No. 08-40746

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

In the Matter of: PACIFIC LUMBER CO.; and SCOTIA PACIFIC CO. LLC, *Debtors*

BANK OF NEW YORK TRUST CO. NA, as Indenture Trustee for the Timber Notes; ANGELO GORDON & CO. LP, AURELIUS CAPITAL MANAGEMENT LP, and DAVIDSON KEMPNER CAPITAL MANAGEMENT LLC; SCOTIA PACIFIC COMPANY LLC, CSG INVESTMENTS; and SCOTIA REDWOOD FOUNDATION, INC.,

***Appellants*,**

v.

OFFICIAL UNSECURED CREDITORS' COMMITTEE; MARATHON STRUCTURED FINANCE FUND LP; MENDOCINO REDWOOD COMPANY LLC; THE PACIFIC LUMBER CO.; UNITED STATES JUSTICE DEPARTMENT; and CALIFORNIA STATE AGENCIES,

Appellees.

On Direct Appeal from the United States Bankruptcy Court for the Southern District of Texas, Corpus Christi Division (Case No. 07-20027)

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(1) No. 08-40746; *Bank of New York Company, NA. as Indenture Trustee for the Timber Notes et al. vs. Official Unsecured Creditors' Committee et al.*

(2) The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

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Marathon Structured Finance Fund L.P. (Marathon Asset Management, LLC ("MAM") is a Delaware limited liability company that serves as the investment advisor to a family of funds. MAM is privately held and is a investment advisor registered with the SEC under the Investment Advisors Act. All of the funds that MAM advises are privately held, with limited partners in the United States and shareholders for certain funds incorporated in the Cayman Islands. MAM's affiliate Marathon Structured Finance Fund, L.P. was a creditor of Palco. Town of Scotia Company LLC now owns assets of the Debtors and has distributed its membership interests to Marathon Special Opportunity Fund, L.P. and MSOF Town of Scotia Corp.)	David Neier William Brewer Steven M. Schwartz Carey D. Schreiber Winston & Strawn, LLP New York, New York Eric E. Sagerman Winston & Strawn, LLP Los Angeles, California John D. Penn Haynes & Boone, LLP Ft. Worth, Texas Trey Monsour Alan Wright Haynes & Boone, LLP Dallas, Texas

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September 8, 2008

STATEMENT REGARDING ORAL ARGUMENT

This case has been set for oral argument on October 6, 2008 at 9:00.

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Appellees Marathon Structured Finance Fund L.P. (“Marathon”) and Mendocino Redwood Company LLC (“MRC”) have moved to dismiss this appeal from an order (the “Confirmation Order”) of the Bankruptcy Court for the Southern District of Texas (“Court”), which confirmed the MRC/Marathon Plan (the “Plan”) for reorganizing Debtors Palco and Scopac. After two lower courts and this Court all denied a stay pending appeal, the Plan was substantially consummated, thereby rendering this appeal equitably moot.

We show herein that if this Court reaches the merits, the Confirmation Order (Excerpt-H)[1] should be affirmed. Many of the appellant Noteholders’ arguments are just camouflaged efforts to challenge the Bankruptcy Court’s well-supported factual valuation finding (Excerpt-G). To the limited extent the Noteholders actually raise legal issues, the Court applied well-settled law in confirming the Plan.[2]

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[1] Record Excerpts are cited as Excerpt-#. Citations to items in the Court docket are to R.[volume number]:[page number assigned by clerk]. Transcripts are cited to the record volume number. Trial exhibits are cited by their designation number as Appellant-# or Appellee-#.

[2] References to the “Noteholders” includes all appellants: The Bank of New York as Indenture Trustee and the individual Noteholders.

COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Did the Court commit clear error in finding that the Plan pays the Noteholders cash equal to the full value of the assets in which they had a security interest and thus gives them the "indubitable equivalent" of their secured claim?

2. Does the Plan violate the absolute priority rule as to the Noteholders' secured claim even though the Plan provides for the full cash payment of that claim?

3. Given that the Plan satisfies §1129(b)(2)(A)(iii) of the Bankruptcy Code by providing the Noteholders the indubitable equivalent of their secured claim, was the Plan also required to let the Noteholders credit bid their claim under an alternative provision, §1129(b)(2)(A)(ii)?

4. Did the Court commit clear error in determining that the Plan does not substantively consolidate the Debtors because, *inter alia*, none of Scopac's assets were diverted to Palco's creditors, the joint Plan treated Palco and Scopac separately, and there was no pooling of Palco's assets with Scopac's assets?

5. Does the Plan fail to provide for payment of Scopac's administrative claim against Palco, even though its terms require payment and the Court included the amount of that claim in the sum paid to the Noteholders?

6. Did the Court commit clear error in finding (a) that good business reasons exist for classifying Scopac's trade claimants separately from the

Noteholders' unsecured deficiency claim and (b) that Bank of America's claim is impaired for voting purposes?

7. Did the Court commit clear error in finding that the Plan does not unfairly discriminate against the Noteholders' unsecured deficiency claim by paying $500,000 to Scopac's trade creditors based on evidence that such payment is necessary to the success of the reorganized entities?

8. Are the Plan's standard exculpation provisions improper where the Court found that they were essential to implementing the Plan, integral to the settlements and transactions incorporated into the Plan, materially beneficial to the Debtors and creditors, important for the final resolution of the claims and the overall objectives of the Plan, and consistent with the Code?

STATEMENT OF FACTS

A. The Debtors and Their Creditors

Pacific Lumber Company ("Palco") owned and operated a sawmill, a cogeneration plant, and the Town of Scotia, California. Excerpt-G p.2. Palco also owned 100% of the stock of Scotia Pacific Company LLC ("Scopac"). Scopac owned and operated over 200,000 acres of timberlands (the "Timberlands") in Humboldt County, California. *Id.* Because Scopac sells its logs almost exclusively to Palco, Scopac's operations are completely integrated with Palco's. *Id.* ¶228. Both companies' operations are extensively regulated by the federal

government and State of California. *Id.* ¶¶245-48. Any entity seeking to own and operate the Timberlands must be approved by the State of California after a detailed investigation. *Id.* ¶247.

Starting in 2004, "thorough[] but unsuccessful[]" efforts were made "in several different ways" to sell Palco and Scopac so as to repay amounts owed to their creditors. *Id.* ¶249. This involved "a broad and thorough process," including contacting over 100 potential purchasers. *Id.* ¶250. The lack of success reflected the companies' "low value." *Id.*

On January 18, 2007 (the "Petition Date"), Palco and Scopac filed petitions for reorganization under chapter 11 of the Bankruptcy Code.[3] *Id.* ¶3. Following certain post-petition financing, Palco owed Marathon $160 million of senior secured debt. *Id.* ¶11. As of the Petition Date, Scopac owed approximately $714 million to the Noteholders, who alleged they had a lien on substantially all of Scopac's assets. Appellant-644 p.24. Scopac also owed $36.2 million to Bank of America, which had a lien on the same assets and a right to payment ahead of the Noteholders. *Id.* p.25; Appellant-514 §7.7.

B. <u>The Competing Plans</u>

After almost a year of bankruptcy proceedings, the Court modified the Debtors' exclusive period to allow parties other than the Debtors to file

[3] All citations to the Bankruptcy Code (the "Code") are to 11 U.S.C.

reorganization plans. Excerpt-G ¶12; R.31:008859-61. Five plans were filed, including three that the Debtors proposed but later withdrew. Excerpt-G p.2, ¶¶15, 26-27.

A joint plan covering each Debtor was proposed by Marathon, the Official Committee of Unsecured Creditors ("Committee"), and MRC. *Id.* ¶¶15, 23. MRC, which is not a creditor or shareholder of either Debtor, owns 230,000 acres of timberlands in the county adjacent to Scopac's Timberlands and (through affiliates) a sawmill and lumber distribution business. *Id.* ¶46, Appellant-638 ¶9. The Court found that MRC is "an experienced, environmentally responsible operator with a proven track record, and whose experience in operating timberlands and working cooperatively with government regulators was uncontroverted at the confirmation hearing." Excerpt-G p.3, ¶¶47-54. MRC's involvement will produce synergies saving the reorganized company some $10 million annually. *Id.* ¶32.

The Plan proposed to reorganize each of the Debtors in order to place the Timberlands and sawmill into a new entity called Newco and the Town of Scotia into another called Townco. Excerpt-G ¶¶28, 36. It also proposed that MRC and Marathon would contribute $580 million in cash, and that Marathon would convert its $160 million of debt into equity and contribute the sawmill and its working capital to Newco. *Id.* ¶¶29-30. MRC would receive 85% of Newco's equity while

Marathon would receive 15% of Newco's equity and 100% of Townco's. Excerpt-G, p.97.

Under the Plan, creditors of Palco and creditors of Scopac were classified and treated separately, and the creditors of each Debtor voted in separate classes. Appellant-649 pp.5, 10-11. As to Scopac's creditors, the Plan proposed to (i) pay the Noteholders $530 million (subject to adjustment) on the Effective Date (Excerpt-G p.5); (ii) pay Bank of America its outstanding principal and non-default interest on the Effective Date plus default interest over 12 monthly installments (*id.* ¶39); (iii) fully pay all allowed administrative and priority claims (*id.* ¶40); and (iv) pay $500,000 to Scopac's trade creditors (R.12:002465). As to Palco's creditors, the Plan proposed to (i) pay $10.1 million to Palco's unsecured creditors (*id.*); (ii) provide certain interests in Newco and Townco to Marathon (*id.* ¶30); and (iii) fully pay all allowed administrative and priority claims (*id.* ¶40). The Plan also proposed to create a litigation trust for the benefit of the Debtors' unsecured creditors. *Id.* ¶37.

The Noteholders, by contrast, proposed a plan for Scopac only (the "IT Plan") that would liquidate Scopac by auctioning its assets. *Id.* p.3, ¶¶62-63.[4] In support of their plan, the Noteholders, with the assistance of a major investment banking firm, "actively sought other bidders throughout" the bankruptcy case. *Id.*

[4] Without access to logs from the Scopac Timberlands, the Palco mill would close within a very short time. *Id.* ¶229.

