.Y. Jan. 17, 2006), which rejected a challenge to a bankruptcy court's subject matter jurisdiction analogous to that which Appellees raise here. In *Enron*, certain creditors appealed from an order of the bankruptcy court sustaining the debtors' objections to the allowance of the creditors' claims, meaning that, for purposes of treatment (i.e., distribution) under the confirmed chapter 11 plan in that case, there was no final claim disallowance order, and the reorganized debtors would have to reserve for these disputed claims. *See id.* at *5-*6. However, the plan also permitted the reorganized debtors to seek to "estimate"

[13] Further, in contrast to *TransTexas*, there is no dispute here that the Bankruptcy Court did have jurisdiction to enter the 507(b) Order. Indeed, the MRC/Marathon Plan expressly provides that the Bankruptcy Court has post-confirmation jurisdiction to hear and determine objections to the allowance of administrative claims. *See* Appellant 134 (Confirmation Order) at ¶¶ 31, 51; *id*. (MRC/Marathon Plan) at Art. XII.

a claim and reserve for the claim based upon the ruling on claims "estimation." *See id.* at *7. Invoking this provision, the reorganized debtors sought to estimate the claims at issue at zero for purposes of establishing reserves under the confirmed plan. The creditors objected on the basis that the pending appeal from the claim disallowance order divested the bankruptcy court of jurisdiction to estimate the claim for purposes of establishing the reserve. *Id.* at *8.

The bankruptcy court held that it had jurisdiction to consider the estimation motion because, while the appeal from the claims disallowance order divested the bankruptcy court "of jurisdiction concerning the substantive issue of whether the claims were properly disallowed . . . this Court[] nevertheless retains jurisdiction to administer the case." *Id.* at *15. The court added, "[m]ore importantly, the terms of the Plan contemplate that an estimation proceeding may occur subsequent to any disallowance of such claim." *Id.*; *see also JPMorgan Chase Bank v. U.S. Nat'l Bank Ass'n (In re Oakwood Homes Corp.)*, 329 B.R. 19, 22 (D. Del. 2005).

Similarly, the MRC/Marathon Plan specifically provides that the Bankruptcy Court will retain jurisdiction to hear objections to the allowance of administrative claims after confirmation of the plan. Under the terms of the confirmed Plan, the Bankruptcy Court could have entered the separate 507(b) Order even in the face of a notice of appeal from the Confirmation Order. The substance of the appeal from the 507(b) Order is the allowed amount of the 507(b) Claim, not the terms of the MRC/Marathon Plan.

2. Appellees Obfuscate The Distinction Between The Treatment Of A Claim Under A Plan And The Allowance Of Such Claim.

Appellees contend that the issues surrounding the 507(b) Motion are intrinsically related to the Confirmation Appeal. This position, however, is based on a fundamental misunderstanding of the difference between the *treatment* of a claim under a plan of reorganization and the *allowance* of a claim. Under the Bankruptcy Code, treatment of claims

and allowance of claims are very different concepts, governed by different rules, and addressed in separate proceedings: The treatment of a claim is at issue when a creditor objects to confirmation of a plan (because the treatment of claims under a plan is at the core of any plan), but the allowance, disallowance, and amount of these claims should be handled separately, in a claims-allowance procedure.

This distinction is highlighted in the structure of the Bankruptcy Code itself. The *treatment* of claims under a plan is governed by the provisions of chapter 11 of the Bankruptcy Code that address the contents and confirmation of a plan. *See* 11 U.S.C. §§ 1123-24, 1129. For administrative claims such as the 507(b) Claim, section 1129(a)(9)(A) requires that the plan provide that, as of the plan effective date, "the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim . . ." (unless the claimants agrees to different treatment). By its terms, this provision does not specify how the amount of these administrative claims should be determined, but only how they must be satisfied, leaving open the question of whether and to what extent a claim becomes an "allowed" administrative claim.

That issue—the "allowance" of claims—is dealt with in an entirely different chapter of the Bankruptcy Code, Chapter 5. *See* 11 U.S.C. §§ 502-503. Bankruptcy Code section 503 specifically addresses the "Allowance of Administrative Expenses." Thus, the treatment of a claim and the allowance of a claim are very different matters.[14]

The MRC/Marathon Plan itself maintain this distinction. Section 2.1 of the MRC/Marathon Plan provides that:

> **2.1 Administrative Expense Claims**. On the later of (i) the Effective Date or (ii) the date on which an Administrative Expense Claim becomes *Allowed*, the

[14] This bifurcation is carried through in the Federal Rules of Bankruptcy Procedure, which treat a proceeding on the allowance of a contested claim and a proceeding on confirmation of a plan as separate and distinct proceedings - "contested matters" governed by separate rules. *See* FED. R. BANKR. P. 3007 (governing objections to claims); 3020 (governing objections and the hearing on confirmation of a chapter 11 plan); 9014 (describing "contested matters").