¶252. Although numerous entities expressed interest in the Timberlands, and although the Court reopened the record to allow the Noteholders to come forward with any bids, no binding bid for the Timberlands was ever submitted. *Id*. ¶¶259-77, 301-12.

The Plan proposed by MRC/Marathon was accepted by more than 95% of Scopac's unsecured creditors in number and more than 99% of Scopac's unsecured creditors in dollar amount, excluding the Noteholders. Appellant-649 pp.5, 10-11. It was also accepted by 98% of Palco's unsecured creditors in number and more than 99% of Palco's unsecured creditors in dollar amount. *Id*. Only the Noteholders' classes voted to reject the Plan. *Id.* The Plan also had "widespread support of the various governmental and regulatory agencies that oversee the Debtors and the Timberlands" as well as numerous other constituencies. *Id*. ¶¶78-91. By contrast, the IT Plan was supported only by the Noteholders. *Id*. ¶77.

C. The Confirmation Hearings and Order

Following extensive discovery, a trial with respect to confirmation of the competing plans began on April 8, 2008 (the "Confirmation Hearing"). Over 25 fact and expert witnesses testified live or through deposition and hundreds of exhibits were admitted into evidence.

On June 6, 2008, the Court issued a 119-page decision containing findings of fact and conclusions of law. Excerpt-G. Most importantly, the Court found that

the value of the Noteholders' collateral in the Timberlands was no more than $510 million, and hence that the Noteholders would be paid in full on their secured claim as long as the Plan paid them that amount. *Id*. pp.9, 61, 114. There were two components to this core finding: valuation evidence and market test evidence.

With respect to the former, the Court evaluated the extensive expert testimony and factual evidence, made credibility findings as to various experts, and, rather than adopting any expert's valuation, reached its own valuation. *Id*. pp.9, 31-61. Indeed, not only was the Court's $510 million figure some $80 million higher than the $430 million figure testified to by MRC/Marathon's expert (*id*. ¶93), it was above the $290-$460 million and $375-500 million ranges set forth in a declaration from the Noteholders' own valuation experts in September 2007 (*id*. ¶171).

With respect to the latter, the Court found that the Timberlands had been subject to an "ample market test" over a lengthy period — including extensive sales efforts before the bankruptcy, the lifting of exclusivity, and the Noteholders' intensive efforts during the bankruptcy case to find bidders. *Id*. ¶253, p.115. Tellingly, no binding bid for the Timberlands had been submitted, much less one that offered more than the amount provided under the Plan. *Id*. pp.9, 118, ¶¶249-53, 259-87, 301-12.

The Court conditioned confirmation of the Plan on several technical modifications. To avoid any risk that any assets of one Debtor might be used to pay claims against another, the Court required that separate litigation trusts be established for Scopac and Palco, with the Scopac trust being for the benefit of the Noteholders. *Id*. pp.7-8. In addition, because there was insufficient evidence to value the so-called Headwaters Litigation, the Court required that it be placed in the Scopac trust and that the Noteholders retain any lien they might have. *Id*. p.8. Finally, the Court ruled that the Plan must be modified to provide the Noteholders with at least a minimum distribution of $510 million. *Id.* p.6. The Court found that with those modifications, the Plan gives the Noteholders everything to which they could be entitled: cash payment equal to the full amount of their secured claim in Scopac's assets, a separate Scopac litigation trust, and a lien on the Headwaters Litigation. *Id*. p.9.

By contrast, the Court found that the IT Plan was not confirmable because, *inter alia*, no binding "stalking horse" bid had been made, there was no evidence that any ultimate winning bidder would receive the numerous required regulatory approvals, there was no showing as to how the various costs required under the plan would be paid, and it was "not proposed in good faith … because it is laden with conflicts of interest …." *Id*. pp.3-4, 118-19. The Court also found that the IT

Plan would pay Noteholders less than they will receive under the MRC/Marathon Plan. *Id*. ¶¶278-93.

As a result of the Court's decision to confirm the Plan, the Noteholders asserted a superpriority claim in an amount exceeding $200 million. R.20:005057-61. Because that claim would have rendered the Plan unconfirmable, the Court held an additional three-day trial. R.120, 8:11-14:24. The Court thereupon denied the Noteholders' motion for a superpriority claim but amended the confirmation findings to require payment to the Noteholders of $513.6 million instead of $510 million, to reflect the Noteholders' lien on Scopac's assets other than the Timberlands and to ensure that the Noteholders receive a distribution equal to the higher of the value of their collateral on the Petition Date and the confirmation date. R.128. The Plan was duly modified to comply with the Court's conditions. Excerpt-H, Attachment; R.12-13:002452-504. The Court thereupon entered the Confirmation Order. Excerpt-H; R.12-002336-2451.

SUMMARY OF ARGUMENT

1. The Court correctly perceived that "[t]he ultimate issue in this case is value." Excerpt-G p.8. On that key factual issue, the Court held that the value of the Noteholders' security interest in all of Scopac's assets — including the non-Timberland collateral as well as the Timberlands — was no more than $513.6 million. That finding is buttressed by extensive evidence and thus is not clearly

erroneous. Because the Plan paid the Noteholders $513.6 million on the Effective Date, it provided them the "indubitable equivalent" of their secured claim.

The Noteholders assert that a higher offer was available, but the Court found on ample evidence and for multiple reasons that it was "not a serious bid." *Id.* p.4. The Noteholders also argue that the Court had to value their collateral through an auction rather than a valuation hearing. That unprecedented assertion would effect a sea change in the law, because the judicial valuation of collateral underlying secured claims is a standard feature in cramdown cases and is plainly contemplated by the Code. In any event, the Court found that the Timberlands had been subject to "an ample market test" through extensive sales efforts both before and during the bankruptcy case. *Id.* ¶253.

2. Because the Plan pays the Noteholders the full value of their secured claim, the Plan by definition cannot be said to have violated the absolute priority rule as to the Noteholders' claim. This is so because, even if applicable, the rule prohibits payment on a junior claim only if the senior claim is not being paid in full. Ignoring that dispositive point, the Noteholders advance the logical fallacy that there should not be any funds available to pay junior creditors because the Noteholders had a security interest in all of Scopac's assets. That argument is refuted by the Court's findings, and the supporting evidence, that (a) Scopac's secured creditors (the Noteholders and Bank of America) are in fact being paid the

full value of all of Scopac's assets, and (b) MRC and Marathon, for their own good business reasons, are investing additional money to pay junior creditors.

3. Because the Plan satisfies the "fair and equitable" requirement of §1129(b)(2)(A) by providing the Noteholders with the indubitable equivalent of their secured claim, the Plan was not required to also give the Noteholders an opportunity to credit bid under an alternative provision of that section. Section 1129(b)(2)(A) is written in the disjunctive, making clear that its three clauses are alternatives to one another. Moreover, the alternative provision relied on the Noteholders does not even apply here because, as the Court correctly found, the Plan involves a reorganization and hence the Debtors' asserts were transferred rather than sold.

4. The Noteholders' substantive consolidation argument is premised on the factually mistaken assertion that value from Scopac's assets is going to Palco's creditors. To the contrary, as already shown, the Court unimpeachably found that the Noteholders received the full value of Scopac's assets (net of deductions not challenged here). Moreover, the Plan kept the Debtors separate for classification, voting, and other purposes.

5. The Noteholders' remaining arguments are without merit. Their assertion that Scopac's administrative claim against Palco was not paid under the Plan is factually mistaken, as the Court found. Equally meritless are their efforts to

establish that no impaired class voted for the Plan. First, the Court found on the record evidence that there were good business reasons for classifying Scopac's trade creditors (Class 8), who voted for the Plan, separately from the Noteholders' unsecured deficiency claim (Class 9). Likewise, Bank of America's Class 5 secured claim, which voted for the Plan, was properly treated as impaired because the deferred payment of default interest was the result of a genuine compromise. Next, the Court correctly found that the payment of $500,000 to Scopac's trade creditors does not constitute unfair discrimination given the unrebutted evidence that this minimal payment is essential to the reorganized company's success. Finally, the Court properly found that the Plan's standard exculpation provision is necessary to the Plan and in the best interests of the Debtors and their creditors.

6. The Noteholders' prayer for relief is both improper and inequitable. In an effort to avoid dismissal of their appeal, the Noteholders now ask this Court to fundamentally rewrite the Plan. Section 1127(b) of the Code, however, forbids making changes to a plan after substantial consummation has taken place. Moreover, the suggested revisions would improperly give the Noteholders far more than they are entitled to, would impose on MRC and Marathon drastically worse terms that were never agreed to, and would render the Plan infeasible, thereby inflicting great harm on numerous other third parties as well.

STANDARD OF REVIEW

On appellate review, the Court's findings of fact cannot be overturned unless "clearly erroneous," and "due regard shall be given to the opportunity of the Bankruptcy Court to judge the credibility of the witnesses." Fed. R. Bankr. P. 8013; see *In re Webb*, 954 F.2d 1102, 1104 (5th Cir. 2008). Conclusions of law are reviewed *de novo*. See *Drive Financial Services, L.P. v. Jordan*, 521 F.3d 343, 346 (5th Cir. 2008).

The Noteholders assert that the normal deference accorded to the Court's factual findings should be approached "with caution" because most of them were proposed by MRC and Marathon. As the cases cited by the Noteholders recognize, however, even where a court adopts the prevailing party's proposed findings, the basic error standard "remains constant." *McLennan v. Am. Eurocopter Corp., Inc.*, 245 F.3d 403, 409 (5th Cir. 2001) (citing *Anderson v. City of Bessemer*, 470 U.S. 564, 571-74 (1985), and *In re Luhr Bros.*, 157 F. 3d 333, 338 (5th Cir. 1988)).

Further, the Court did not just adopt the proposed findings from MRC and Marathon. On the most important issue, the Court found the value of the Timberlands to be as much as $80 million more than asserted by MRC and Marathon. Moreover, the first nine pages of the Court's opinion were not proposed by MRC and Marathon, but rather were prepared exclusively by the Court. Excerpt-G pp.1-9. On those pages, the Court found, among other things, that the

maximum value of the Timberlands was $510 million, that they had been subject to exposure to the market, that no other binding bids for them had been made, that the largest Noteholder's proposal to purchase them was not genuine, and that none of Scopac's assets were going to other creditors. *Id*. Moreover, the Court made its own findings following the hearing on the Noteholders' superpriority claim, entirely rejecting those proposed by MRC and Marathon. R.128. Clearly, the Court was not "inattentive" to the evidence in any way that would warrant anything less than full deference to its factual findings as required under the clearly erroneous standard. See *Anderson*, 470 U.S. at 571-74; *Beal Bank, S.S.B. v. Way Apartments, D.T.*, 201 B.R. 444, 449 (N.D. Tex. 1996).

ARGUMENT

I. THE PLAN PROVIDES NOTEHOLDERS THE "INDUBITABLE EQUIVALENT" OF THEIR SECURED CLAIM.

The Court held that the Plan could be confirmed over the Noteholders' objection as secured creditors ("crammed down") under §1129(b)(2)(A)(iii) of the Code. Excerpt-G pp.6, 113-14. That section provides that a plan is "fair and equitable" to holders of secured claims if it provides "for the realization by such holders of the indubitable equivalent of such claims."

The Court carefully articulated the legal standards applicable to the "indubitable equivalent" requirement. Excerpt-G p.113. Under those standards, the court examines "(i) whether the treatment that an impaired, non-consenting

secured creditor receives under the plan is 'completely compensatory,' and (ii) the likelihood that the secured creditor will receive payment." *Id*. (citing *In re San Felipe @ Voss, Ltd.*, 115 B.R. 526, 529 (S.D. Tex. 1990)). It is axiomatic that an immediate cash payment in an amount equal to the present value of the secured creditor's collateral satisfies this standard. Excerpt-G p.113 (citing cases); see*, e.g.*, *In re Temple Zion*, 125 B.R. 910, 922 (Bankr. E.D. Pa. 1991) ("A cash payment of its claim in full is unquestionably the equivalent or better of [the creditor's] retention of the full measure of its security interest in the Debtor's realty.").

Critically, the "indubitable equivalent" requirement applies only to the extent of the value of the secured creditor's collateral — not to its entire claim. *In re Sandy Ridge Dev. Corp.*, 881 F.2d 1346, 1350 (5th Cir. 1989). The Noteholders conceded that their claim is greater than the value of their security interest in Scopac's assets. Pursuant to §506 of the Code, therefore, the Plan divided the Noteholders' claim into a secured portion (Class 6) and an unsecured deficiency portion (Class 9). See *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 372 (1988); *In re Sandy Ridge*, 881 F.2d at 1349. As a result, the Noteholders were only entitled to receive the "indubitable equivalent" of their Class 6 (secured) claim.

The Noteholders claimed security interests in (a) Scopac's Timberlands and (b) Scopac's non-Timberlands assets. As we now show, the Court made detailed factual findings as to the value of each such interest. It is highly significant, therefore, that, even though the Noteholders argue that they have been denied the indubitable equivalent of those interests, they scarcely mention those findings.

A. The Finding that the Timberlands Are Worth No More Than $510 Million Is Not Clearly Erroneous.

As the Court said, "[t]he key issue during the confirmation hearing that resulted in confirmation of the MRC/Marathon Plan was the determination of the value of the timberlands." R.6:000057. In making that valuation finding, the Court "heard extensive testimony from a multitude of experts and reviewed thousands of pages of expert reports and exhibits." *Id.* Then, rather than "simply adopt[ing] the conclusions of the MRC and Marathon experts" — as the Noteholders incorrectly allege — the Court made its own "informed factual finding that the value of the timberlands is not more than $510 million." *Id.* That finding is amply supported by the record evidence and the Noteholders' efforts to impeach the finding are plainly meritless.

1. The Evidence Supports the Court's Finding.

<u>MRC/Marathon's Expert</u>. The Court's factual findings concerning the value of the Timberlands cover 50 pages. Excerpt-G pp.31-81. The Court began by evaluating the testimony of MRC and Marathon's expert, Richard LaMont.

LaMont is a timberland appraiser who has conducted appraisals of over 200 timberland properties. Excerpt-G ¶92; R.100:261:17-262:3.[5] As is industry practice, LaMont prepared a 50-year harvest forecast and used two different methods — an income approach and sales comparison approach — to value the Timberlands. Excerpt-G ¶¶95-96; Appellee-144 ¶ 17.

Under the income approach, LaMont developed three harvest scenarios using computerized modeling to account for regulatory constraints, species mix, age distribution, growth rates, and local market conditions. Excerpt-G ¶¶98-108; Appellee-144 ¶¶19-24. He then applied log prices to the harvest forecasts to determine total revenue. Excerpt-G ¶109; Appellee-144 ¶25. In doing so, he accounted for a recent decline in log prices. Excerpt-G ¶¶111-13; Appellee-144 ¶25. LaMont next calculated the costs associated with harvesting the timber, including the costs of complying with environmental regulations. Excerpt-G ¶¶114-15; Appellee-144 ¶26. Finally, he applied a discount rate to discount the cash flows to present value. Excerpt-G ¶117; Appellee-144 ¶27. That rate took into account the regulatory constraints and uncertainties associated with timberland property in Northern California. Excerpt-G ¶117; Appellee-144 ¶28. Based on this approach, LaMont concluded that the fair market value of the Timberlands was $430 million as of April 30, 2008. Excerpt-G ¶¶119-20; Appellee-144 ¶¶4, 29, 32.

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[5] The pagination on the transcripts in the record differs from the pagination of the preliminary transcripts cited by the Court in its findings.

Under the comparable sales approach, LaMont compared the Timberlands to comparable sales over the last 10 years. Under that approach, he found that the Timberlands' fair market value was $425 million, thus confirming the valuation he reached using the income approach. Excerpt-G ¶¶122-128; Appellee-144 ¶33.

The Court concluded that LaMont is "an experienced appraiser of timberlands" and "a credible witness whose testimony deserves significant weight, and whose conclusions are given great weight by the Court." Excerpt-G ¶¶132-34.

The Opposing Experts. By contrast, the Court either rejected or gave little weight to competing appraisals offered by the Noteholders and Scopac.

On behalf of the Noteholders, James Fleming opined that the Timberlands' fair market value on October 1, 2007 was $605 million (thus confirming that the Noteholders were significantly undersecured). Excerpt-G ¶¶135-36; Appellant-446. But the Court concluded in detailed findings, supported by cites to the record, that "Fleming's analysis has significant flaws." Excerpt-G ¶¶139-163. It also found that "Fleming was unable credibly to explain these flaws during his testimony at the Confirmation Hearing, and his valuation opinion is accorded little weight." *Id.* ¶164.

Glenn Daniel of Houlihan Lokey Howard & Zukin ("Houlihan") — the Noteholders' financial advisor — opined that the value of the Timberlands was $575-$670 million. Appellant-452 ¶21. The Court found Daniel's opinion

"unreliable" due to his "lack of personal expertise in timber valuation," as well as number of "substantive flaws" in his methodology. Excerpt-G ¶¶167, 174-85. It also found that Daniel had been "essentially ordered by his superiors, over his objections, to provide the valuation opinion in this case." *Id.* ¶169. Tellingly, a senior Houlihan employee, Christopher DiMauro, had — as recently as September 2007 — submitted a declaration estimating the value of the Timberlands at between $375 and $500 million under the income approach and between $290 and $460 million under a comparable sales approach. Appellee-151 ¶¶14-15. The Court found that "[t]he clear inference is that the decision to have Mr. Daniel rather than Mr. DiMauro testify at the Confirmation Hearing was due to the fact that Mr. DiMauro had previously testified before the Court to a valuation much lower than that to which Houlihan is now opining." Excerpt-G *¶*171.[6]

* * * * *

After considering all the expert opinions as well as the extensive evidence underlying those opinions, the Court found, as a matter of fact, that "the value of the Timberlands to be not more than $510 million." Excerpt-G p.61. Moreover, contrary to what the Noteholders imply (at 15), the Court was not bound to accept

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6 Scopac offered several experts whose testimony taken together was that the value of the Timberlands exceeded $1 billion. Appellant-568. The Court found extensive flaws in these experts' analyses, many of which were highlighted in the testimony of Marathon's expert, Dr. Tedder. Excerpt-G ¶¶187-217; Appellee-145. Accordingly, the Court gave the opinions of Scopac's experts "little weight." Excerpt-G ¶218.

any one expert's evaluation, but rather had ample discretion to adjust the number generated by any expert to account for changes in assumptions it considered appropriate.[7] That is precisely what the Court did.

2. The Court Correctly Found That There Was No Firm Offer for the Timberlands Greater Than $510 Million.

Rather than take on the Court's valuation findings directly, the Noteholders instead argue that those findings should be disregarded because there were "offers" for the Timberlands greater than $510 million. This contention is also contrary to the findings and underlying evidence.[8]

The Beal (SRF) "Bid". The Noteholders assert (at 36) that Scotia Redwood Foundation ("SRF"), an affiliate of the largest Noteholder, Beal Bank, "had made a firm offer of a minimum of $603 million ...." The Court made well-supported factual findings to the contrary — findings the Noteholders do not even mention. Specifically, the Court found that the Beal "term sheet contains numerous contingencies and raises substantial concerns about its genuine[ne]ss." Excerpt-G p.4. Among other things, the Court found (with supporting record citations) that:

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7 See, *e.g.*, *In re Brice Road Dev., LLC*, 2008 WL 3550898, *5-6 (B.A.P. 6th Cir. Aug. 14, 2008); *In re Mirant Corp.*, 334 B.R. 800, 824 (Bankr. N.D. Tex. 2005).