> Reorganized Entities shall either (x) pay to each Holder of an *Allowed* Administrative Expense Claim, in Cash, the full amount of such *Allowed* Administrative Expense Claims, or (y) satisfy and discharge such Administrative Expense Claim in [a manner] agreed upon in writing:…

(emphasis added). Thus, consistent with Bankruptcy Code sections 1123 and 1124, the Plan provides a mechanism for the satisfaction of administrative claims. The Plan does not, however, establish the amount in which any particular administrative claim (including that of the Indenture Trustee) is "allowed." Rather, the Plan defines an "Allowed Claim," in pertinent part as one

> as to which no objection to the allowance thereof . . . has been interposed within the applicable period of limitation . . . , or *as to which an objection has been interposed and such claim has been allowed in whole or in part by a Final Order*.

Appellant 134 at Appendix A (emphasis added). By its terms, the MRC/Marathon Plan addressed only the manner in which an "allowed" administrative claim should be *treated*, but left the process of "allowance" to the entry of a separate order in a claims allowance proceeding.

The Bankruptcy Court recognized this distinction when it entered a separate order on the 507(b) Motion. The entry of that separate order reflected the fact that a proceeding on the allowance of a disputed claim is a separate "contested matter" under the Federal Rules of Bankruptcy Procedure ("FRBP"). FRBP 9014(a) states that, "[i]n a contested matter not otherwise governed by these rules, relief shall be requested by motion . . . ." An objection to an administrative expense claim is a "contested matter" within the meaning of FRBP 9014(a). *See, e.g., Toma Steel Supply, Inc. v. Transamerican Natural Gas Corp. (In re Transamerican Natural Gas Corp.),* 978 F.2d 1409, 1416 (5th Cir. 1992). Plan confirmation proceedings are also "contested matters," but are subject to different rules. *See* FED. R. BANKR. P. 3016-21. The MRC/Marathon Plan, typical of the vast majority of chapter 11 plans, expressly provided that objections to administrative claims could (and would) occur after MRC/Marathon Plan's

Effective Date. *See* Appellant 134 (Confirmation Order) at ¶¶ 31, 51; *id*. (MRC/Marathon Plan) at Art. XII.

Had Appellants not appealed from the separate 507(b) Order, they would have been barred from challenging the disallowance of the administrative claim in any other proceeding—including in connection with the Confirmation Appeal. *See* FED. R. BANKR. P. 8001(a); *see also Zer-Ilan v. Frankford (In re CPDC Inc.)*, 221 F.3d 693, 698 (5th Cir. 2000) (noting that the failure to file a notice of appeal deprives the reviewing court of jurisdiction and mandates dismissal); *Quave v. Progress Marine*, 912 F.2d 798, 801 (5th Cir. 1990). The disallowance of such administrative claims was not an issue in the Confirmation Appeal, and could only be an issue on appeal from the 507(b) Order.

3. It Is Irrelevant To This Appeal That Certain Of Appellants Included, As An Issue On The Confirmation Appeal, Whether The MRC/Marathon Plan Failed To Provide For The Payment In Full Of The 507(b) Claim.

Appellees argue (Motion at ¶ 19) that certain Appellants included as one of the issues on appeal to the Fifth Circuit whether the Plan adequately provided for payment in full of the Indenture Trustee's superpriority claim. The issue to which they point is:

> [W]hether the Bankruptcy Court erred as a matter of law in concluding that the MRC/Marathon Plan satisfies 11 U.S.C. § 1129(a)(9) because it does not adequately provide for payment in full of the Indenture Trustee's superpriority claim asserted under 11 U.S.C. §§ 507(b) . . . .

Memo. at p. 18.[15] Appellees go (Memo. at p. 17 and n.6) so far as to seek judicial estoppel against the Indenture Trustee because of a statement the Indenture Trustee made in connection with a request to have the Fifth Circuit certify the Confirmation Order for direct appeal.