8 The Noteholders also indirectly attack the Court's valuation finding by arguing that MRC and Marathon paid more than the Timberlands' calculated value. We address this equally meritless contention in Part II below.

- "SRF ... conditioned its obligation to close upon the execution of an acceptable Acquisition Agreement." Excerpt-G ¶264. Even though weeks subsequently passed, no such agreement was ever submitted and, indeed, the Noteholders' representatives had not even seen a draft of one. *Id.* ¶¶264, 269; R.104, 198:12-18; R.108, 123:23-124:5.

- "[T]he Beal Term Sheet could not be accepted by the Indenture Trustee unless it received a two-third vote from the Noteholders instructing it to do so." Excerpt-G ¶262; . Despite being in contact with approximately 75% of the Noteholders, the Indenture Trustee had not received such an instruction. *Id.* ¶267; R.108, 123:1-9. Absent such an instruction, the Indenture Trustee would be required to credit bid the amount of the outstanding debt owed to the Noteholders (R.108, 123:10-18), which would "creat[e] an immediate breach of the Beal Term Sheet." Excerpt-G ¶267.

- "SRF conditioned its obligation to close upon receipt of all required governmental consents and approvals to the conveyance and assignment of Scotia's assets to it." Excerpt- G ¶264. SRF and Beal, however, had made "no meaningful contact with California regulators even though the sale pursuant to the Indenture Trustee Plan would be subject to regulatory approvals." *Id.* ¶271; R.104, 187:17-188:11.

- "Beal Bank has never owned a redwood forest, nor is Beal Bank an experienced timber operator.... Beal Bank has no foresters as employees." Excerpt-G ¶271; R.104, 121:21-123:1. "Nor did the Indenture Trustee prove that Scotia Redwood Foundation was capable of performing under the term sheet." Excerpt-G p.4.
- Even though "certain matters" pertaining to this proposal were within his "sole purview," Mr. Beal did not testify. *Id.* ¶270.

In short, the Court had ample evidence for its finding that "the term sheet appears to be a straw man for a foreclosure sale and not a serious bid to reorganize the Debtors or even Scopac," and thus lacked probative value. Excerpt-G p.4; see *In re Pullman Const. Indus., Inc.*, 103 B.R. 983, 987 (Bankr. N.D. Ill. 1989) (conditional offer has no probative value); see also *In re Moonraker Assocs., Ltd.*, 200 B.R. 950, 955 (Bankr. N.D. Ga. 1996) (credit bid not probative of value because undersecured creditor can bid in excess of fair market value knowing that any additional funds will be returned to it).

<u>The Timberstar "Offer"</u>. The Noteholders also assert (at 18-19, 36) that Timberstar Operating Partnership L.P. had "indicat[ed] its willingness to offer $600 million for the Timberlands." The sole expression of that "willingness" was a "Notice of Interest in Purchase of Timberlands" filed on May 15, 2008. R.18:004470-72. The Court correctly found that, on its face, the notice of interest

was "subject to due diligence, financing and execution of documentation." Excerpt-G ¶¶302, 308. As a result, the Court concluded that "the possible bid set forth in the Notice is highly speculative and the additional evidence should not be given any weight." *Id.* ¶309. There is nothing in the record to refute this finding.

The UBS Report. The Noteholders also point out (at 17) that UBS had opined in 2004 that MRC might pay $600-700 million for the Timberlands. That assessment has no probative value. MRC's Chairman explained that MRC did not give UBS those numbers, but instead merely made an unquantified expression of interest without having undertaken any due diligence at a time when the Debtors were operating at a higher production level. R.101:190-92. In short, a guess by UBS made four years earlier cannot impeach the Court's detailed findings on the Timberland's value.

B. The Court Valued Noteholders' Non-Timberland Collateral and Ensured that the Plan Provided Noteholders With that Value.

The Noteholders assert (at 34-35) that the Plan "strips the Noteholders' lien from [the] non-Timberland collateral without a finding of value and without providing any additional compensation." Once again, this argument ignores, and is contrary to, the Court's well-supported findings.

As part of addressing the Noteholders' belated motion for a §507(b) superpriority claim, which the Court viewed as a request to reconsider its confirmation findings, the Court specifically considered the value of the non-

Timberland collateral. R.129, 18:9-20, 192:13-194:12. As to that issue, the Court found that "in addition to the forests and the lawsuit, … the other assets that were the security for the Indenture Trustee equaled [$]48.7 million," and that this figure represented the greater of the value on the Petition Date or the confirmation date. R.128, 26:20-27:11. That finding is fully supported by the record evidence.[9]

Having valued the non-Timberland collateral at $48.7 million, the Court found that because Bank of America's $36.2 million claim was secured by the same collateral and had priority in payment, the Noteholders were entitled to only $12.5 million of the $48.7 million. R.128, 27:17-28:2. The Court further found that the $8.9 million that the Noteholders had received during the bankruptcy case to pay their legal fees had to be deducted from the remaining $12.5 million. *Id.* at 28:3-28:10.[10] Hence, the Court found that the Noteholders should receive a net additional amount of $3.6 million to account for the non-Timberland collateral. *Id*. Finally, believing that there was not enough evidence regarding the claims in the Headwaters Litigation, the Court required that the Noteholders retain any lien they may have. Excerpt-G p.8.[11]

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9 See Appellee-280; Appellant-482-83, 748-51 (monthly operating reports that show the value of the non-Timberland collateral); Appellant-739 (attachment to statement of Scopac CFO showing balance sheet amounts for relevant dates).

10 As undersecured creditors, the Noteholders were not entitled to payment of their legal fees. See 11 U.S.C. §506(b).

11 The Noteholders do not challenge the ruling requiring the Plan to allow them to retain their purported interest in any proceeds from the Headwaters Litigation.

In short, the Court made well-supported findings to ensure that the Noteholders received the value of all of their collateral, not just the Timberlands. The Noteholders do not even make a pretense of attacking these findings. Consequently, their assertion that they were stripped of the value of their non-Timberlands collateral is baseless.

C. Summary: The Plan Provides Noteholders the Indubitable Equivalent of Their Secured Claim.

Adding the $510 million maximum fair market value of the Timberlands to the $3.6 million (net of Bank of America's senior claim and deduction of attorneys' fees) for the value of the non-Timberland collateral, the Court found that the maximum value of the Noteholders' secured claim was $513.6 million. R.128, 28:16-18. The Court further found that, because the Plan provided for payment in cash of $513.6 million to the Noteholders on the Effective Date, the Noteholders were receiving the "indubitable equivalent" of their secured claim. Because those findings are not clearly erroneous, the Noteholders' argument that they did not get the "indubitable equivalent" of their secured claim is meritless. As the Court correctly said, the Plan "honors both the letter and spirit of the Bankruptcy Code by paying exactly what the Bankruptcy Code requires: cash equal to the value of the allowed secured claim on the effective date." R.6:000058.

D. An Auction Was Not Required.

The Noteholders (at 36-38) assert that the Code required that the Debtors' assets be valued through an auction rather than a valuation hearing. Such a holding would be unprecedented and would dramatically change the way bankruptcy cases are handled.

As a threshold matter, the Noteholders cannot show that they are aggrieved by the failure to hold an auction of Scopac's assets. The Court found that the Noteholders are likely receiving more under the Plan than they would under an auction. Excerpt-G ¶¶288-93. They have not challenged, much less disproved, that well-supported factual finding.

In any event, the Noteholders cite no case for the proposition that an auction was required in order to determine value in this context. Instead, they rely on the inapposite decision in *Bank of America N.T.&S.A. v. 203 N. LaSalle Street Partnership*, 526 U.S. 434, 458 (1999). There the debtor, during the period in which it had the exclusive right to propose a plan of reorganization, proposed a plan under which existing shareholders would retain equity by allegedly infusing new value even though creditors were not being paid in full. The Supreme Court held that in that situation "some form of market valuation" is necessary before allowing former shareholders to retain any equity.

First, *LaSalle* does not imply, much less hold, that courts can never determine the value of assets through appraisal evidence, and courts continue to routinely do so even in "cramdown" cases.[12] As one court recently stated, any rule that would require "an auction process ... whenever there is a valuation dispute in connection with a confirmation hearing.... would make the Chapter 11 process irrelevant, as all cases could be handled in a Chapter 7 liquidation context." *In re Oneida Ltd.*, 351 B.R. 79, 93 (Bankr. S.D.N.Y. 2006).

Second, unlike *LaSalle*, here the Debtors' shareholders retained no equity in the reorganized entities. Thus, the policy concerns motivating *LaSalle* — that insiders might use their position to retain equity at the expense of creditors — are not present in this case. See, *e.g.*, *In re PWS Holding Corp.*, 228 F.3d 224, 237-39 (3d Cir. 2000) (the concern in *LaSalle* was that existing equity could set a low price for its interest).

Third, *LaSalle* specifically suggested that, even in the situation where a market test is required, lifting exclusivity to allow competing plans would provide the necessary market test. 526 U.S. at 458. Subsequent decisions agree.[13] Here,

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[12] See, *e.g.*, *In re Brice Road Dev., LLC*, 2008 WL 3550898, *5-6 (B.A.P. 6th Cir. Aug. 14, 2008); *In re Calpine Corp.*, 2007 Bankr. LEXIS 3420, *4 (Bankr. S.D.N.Y. Oct. 4, 2007); *In re Nellson Nutraceutical, Inc.*, 2007 Bankr. LEXIS 99, *62 (Bankr. D. Del. Jan. 18, 2007); *In re Prussia Assocs.*, 322 B.R. 572, 580-83 (Bankr. E.D. Pa. 2005); *Beal Bank, S.S.B. v. Waters Edge Ltd. P'ship*, 248 B.R. 668, 682-84 (D. Mass. 2000).

[13] *See In re Global Ocean Carriers Ltd.*, 251 B.R. 31, 49 (Bankr. D. Del. 2000); *In re Davis*, 262 B.R. 791, 798 (Bankr. D. Ariz. 2001); *In re Union Fin. Serv. Group, Inc.*, 303 B.R. 390, 424 (Bankr. E.D. Mo. 2003).

as shown above, exclusivity had been lifted and competing plans were before the Court — thus satisfying *LaSalle* even if it did apply.

In any event, the Court found that "an ample market test for the Debtors' assets" had in fact been provided. Excerpt-G ¶253. As noted above, it found that the Timberlands had been thoroughly marketed both before and during the bankruptcy case. *Id*. ¶¶249-53, 259-77. Even beyond the extensive pre-petition efforts, the record reflects the presence of other potential bidders throughout the plan process, and indeed counsel for the Noteholders acknowledged that "[w]e've had a mini auction here all along." R.114, 201:19-24. On behalf of the Noteholders, since April 2007, Houlihan had been seeking offers for the property. R.108, 52:2-53:2. There were tentative expressions of interest, including by SRF (Beal) and Timberstar as discussed above, as well as inquiries by Harvard Management Company and the Nature Conservancy. Excerpt-G ¶¶273-77. But none of these other entities submitted a firm bid for the Timberlands, much less one for an amount greater than that provided under the Plan. This is true even if (contrary to fact) one treated the Beal term sheet as being a firm offer: the Court found, based on unrebutted evidence, that the Noteholders are receiving more under the Plan than they would have under the Beal term sheet. *Id*. ¶¶278-87.[14]

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[14] The Beal expression of interest at $603 million was a gross amount before deductions for sale expenses and other amounts and payment of administrative claims, whereas under the Plan the Noteholders received a minimum of $513.6 million in cash. Appellee-190. The

The Noteholders also complain (at 19) that "the speed of the confirmation process ... precluded any realistic opportunity" for other potential bidders "to conduct due diligence and assemble their own bids." But the Court's schedule was expressly agreed to by all parties, including the Noteholders. R.81, 14:3-9, 59:23-60:3, 61:18-62:1. Moreover, more than six months passed between the lifting of exclusivity and confirmation, and the Confirmation Hearing was spread over three months. Hence there was ample time for any genuinely interested parties to submit a bid.[15]

Finally, lacking any legal support to their argument, the Noteholders point to (at 38) a September 2007 e-mail from Mr. Dean of MRC (Excerpt-I) in which he referenced a "bogus appraisal" by Marathon and the Debtors. But as Mr. Dean explained, he was referring to a valuation by Marathon for the Timberlands that was "unrealistically high" and made with "very little knowledge about Scopac ...." R.122, 171:2-172:24. Mr. Dean was not suggesting that anyone was committing fraud. *Id.* 172:2-7. The Court considered the e-mail, noted its context, said that "it is not surprising to me that businessmen speak in such kinds of terminology during

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unrefuted evidence was that, after deductions to pay administrative and other required expenses and taking into account the time value of money, the Noteholders would receive less under the Beal expression of interest than under the Plan. *Id.*

[15] The Noteholders suggest in passing that the termination of exclusivity was limited, but they expressly agreed to the Court's order on which parties would have a right to submit a plan. R.82, 19:25-20:11, 31:8-19. Moreover, the Noteholders could have had others join their Plan as MRC joined the Marathon Plan, and nothing prevented other interested entities from seeking permission to file a competing reorganization plan.

the course of a bankruptcy case," and found that it did not affect the Court's valuation. R.128, 12:18-13:16, 16:13-16:15.

II. THE PLAN DOES NOT VIOLATE THE ABSOLUTE PRIORITY RULE.

The Noteholders contend that the Plan violates the absolute priority rule as to Class 6 — the Noteholders' $513.6 million secured claim. The absolute priority rule provides that "a plan of reorganization may not allocate any property whatsoever to any junior class on account of their interests or claims in a debtor ... unless such senior classes receive property equal in value to the full amount of their allowed claims ...." 7 LAWRENCE P. KING ET AL., COLLIER ON BANKRUPTCY ¶1129.04[4][a], at 1129-93 (15th ed. rev. 2008) (emphasis added); *accord In re Cajun Elec. Power Co-op., Inc.*, 185 F.3d 446, 451 n.4 (5th Cir. 1999). Thus, once a secured class is paid in full, the absolute priority rule is satisfied as to that class.

The Noteholders' absolute priority rule argument fails because, as just shown, the Court made an amply-supported factual finding that, under the Plan, the Noteholders received cash equal to the maximum amount of their secured claim: $513.6 million. See Part I *supra*. Because Scopac's secured creditors are having their secured claims paid in full, it follows any payment to Scopac's unsecured creditors does not violate the absolute priority rule.[16]

[16] Indeed, consistent with the fact that satisfaction of the "indubitable equivalent" test for a secured claim ensures that the substance of the absolute priority rule is satisfied as to that

Studiously ignoring that fatal factual flaw in their absolute priority rule argument, the Noteholders instead serve up an abstract logical fallacy. They contend (at 23-24) that because the collateral for their secured claim included all of Scopac's assets, any funds paid toward administrative, priority, and general unsecured claims against Scopac must have come from their collateral. This argument fails for several reasons.

First, the Noteholders' assertion that the payment to Scopac's unsecured creditors must have come from the value of their collateral overlooks the fact that MRC and Marathon have invested $580 million in cash and Marathon converted some $160 million of debt into equity, thereby freeing additional value to be paid to creditors. Excerpt-G ¶¶29-30; R.12:002468. The funds used to pay Scopac's unsecured creditors came from the value infused by MRC and Marathon.

Moreover, the Noteholders' argument is based on a logical fallacy that MRC and Marathon would not invest more than the stand-alone value of Scopac's assets. To the contrary, MRC and Marathon paid more than the value of Scopac's assets for several reasons, none of which is disputed:

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claim, the absolute priority rule does not apply to secured claims. To the contrary, as courts have observed, the rule is codified in the section of the Code addressing the fair and equitable treatment of <u>unsecured</u> claims. 11 U.S.C. §1129(b)(2)(B); see, *e.g.*, *Mercury Cap. Corp. v. Milford Conn. Assocs., L.P.*, 354 B.R. 1, 13 (D. Conn. 2006).

- The uncontroverted evidence was, and the Court found, that the reorganized company would experience valuable synergies worth some $10 million annually based on sharing personnel, distribution infrastructure capability, and relationships with MRC, which was already in the same business. Excerpt-G p.96; Appellant-638 ¶¶29-30. Because MRC is an experienced timberland operator with unique skills and capacity to operate the Timberlands, the Timberlands were worth more to MRC. This unique MRC premium does not reflect the fair market value of the Timberlands, and the Noteholders are not entitled to extra distributions as a result of the unique synergies that will be available to MRC.[17]

- The Plan provides for the re-integration of Palco's sawmill and Scopac's Timberlands. As the Court found, the success of the new operation "depends on keeping the Timberlands and Mill together." Except-G p.63. The Noteholders are not entitled to extra distributions as a result of the increase in value that will result from this re-integration. Moreover, the Court correctly found that a plan for only Scopac would devastate Marathon's collateral at Palco, noting that

[17] See, *e.g.*, *In re Adelphia Commc'ns Corp.*, 368 B.R. 348, 357-58 (Bankr. S.D.N.Y. 2007); *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 59 (Del. Ch. 2007).

"the mill would likely be shut down and liquidated, along with the town of Scotia and the Debtors' remaining assets, resulting in a loss of jobs for the community and a way of life in the town of Scotia." *Id.* p.3. Thus, Marathon had extremely good business reasons to pay more than fair market value for Scopac.

- Finally, in order to confirm a plan of reorganization, administrative and other priority claims must be paid in full. 11 U.S.C. §1129(a)(9). Thus, to confirm the Plan, MRC and Marathon were required to provide additional funds beyond the value of Scopac's assets to pay priority claims. The Noteholders would have had to pay those same claims had the Court confirmed the IT Plan, and in fact the Court determined that those sums would have been much higher under the IT Plan. Excerpt-G ¶283.

For all of these reasons, the fact that MRC and Marathon contributed more than the value of the Noteholders' collateral in no way proves that the absolute priority rule was violated as to Class 6.[18]

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[18] In addition, the Noteholders' challenge to payment of Scopac's administrative claims ignores that the Noteholders agreed in all cash collateral orders that administrative claims for fees and expenses of the professionals of Scopac and the Committee would be paid prior to the Noteholders' claims. Appellee 225 ¶32; R.23:527 ¶34; Appellee 231 ¶34. This provides yet another reason for rejecting the Noteholders' assertion that the payment of Scopac's administrative claims violated the absolute priority rule.

Finally, the Noteholders assert (at 25) that the absolute priority rule was violated because, supposedly, they received only 70% of their claim while unsecured creditors might receive in excess of 75% of their claims. This is, charitably, misleading. As required by §506(a) of the Code, the Noteholders' claim was divided into a secured claim (Class 6) and an unsecured claim (Class 9). Class 6 received a 100% recovery. The 70% figure used by the Noteholders includes their unsecured deficiency claim in Class 9. But the Noteholders cannot and do not assert that the treatment of Class 9 violates absolute priority given that the classes junior to Class 9 received no distribution under the Plan. R.12:002465-66; see *In re Briscoe Enter., Ltd. II*, 994 F.2d 1160, 1168 n.41 (5th Cir. 1993).

III. THE PLAN WAS NOT REQUIRED TO GIVE THE NOTEHOLDERS AN OPPORTUNITY TO CREDIT BID.

The Noteholders assert (at 28-33) that for the Plan to be confirmed as fair and equitable, §1129(b)(2)(A)(ii) of the Code required that the Noteholders be given the opportunity to credit bid (*i.e.*, bid the amount owed them) at an auction for the Scopac collateral. That argument fails because the Court unimpeachably found that the Plan satisfies §1129(b)(2)(A)(iii) of the Code, which expressly is an alternative to Clause §1129(b)(2)(A)(ii).