The issue raised in connection with the Confirmation Appeal, however, is whether, if the 507(b) Claim was allowed, the MRC/Marathon Plan appropriately provided for its payment. In

[15] The Indenture Trustee and another set of Appellants did not include the identified issue as an issue for the appeal from the Confirmation Order.

contrast, the issue on this Appeal is not whether the MRC/Marathon Plan complied with section 1129(a)(9)(A) of the Code in the Plan's treatment of Appellants' administrative claim, because that issue does not arise out of the Bankruptcy Court's denial of the 507(b) Motion. The issue on this Appeal is the amount of the 507(b) Claim, not whether that Claim is treated properly under the MRC/Marathon Plan.

B. This Appeal Is Not Equitably Moot Because This Court Can Fashion Relief Of Some Kind For Appellants Without Adversely Affecting The Rights Of Third Parties.

In arguing that this Appeal should be dismissed as equitably moot, Appellees do little more than re-hash the same arguments they made to the Fifth Circuit in connection with their motion to dismiss the Confirmation Appeal. This effort to conflate the Confirmation Appeal and this Appeal (from a claims disallowance order) and to apply equitable mootness to both ignores the fundamental difference between the two orders. Indeed, Fifth Circuit and other circuit-level authority strongly suggests that appeals from claims disallowance orders would not be subject to dismissal on equitable mootness grounds. *Cf. In re SI Restructuring, Inc.*, 542 F.3d 131, 137 (5th Cir. 2008) (appeal seeking recovery of funds paid to appellee's counsel not moot despite confirmation and substantial consummation of a plan); *Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944, 953 (2d Cir. 1993) (the court could fashion effective relief on appeal from order disallowing administrative claim by remanding with instructions to the bankruptcy court to order the return of any funds that were erroneously disbursed).

Moreover, this Appeal cannot be dismissed as equitably moot as long as this Court can fashion any effective relief. *See, e.g, In re Hilal*, Case No. 07-20571, 2008 U.S. App. LEXIS 14318, at *3 (5th Cir. July 8, 2008); *In re Manges*, 29 F.3d 1034, 1042-43 (5th Cir. 1994); *In re Sun Country Dev., Inc.*, 764 F.2d 406, 407 n.1 (5th Cir. 1985). As demonstrated below, Appellees have not sustained their heavy burden to demonstrate that no relief of any kind can be

afforded to Appellants in this Appeal. *See, e.g.*, *Suter v. Goedert*, 504 F.3d 982, 986 (9th Cir. 2007) (the "party asserting mootness has the heavy burden of establishing that there is no effective relief remaining for the Court to provide")

1. Because the MRC/Marathon Plan Expressly Provided That The Reorganized Debtor Would Pay All Allowed Administrative Claims And Permitted The Assertion Of Such Claims For 30 Days *After* The Plan's Effective Date, This Appeal Cannot Be Equitably Moot.

The MRC/Marathon Plan expressly gave administrative claimants up to 30 days after that Plan's Effective Date to file administrative claim requests, and in no way limits the amount that HRC would be bound to pay on such claims. The allowance of the 507(b) Claim would not require the return of any distribution made to any other creditor under the MRC/Marathon Plan. Thus, relief in this Appeal cannot result in the "unraveling" of that Plan or harm any third parties who are not currently parties to this Appeal.

A hypothetical exposes the logical fallacy of Appellees' position. Suppose that Appellants had never filed their superpriority administrative claim, but that, instead, individuals harmed by toxic waste illegally dumped by Scopac after the Petition Date filed administrative claims totaling $200 million within 30 days of the Effective Date. The MRC/Marathon Plan permitted the filing of such claims and, if they were allowed, required HRC to pay those amounts, just as any debtor in possession would be required to pay postpetition environmental or tort damages. *See Reading Co. v. Brown*, 391 U.S. 471 (1968). Appellees could not legitimately suggest that such an administrative expense request, or an appeal from an order denying it, would be equitably moot. Under the MRC/Marathon Plan, the 507(b) Claim is treated no differently.

2. Reversal Of The 507(b) Order Would Not Adversely Affect Any Third Parties.

Without any evidence to support them, Appellees argue (Memo at p. 22) that reversal of the 507(b) Order would adversely affect third parties. This statement is incorrect because no third parties' rights under the confirmed Plan would be affected or altered by the allowance of the 507(b) Claim. The allowance of that claim in some amount following a reversal on appeal of the 507(b) Order would simply result in HRC being obligated to pay that claim. The allowance of the 507(b) Claim would not require any creditor who received a distribution under the MRC/Marathon Plan to return a single penny of that distribution because the Plan imposes the obligation to pay such administrative claims solely on Appellees' wholly-owned subsidiary, HRC. Since no third parties' rights would be affected or altered, this Appeal is not equitably moot. *See SI Restructuring*, 542 F.3d at 137.