A. Because The Plan Satisfies §1129(b)(2)(A)(iii), There is No Need for It Also To Satisfy §1129(b)(2)(A)(ii)

Section 1129(b)(2)(A) provides that a plan is "fair and equitable" to a class of secured creditors if it satisfies the requirements of §1129(b)(2)(A)(i) ("Clause i"), §1129(b)(2)(A)(ii) ("Clause ii"), "or" §1129(b)(2)(A)(iii) ("Clause iii"). Clause iii is satisfied if the plan provides the creditor with the "indubitable equivalent" of its secured claim. Based on its factual finding that the Plan gives Class 6 the indubitable equivalent of their secured claim, the Court found that the Plan is fair and equitable to Class 6 under Clause iii. Excerpt-G pp.113-14.

The Noteholders assert (at 28-33) that even though the requirements of Clause iii were satisfied, the Plan could not be confirmed as fair and equitable unless it also met the requirements of Clause ii, under which the Noteholders purportedly would have a right to credit bid.[19] This effort to rewrite §1129(b)(2)(A) is untenable.

"As long as statutory scheme is coherent and consistent, there is generally no need for a court to inquire beyond the plain language of the statute." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240-41 (1989). By its plain terms,

[19] Contrary to the Noteholders' suggestion, even in a sale under section 363 outside a plan of reorganization, there is no absolute right to credit bid because the court may deny the opportunity to credit bid under section 363(k) "for cause." 11 U.S.C. §363(k); see *In re NJ Affordable Homes Corp.*, 2006 WL 2128624, *16 (Bankr. D.N.J. June 29, 2006); *In re Takeout Taxi Holdings, Inc.*, 307 B.R. 525, 536 (Bankr. E.D. Va. 2004); *In re Theroux*, 169 B.R. 498, 499 n.3 (Bankr. D.R.I. 1994); *In re Diebart Bancroft*, 1993 WL 21423, *5 (E.D. La. Jan. 26, 1993).

§1129(b)(2)(A) is written in the disjunctive — it says that to be fair and equitable, a plan must satisfy Clause i, ii, "or" iii. Indeed, this Court has specifically recognized that "[t]he statute provides three alternative minimum requirements for the plan to be considered fair and equitable with regard to secured creditors." *Briscoe Enterprises*, 994 F.2d at 1168 (emphasis added). This Court pointedly added that it had "not transformed the 'or' in 1129(b)(2)(A) into an 'and.'" *Id*. Thus, because the plan in *Briscoe* satisfied §1129(b)(2)(A)(i), the plan did not need to also satisfy clause iii. *Accord*, *e.g.*, *In re Criimi Mae, Inc.*, 251 B.R. 796, 806 (Bankr. D. Md. 2000) ("[A]ny doubt as to whether subsections (i), (ii), and (iii) were meant to be alternative paths to meeting the fair and equitable test of section 1129(b)(2)(A) is put to rest by the Bankruptcy Code itself." (citing cases)). As one court succinctly stated, "[t]here is no express code requirement that a sale proposed by a chapter 11 plan must give secured creditors the right to make a credit bid." *In re Broad Assocs. LP*, 125 B.R. 707, 711 (Bankr. D. Conn. 1991).

Indeed, *Criimi Mae* rejected the same argument that the Noteholders press here and held that a plan could be confirmed under Clause iii by providing the "indubitable equivalent" of a secured claim even though it provided for the sale of the dissenting creditor's collateral without any right to credit bid. 251 B.R. at 806. Like the Noteholders here, the creditor in *Criimi Mae* argued that, because Clause ii is supposedly "more specific" than Clause iii, Clause ii should govern. The court

recognized that it was being urged to follow a rule of construction employed "where statutes conflict," but stated that, with respect to §1129(b)(2)(A), the statute "plainly indicates that subsections (i), (ii) and (iii) are to be treated as distinct alternatives. As a result, the provisions are not in conflict and the argued-for rule of construction is inapplicable." *Id.* at 807. This ruling is both persuasive and on point.

Contrary to the Noteholders' argument (at 33), following the plain language of the statute does not render the credit bid requirement in Clause ii "superfluous." Clause iii applies only in cases where the court makes a valuation determination and finds that the creditor is receiving the indubitable equivalent. Clause ii operates in cases where no such valuation determination has been made. As such, they simply are distinct alternative ways in which a plan can be fair and equitable to secured claims.

The Noteholders' strained interpretation of §1129(b)(2)(A) is further undermined by the terms of Clause i. Clauses i, ii, and iii are designed to be equivalents of one another. Clause i, which contains no right to credit bid, permits a plan providing for a transfer of the collateral to be confirmed if the secured creditor receives a note whose value is equal to the value of the collateral. Thus, it was undisputed that the Noteholders could have been forced to take a note with a present value of $513.6 million, which was the value of their collateral as found by

the Court. R.114, 166:23-177:5, 184:9-11. The Noteholders argue that, under Clause i, the Plan would have had to let them retain their lien in order to preserve a right to realize on the "upside" (i.e., for the possibility that the collateral might appreciate in value). This argument misinterprets the Code. The lien retained under Clause i protects only against a default under the new note and only to the extent of the present value of the collateral as determined by the court. Thus, under §1129(b)(2)(A), a secured creditor is entitled only to the present value of its collateral, not to the "upside," and that present value either can be paid over time under Clause i or paid immediately under Clause iii. Put otherwise, since it is undisputed that the Noteholders could have been required to take a note in the amount of $513.6 million, it makes no sense that they could not be required to take the same amount in cash, which is undoubtedly better than a note.[20]

Further, §1111(b)(2) of the Code addresses a secured creditor's possible concern that a court might undervalue its collateral under Clause iii by allowing a secured creditor to elect to have its entire claim treated as secured. If the Noteholders had so elected here, they would have been entitled to retain their lien and receive a note in the face amount of their total claim (approximately $790 million) and a stream of payments whose present value equaled the value of their

[20] Indeed, the absurdity of the Noteholders' interpretation of §1129(b)(2)(A) becomes clear when one recognizes that, under their own interpretation, the Plan could have given the Noteholders a new Note in the amount of $513.6 million and then repaid it the day after the Effective Date.

collateral ($513.6 million). Excerpt-G p.5; see 11 U.S.C. §1129(a)(7)(B). The Plan expressly provided for such an election. Excerpt-H, Attachment §4.6.2.

As the Court found, the Noteholders made a "tactical and strategic decision" against making the 1111(b)(2) election, even though that option might have allowed them to obtain "more than the cash amount of [their] secured claim ...." R.6:000057. The Noteholders now try to explain this away by contending (at 29) that they could not have made the 1111(b)(2) election. Throughout most of the bankruptcy, however, the Noteholders proceeded as though they had a right to make the 1111(b) election. During the hearing on the disclosure statement, the Noteholders requested and obtained an extension of the deadline to make the 1111(b)(2) election. R.92, 33:10-36:2. Only in closing argument, after the Noteholders' time to make an 1111(b)(2) election had expired, did counsel argue that such an election might not be available, and even then counsel said that the Noteholders were considering requesting a second opportunity to make the 1111(b)(2) election. R.114, 193:7-11, 352:15-353:5.

In any event, the Noteholders' contention is without merit. They cite no case holding that the 1111(b)(2) election may not be made when a plan proceeding under §1129(b)(2)(A)(iii) expressly provides for such an election.[21] In addition,

[21] The cases cited by Noteholders are inapposite. The plan in *In re Kent Terminal Corp.*, 166 B.R. 555, 559 (Bankr. S.D.N.Y. 1994), was rejected because it denied the secured creditor the protection of <u>both</u> the right to credit bid and the right to make an 1111(b)(2) election.

the Noteholders' assertion that §1111(b)(2) did not apply is wrong because the Plan did not involve a "sale" of the collateral. See pages 41-43 *infra*.

In short, because the "indubitable equivalent" requirement of Clause iii was satisfied, the Plan did not need to satisfy the alternative requirements of Clause ii. The Noteholders' credit bid argument fails for this reason.

B. Clause ii Would Not Apply Anyway.

The Noteholders' credit bid argument fails for the additional reason that Clause ii does not apply in this case. Clause ii only applies when a plan provides "for the sale ... of any property that is subject to the liens" at issue. The Plan, however, did not involve a "sale" of Scopac's assets. Rather, the Debtors were reorganized and, as part of that reorganization, certain of their assets were transferred to the newly formed entities pursuant to §1123(a)(5)(B) of the Code. The Plan expressly provides that "on the Effective Date, the Debtors shall transfer all assets of the Estates and interests in the Estates, to the fullest extent of Sections 541 and 1123(a)(5)(B) of the Bankruptcy Code." Excerpt-H, Attachment §7.6.2; R.12:002469. As such, the Court determined that the Plan provides for a transfer of Debtors' assets, not their sale. Excerpt-G p.7.

And the decision in *In re California Hancock, Inc.*, 88 B.R. 226, 228 (B.A.P. 9th Cir. 1988), is not on point for several reasons, including the fact that it dealt with the rights under §1111(b)(1) of non-recourse creditors.

This determination is entirely consistent with the Code, which distinguishes between a "sale" and a "transfer" of assets. *Compare* 11 U.S.C. §1123(a)(5)(B) ("transfer") with §1123(a)(5)(D) ("sale"); and §1129(b)(2)(A)(i)(I) ("transfer") with §1129(b)(2)(A)(ii) ("sale"); see *In re Crowthers McCall Pattern, Inc.*, 120 B.R. 279, 285 n.6 (Bankr. S.D.N.Y. 1990) (recognizing that "transfers" under §1123(a)(5)(B) cannot be limited to "sales" of property because §1123(a)(5)(D) expressly includes sales as a means of implementation). The Code defines "transfer" as "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing or parting with (i) property; or (ii) an interest in property." 11 U.S.C. §101(54). The transfer of Scopac's assets to Newco falls squarely within this definition.

Ignoring the Code's definition of "transfer" and the distinction it makes between transfers and sales, the Noteholders assert (at 29) that the Court's conclusion "defies the common sense meaning of 'sale.'" But they cite no bankruptcy authority for this bald assertion, relying instead on the Uniform Commercial Code and Black's Law Dictionary. Besides being irrelevant, neither helps the Noteholders. The U.C.C. defines "sale" to require both a seller and a buyer as part of a "contract for sale" (U.C.C. §2-106) and Black's Law Dictionary includes "mutual assent" as one of the four elements of a "sale" (BLACK'S LAW DICTIONARY 1364 (8th ed. 2004)). There was no "contract for sale" here and

certainly no “mutual assent.” On the contrary, Scopac (the purported “seller”) objected to confirmation of the Plan.[22]

In short, not only is Clause ii irrelevant because Clause iii was satisfied, but Clause ii does not, in any event, apply to the Plan.

IV. THE PLAN DOES NOT INVOLVE A *DE FACTO* SUBSTANTIVE CONSOLIDATION.

Substantive consolidation occurs “when the assets and liabilities of separate and distinct entities are combined in a single pool and treated as if they belong to one entity.” See *In re Babcock & Wilcox Co.*, 250 F.3d 955, 959 n.5 (5th Cir. 2001). The factual basis for the Noteholders’ substantive consolidation argument (at 43) is the same recycled factual assertion made in support of their earlier arguments — that “Scopac’s asset value is being used to satisfy unsecured creditors of both Scopac and Palco.”

As shown above, the Court made factual findings to the contrary: it found that the full value of all of Scopac’s assets is being paid to Scopac’s secured creditors. See Part I *supra*. Likewise, the Court found that the Plan does not substantively consolidate Scopac and any other debtor because “none of the assets

[22] The only evidence cited by the Noteholders (at 29) for their assertion that the Plan involved a sale — the testimony of Matthew Breckenridge — does not suggest a contrary conclusion. Not being a lawyer, much less a bankruptcy lawyer, Mr. Breckenridge used terms like “sale,” “purchase,” and “foreclosure” the way a layman would use them. The Court considered this testimony but, based on the actual plan structure, determined that the Plan provided for a transfer, not a sale, of the Debtors’ assets. Excerpt-G, p.7.

of Scopac are being used to pay the debts of any other debtor ...." Excerpt-G p.7. Moreover, it is undisputed that Palco and Scopac were also kept separate for classification and voting purposes. Appellant-649 pp.5, 10-11.

As such, this argument is simply another attempt by the Noteholders to transform their attack on the valuation finding into a legal issue. Because the Court's finding that the Plan pays the full value of all of Scopac's assets to its secured creditors (Bank of America and the Noteholders) is unimpeachable, it follows by definition that none of Scopac's assets were diverted to pay any other debtor's creditors.[23]

Indeed, the Court was fully attuned to the issue of substantive consolidation. As explained at page 9 above, the Court required that the Plan be modified to create separate litigation trusts specifically to avoid any possible issue of substantive consolidation.

The Noteholders seek to buttress their argument by asserting that the Debtors' intercompany claims were eliminated. To the contrary, the value of Scopac's post-petition (administrative) intercompany claim against Palco was paid directly to the Noteholders, not eliminated. See pages 45-46 *infra*. And Scopac's

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[23] Because the Noteholders' secured claim has been paid in full, they in fact lack standing to assert any claim of substantive consolidation, since a party lacks bankruptcy appellate standing unless it has been "directly and adversely affected pecuniarily" by the ruling on that issue. *In re Coho Energy, Inc.*, 395 F.3d 198, 202-03 (5th Cir. 2004).

only pre-petition intercompany claim was treated as an administrative claim under §503(b)(9) of the Code and thus was paid. R.124, 94:13-95:14.

Finally, the Noteholders' argument is not advanced by the fact that the Plan provides for the transfer and merger of certain assets (the sawmill and the Timberlands) after the Effective Date, as expressly contemplated by §1123(a)(5)(B) of the Code. The fact that the assets were ultimately transferred to the same entity in no way suggests that the proceeds were not used to pay each of the creditors of the debtor that had owned each asset. To the contrary, as the Court correctly found, the value of all of Scopac's assets was used to pay Scopac's secured creditors. Excerpt-G p.7.

V. THE PLAN PROVIDES FOR FULL PAYMENT OF INTERCOMPANY ADMINISTRATIVE CLAIMS.

The Noteholders' assertion (at 45) that the Plan failed to pay Scopac's intercompany administrative claim against Palco is factually incorrect. The Court found that the Plan "requires that all Allowed Administrative Expense Claims and Priority Claims will be paid in accordance with section 1129(a)(9) of the Bankruptcy Code …." Excerpt-G p.107.

The Noteholders' only citation for their contrary assertion (at 45) is §4.10.2 of the Plan, which is part of Article IV. But Article IV of the Plan only applies to pre-petition claims and thus does not apply to the $11 million post-petition administrative claim to which the Noteholders refer. By contrast, Section 2.1 of

the Plan applies to post-petition administrative claims and expressly provides that such post-petition claims will be paid in full in cash. Excerpt-H, Attachment §2.1; R.12:002458-59.

The Noteholders likewise err factually in asserting that Scopac's $11 million post-petition claim against Palco went unpaid. The $11 million was an account receivable of Scopac.[24] As discussed above, the Court valued Scopac's non-Timberland assets, including accounts receivable, and included the value of those assets in the $513.6 million (net) amount that the Plan had to pay over to the Noteholders. See Part I *supra*.[25]

VI. AT LEAST ONE IMPAIRED CLASS VOTED FOR THE PLAN.

The Noteholders challenge the Court's conclusion that at least one impaired class voted for the Plan as required by §1129(a)(10) of the Code. They argue (A) that the trade claimants in Class 8, who voted for the Plan, should not have been put in a class separate from the Noteholders' unsecured deficiency claim in Class 9, which voted against the Plan; and (B) that Bank of America's claim in Class 5, which voted for the Plan, should not have been treated as impaired for voting

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[24] The Noteholders incorrectly cite to DKT–3288, which does not concern accounts receivable. It appears that the $11 million figure arises from accounts receivable listed in the monthly operating reports. Appellee-280 p.2.

[25] The Noteholders are factually wrong in their assertion (at 45-56) that the so-called Class 6 Distribution Adjustment allowed Palco's pre-petition claims to be offset against Scopac's post-petition claims. The Class 6 Distribution Adjustment by its express terms addresses "receivable arising after the Petition Date" and does not include any pre-petition claims. Excerpt-H, Attachment p. 4.

purposes. Although the Noteholders would have to win <u>both</u> these arguments to establish that no impaired class voted for the Plan, neither of them is persuasive.

A. Separate Classification of Classes 8 and 9 Was Proper.

Under §1122 of the Code, claims of the same priority may be put into separate classes if there are any "good business reasons" for doing so. *In re Briscoe Enterprises*, 994 F.2d at 1167. "Whether there were any good business reasons to support the debtor's separate classification is question of fact and thus subject to clearly erroneous review." *Id.* (citation omitted). By contrast, a plan may not "classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan." *In re Greystone III Joint Venture,* 995 F.2d 1274, 1279 (5th Cir. 1991).

Under the Plan, Class 8 consists primarily of Scopac's trade creditors and Class 9 consists primarily of the Noteholders' unsecured deficiency claim. The Court found as facts (1) that "reasonable business reasons exist for separately classifying" Scopac's trade creditors and the Noteholders' deficiency claim, and (2) that "[t]he classification scheme in the MRC/Marathon Plan was not an attempt to obtain an Impaired consenting Class." Excerpt-G p.93.

Those findings are amply supported. First, the Court found that "the Holders of Scopac Trade Claims in Class 8 have a different stake in the future viability of the ongoing business than do the Claimants in Class 9 (primarily the

unsecured deficiency claim of the Noteholders)" (*id.*), and the record evidence established this fact (Appellant-638 ¶103). It also found that separately classifying those claims — and providing them with different distributions, as discussed below — was appropriate because the success of the reorganization depended on maintaining good relations with Scopac's trade creditors. As to Class 8, the Court found:

> The Holders of these Claims are small, local creditors [for goods, supplies, equipment or services] in a close knit and insulated timber community. The goodwill of these trade creditors is important for the successful future operation of Scopac's businesses because there is a limited market in which to obtain these goods and services. Thus, if the holders of Allowed Scopac Trade Claims do not receive a substantial cash recovery as part of the reorganization, Scopac's operations will suffer.

Excerpt-G ¶¶241-42. By contrast, as to Class 9, the Court found:

> Class 9 is not comprised of trade creditors with whom the Debtors intend on maintaining business relationships, but rather primarily represents the unsecured deficiency claim of the Noteholders with whom there is not currently and will be no ongoing business relationship.

Id. ¶244. These findings have full record support. Appellant-638 ¶¶103-04.

The Noteholders do not and cannot show that these findings are clearly erroneous. The Noteholders primarily assert (at 49-50) that there was no evidence that the reorganized company's operations could not obtain trade services without making substantial payments to trade creditors. To the contrary, there was record

testimony that "[t]here is a limited market for trade goods and services, and the ongoing business operations may be unable to obtain trade goods and services if the trade creditors were not paid a substantial cash recovery on account of their claims." Appellant-638 ¶103 (emphasis added). Still further evidence supporting the classification is described at pp. 51-54 *infra*.

B. The Court Properly Treated Class 5 As Impaired.

Section 1124(1) of the Code provides that "a class of claims … is impaired under a plan unless … the plan leaves unaltered the legal, equitable, and contractual rights to which such claim … entitles the holder of such claim …." The finding as to whether a class is impaired is reviewed only for clear error. See *In re Block Shim Dev. Co.,* 118 B.R. 450, 455 (N.D. Tex. 1990), *aff'd*, 939 F.2d 289 (5th Cir. 1991).