The Third Circuit's decision in *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996), heavily relied on by Appellees, is inapposite. In *Continental Airlines*, the debtor proposed a plan of reorganization pursuant to an investor agreement that required the reorganized debtor to pay allowed administrative claims in full, but specifically provided that "the Investors' obligation to proceed with the arrangements was subject, *inter alia*, to the payments and obligations for administrative claims being no higher that a specified amount, or 'cap.'" *Id.* at 563; *see also* 556. During the confirmation hearing (i.e., while the confirmation evidentiary record was still open), the bankruptcy court addressed one administrative claim that, if allowed, would cause the cap to be exceeded. The bankruptcy court disallowed the claim as part of the confirmation hearing and incorporated the disallowance of the claim into the Confirmation Order itself. *Id.* at 563.

In contrast, the MRC/Marathon Plan includes no condition "capping" Appellees' exposure for paying allowed administrative claims—a condition to which the Third Circuit repeatedly referred—and expressly permitted administrative claims in unlimited amounts to be filed for 30 days after the Effective Date. *See id.* at 556, 563-64.

In any event, the majority's opinion in *Continental Airlines* is not binding on this Court. This Court may and should follow the better-reasoned approach taken by Justice Alito (then a judge of the Third Circuit) in his dissenting opinion in *Continental Airlines*. That dissent is far more consistent with the overriding principle that an appeal is not equitably moot unless there is no possible relief that the appellate court could grant. As explained by Justice Alito:

> The [creditors] are not seeking to upset the plan of reorganization; rather, they are attempting to obtain payments that they claim are due to them *pursuant* to that plan. Moreover, even if the success of the reorganization might be imperiled if the [creditors] obtained the full relief that they are seeking—an empirical proposition that is not self-evident—the courts could surely fashion some measure of lesser relief that would not disturb the reorganization. In order to justify its decision, which slams the courtroom door on the [creditors] before they are even heard on the merits, the majority would have to show that the [creditors] could not be awarded *any relief*—not one dollar-without upsetting the Continental reorganization, and obviously they cannot do that.

Id. at 571 (Alito, J., dissenting) (emphasis in original). Justice Alito's statement comports with Fifth Circuit precedent—where a creditor is seeking a type of payment in order of priority and third-party creditors would not have to repay the estate, an appeal from the denial of such payment is not equitably moot. *See In re Grimland*, 243 F.3d 228, 232 (5th Cir. 2001) (where the result of an appeal of an administrative claim would not formally reorder the priorities of claims under a plan, the appeal is not equitably moot); *see generally* Fifth Circuit Oral Argument, Oct. 6, 2008, at 10 (Chief Judge Edith Jones) (noting Justice Alito's dissent), *available at* http://www.ca5.uscourts.gov/OralArgumentRecordings.aspx?prid=280244.

Appellees' reliance (Memo. at pp. 20-22) on *In re GWI PCS I, Inc.*, 230 F.3d 788 (5th Cir. 2000), is likewise misplaced, because the appellate relief sought there would have affected the rights of investors in the reorganized debtor who were not parties to the appeal. In addressing the "Effect On Parties Not Before The Court," 230 F.3d at 802, the *GWI PCS* court focused on the fact that a reversal on appeal that imposed an additional $894 million obligation on the subsidiary debtors "would have a detrimental effect on the *post-bankruptcy investors and entities* and on the success of the Business Alternative, which was the route preferred by the majority of the bankruptcy participants in resolving the debtors' chapter 11 petition." *Id.* Here, in contrast, MRC, Marathon and their wholly-owned company, HRC, do not qualify as "parties not before the Court" or "post-bankruptcy investors and entities," but, rather, were plan proponents and are parties to this appeal. Moreover, in contrast to *GWI PCS*, the resolution of this appeal will not affect the other "bankruptcy participants" (other creditors), because the distributions to those creditors will in not be affected by the outcome of this appeal.

Indeed, a subsequent district court decision examining *GWI PCS* highlights the importance of this distinction, and makes clear that where third parties are not affected and the plan will not "unravel," an appeal is not equitably moot. In *In re Equinox Oil Co.*, Civ.A. 00-3320, 2001 U.S. Dist. LEXIS 8165 (E.D. La. June 11, 2001), the appellees in an appeal from an order of the Bankruptcy Court resolving a dispute over insurance proceeds argued that the appeal should be dismissed as equitably moot, "because the debtor's chapter 11 plan was substantially consummated." *Id.* at *25. The district court *rejected* this argument, reasoning that even though the appellants had not sought a stay pending appeal, and the plan had been substantially consummated, "the Debtor has failed to show that granting the M&M holders priority would unravel the plan and divest rights acquired by third parties who relied on the finality of the plan."

Id. at *31. In reaching this result, the District Court also noted, "the dangers associated with allowing the bankruptcy court to be the de facto final decision maker of a controversy merely by confirming a plan of reorganization and denying a motion for a stay." *Id.* at *32.

Resorting to hyperbole, Appellees contend that reversing the 507(b) Order would eliminate the "'benefits [they] bargained for' by destroying the reorganized companies into which they have invested over a half a billion dollars." *See* Memo. at p. 24 (quoting excerpt from *In re Crystal Oil Co.*, 854 F.2d 79, 81 (5th Cir. 1988)). The fact is, however, that Appellees here "bargained for" a Plan that obligated HRC to pay all allowed administrative claims, without any "cap" on administrative claims, and permitted administrative claims in unlimited amounts to be asserted for up to 30 days after the Effective Date.

3. There Is No Evidence To Support The Proposition That Allowing Any Of The Sub-Claims That Form The 507(b) Claim Would Unravel The Plan.

Appellees cannot satisfy their burden of demonstrating that there is ***no*** relief that this Court could grant, because they did not present any evidence to the Bankruptcy Court that they would be unable to pay any of the sub-claims that make up the 507(b) Claim, including at least a portion of the claim for the diminution in value of the Timberlands collateral. The projections relied upon by MRC/Marathon during the Confirmation Hearing show that during 2009 and 2010 HRC is projected to generate free cash flow of approximately $11.3 million and $15.5 million, respectively. Appellee 243. By 2013 (5 years after confirmation), HRC is projected to generate approximately $17.6 million in free cash flow. *Id.* Moreover, by the end of the projection period, HRC projects nearly $200 million a year in free cash flow. *Id.* Over time HRC will generate cash flows that are more than ample to satisfy the 507(b) Claim, without jeopardizing the success of the Plan.

Indeed, Appellees' conduct underscores the point that some relief is possible in this Appeal. Appellees' prompt readiness to agree to pay the additional $3.6 million directed by the Bankruptcy Court in connection with the denial of the 507(b) Motion belies the notion that Appellees cannot pay even one dollar of the three sub-claims that form the 507(b) Claims.

The Second Circuit has addressed this issue in *Chateaugay*. In that case, the debtors confirmed and substantially consummated their plan of reorganization. 10 F.3d at 948. Frito-Lay sought a determination on appeal that certain safe-harbor lease indemnification claims should be treated as administrative priority claims pursuant to section 365, 503, and 507 of the Bankruptcy Code. *Id*. at 950. The debtors argued that the claims of Frito-Lay were equitably moot because the debtors' plan was confirmed and consummated, and that requiring the debtors to pay the $20 million administrative claim would "unravel" the confirmed plan. *Id*. at 952-53. The *Chateaugay* court held that the appeal was not equitably moot because effective relief could be fashioned without imperiling the debtors' fresh start, even though any finding in favor of Frito-Lay would necessarily require the return of wrongfully distributed or wrongfully re-vested funds in one or more entities, some of which were not even before the court. *Id*. at 953.

In language that resonates here, the Second Circuit observed that "[a] claimant should not be out of court on grounds of mootness solely because its injury is too great for the debtor to satisfy in full." *Id*. at 954. Any claimant would be foolish not to accept some form of recovery "that does not impair feasibility or affect parties not before this Court, rather than suffer the mootness of its appeal as a whole." *Id*.

The fact that the allowance of an administrative claim would require Appellees to share some of their future profits is hardly grounds for dismissal.

CONCLUSION AND PRAYER

Based on the facts and authorities set forth above, Appellants respectfully request that this Court deny Appellees' Motion, consider the merits of this Appeal, and reverse the entry of the 507(b) Order.

Dated: December 19, 2008
Houston, Texas

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of Appellants' Opposition to Motion of Appellees Mendocino Redwood Company, LLC and Marathon Structured Finance Fund L.P. to Dismiss Appeal has been served on counsel listed below by CM/ECF and electronic mail on this 19th day of December, 2008.

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