The Noteholders concede that Bank of America's Class 5 claim was impaired within the plain terms of §1124(1) because Class 5 will receive some $1 million of its distribution in 12 monthly installments, rather than immediately on the Effective Date. Excerpt-H, Attachment §4.5.2; see *In re Block Shim Dev. Co.*, 939 F.2d 289, 291-92 (5th Cir. 1991) (delay in payment constitutes impairment). The Noteholders nevertheless assert (at 50) that this was an "artificial" impairment done to manufacture an impaired class and that the Court should have treated Class 5 as unimpaired.

The Court found that the Plan "does not artificially 'manufacture' the impairment of any" class (Excerpt-G p.99), and the Noteholders fail to show clear error in this finding. First, they fail to cite any testimony or other evidence that the Plan's treatment of Class 5 was driven by a desire to gerrymander voting, and none exists. To the contrary, the partial deferral of payment to Class 5 reflected a compromise as to its disputed claim to a default rate of interest. *See Southland Corp. v. Toronto-Dominion*, 160 F.3d 1054, 1060 (5th Cir. 1998) (availability of default interest depends upon a case-specific balancing of the equities).

Further, even if the Plan had provided for full and complete payment to Class 5 on the Effective Date, that class still would have "impaired" under §1124. In 1994, Congress repealed §1124(3), which had provided that claims were unimpaired if paid in full on the plan effective date. Due to that repeal, the fact that a plan proposes full cash payment on the effective date does not render a creditor unimpaired and unable to vote. See *In re Nucentrix Broadband Networks, Inc.*, 2004 Bankr. LEXIS 2552, at *21 (Bankr. N.D. Tex. May 10, 2004) (citing cases).[26] Because Bank of America's claim therefore would have been impaired within the meaning of §1124 even if it had been paid in full on the Effective Date,

[26] Indeed, in the Court below, the Noteholders took the position that, for this reason, their Class 6 claim was impaired under §1124 even though it was being paid in full on the Effective Date. R.16:003845-47.

it necessarily follows that that claim was properly treated as impaired under the Plan.

C. In Sum, At Least One Impaired Class Voted To Accept The Plan.

For the Noteholders to prevail on their classification argument, this Court would have to determine that the Court's findings were clearly erroneous as to both (A) separate classification of Classes 8 and 9 and (B) impairment of Class 5. Because the Noteholders fail to carry that high burden as to either argument, much less both of them, their attack on this ground fails.

VII. THE PLAN DOES NOT UNFAIRLY DISCRIMINATE AGAINST CLASS 9.

Under §1129(b)(1) of the Code, a reorganization plan may provide different treatment to claims of the same priority — that is, may discriminate between them — as long as the discrimination is not unfair. Discriminatory treatment is considered fair if it has a reasonable basis, is necessary for the plan, is proposed in good faith, and is reasonable in relation to its rationale. *Ramirez v. Bracher,* 204 F.3d 595, 598 n.2 (5th Cir. 2000) (Benavides, J., concurring); *In re Ambanc La Mesa Ltd. P'ship*, 115 F.3d 650, 656 (9th Cir. 1997).

The Noteholders argue (at 51-55) that the Plan unfairly discriminates against their Class 9 unsecured deficiency claim because that claim receives only rights to share in potential litigation recoveries, whereas the Class 8 trade creditors also

receive a *pro rata* share of $500,000 in cash. The Court made factual findings on this issue — including that the "goodwill of these trade creditors in Class 8" is "important for the successful future operation of Scopac's business" and that "if the holders of Allowed Scopac Trade Claims do not receive a substantial cash recovery as part of the reorganization, Scopac's operations will suffer." This Court, moreover, has recognized that such findings would justify differential treatment of trade creditors. *Greystone*, 995 F. 2d at 1281.

Those factual findings are supported by the record and thus are not clearly erroneous. The chairman of MRC testified that it was essential for trade claimants to receive a substantial payment in order to ensure that the reorganized entities will "(a) continue to have the benefit of services provided by existing vendors and to seamlessly continue operations; (b) draw on the body of institutional knowledge held by Scopac's various vendors, employees and contractors; (c) have the confidence of the community and thus attract capable new vendors, employees and contractors; and (d) create positive employee and community morale for the newly reorganized operation." Appellant-638 ¶104. No contrary testimony or other evidence was presented.

Seeking instead to nitpick the findings, the Noteholders assert that "critical" vendors had already been paid during the bankruptcy case. To the contrary, Scopac's Vice President testified that many of the company's critical vendors had

not been paid and agreed that "it would be good for the reorganization efforts of the company if those people receive a substantial portion of their claims against the company upon the reorganization of these Debtors." R.111, 100:13-17.

Next, the Noteholders argue that Class 8 includes former employees who are not providing ongoing services. But the testimony, expressly addressing the treatment of the "claims of former employees" (among others), established that Scopac operates "in a close knit and insulated timber community," making clear that the "goodwill" of the community — which includes those former employees — "is important for the future operations of the business." Appellant-638 ¶103.

The Noteholders also assert that Class 8 includes some national vendors. But they provide no record support for their bald assertion that such vendors would not require substantial payment to do business with the reorganized debtors — an assertion contrary to the record testimony that substantial payment to all vendors is essential to ensure that the reorganized companies will be able to seamlessly continue doing business with their knowledgeable existing vendors. *Id.* ¶104.

Last, the Noteholders assert that the reorganized companies had no need to pay local vendors because those vendors have no choice but to do business with the new company. Not only is that mere speculation, but the evidence established that some substantial payment is essential to the new company in order to "create

positive employee and community morale for the newly reorganized operation." *Id*.

In sum, the evidence amply supports the finding that the small amount of funds being paid to trade creditors to ensure the goodwill and continued support of the vendor community — less than one-tenth of 1% of the total distribution — is both necessary and reasonable.

VIII. THE PLAN'S EXCULPATION PROVISIONS ARE PROPER.

The only parties receiving the challenged exculpation are MRC, Marathon, Newco, Townco, and the Committee (and their personnel). The exculpation clause, by its own terms, is limited to matters concerning this bankruptcy and excludes liability based on gross negligence or willful misconduct. Excerpt-H, Attachment §10.3. Thus, with respect to the Committee and its personnel, the provision merely sets out the applicable standard of liability and hence cannot be said to violate the Code. See *In re Hilal*, 534 F.3d 498, 501 (5th Cir. 2008).

With respect to the other exculpated entities, courts have held that third parties who are not liable for the debtor's obligations may receive a release in a plan of reorganization under appropriate circumstances. Specifically, courts have applied some or all of following factors when considering third-party releases: (i) an identity of interest between the debtor and the third party; (ii) substantial contribution by the non-debtor of assets to the reorganization; (iii) the essential

nature of the injunction to the reorganization; (iv) whether a substantial majority of creditors support the injunction; and (v) whether the plan provides for all or substantially all of the claims affected by the injunction. See *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 293 (2d Cir. 1992); *In re A.H. Robins Co.*, 880 F.2d 694, 701 (4th Cir. 1989); *In re Continental Airlines*, 203 F.3d 203, 212 (3d Cir. 2000).

The Court made the following findings in approving the exculpation provision at issue here:

- it is, "under the circumstances present, fair, reasonable and necessary to the successful effectuation of the MRC/Marathon Plan and justified by the substantial consideration contributed under the MRC/Marathon Plan for the benefit of the Holders of Allowed Claims";
- it "is an integral element of the settlements and transactions incorporated into the MRC/Marathon Plan";
- it "confers material benefits on, and is in the best interests of, the Debtors, their estates, and the holders of Claims and interests"; and
- it "is important to the overall objectives of the MRC/Marathon Plan to finally resolve all Claims among or against the parties-in-interest."

Excerpt-G p.117.

Under these circumstances, the Court surely did not commit clear error in approving the exculpation provision, which simply give the entities investing hundreds of millions of dollars the same protection as the Debtors. First, there is an identity of interests between the Debtors, on the one hand, and MRC, Marathon, Newco, and Townco, on the other. MRC and Marathon invested $580 million (and

Marathon converted debt into equity) for the benefit of the Debtors' creditors, giving them recoveries above and beyond what they would otherwise receive. The Debtors' assets were transferred to Newco and Townco; MRC and Marathon became the owners of Newco and Townco; and the Debtors successfully emerged from Chapter 11. Second, the contributions made by MRC and Marathon were plainly substantial. Third, absent the exculpation, MRC, Marathon and the Committee, and, indirectly, the Newco and Townco could remain exposed to the very liabilities that the bankruptcy discharge is supposed to cover. If a disgruntled creditor of the Debtors could pursue MRC or Marathon for matters arising out of the Debtors' bankruptcy cases, thereby reaching the assets of Newco or Townco, the discharge injunctions in the Code would be rendered meaningless. As a result, MRC and Marathon would not have been willing to make the contributions contemplated in the Plan without such protection. Fourth, the Plan received overwhelming creditor support. See page 7 *supra*. Under these circumstances, and given that any claim covered by the exculpation provision necessarily would constitute a collateral attack on the Confirmation Order, the Court accordingly acted well within its discretion in prohibiting such claims. *See In re SLI Inc.*, 2006 U.S. App. LEXIS 5188, at *9 (3d Cir. 2006) ("Because they are consideration for

investment that was crucial to the Plan, the releases form an 'integral nexus' with the feasibility of the ... plan of reorganization.").[27]

The cases cited by the Noteholders are not to the contrary. In *Feld v. Zale Corp.*, 62 F.3d 746, 755 (5th Cir. 1995), the releases were not as part of a plan of reorganization and pertained to claims of non-creditors having nothing to do with the bankruptcy proceedings. In *In re Wool Growers Cert. Storage*, 371 B.R. 768, 778 (Bankr. N.D. Tex. 2007), the release was of the debtors' insiders, who may have been liable for breach of fiduciary duty and gross negligence. Here, the exculpation provision is tied to the reorganization plan and the conduct during the bankruptcy of MRC and Marathon, neither of which owed fiduciary duties to the Debtors' creditors.

IX. THE REQUESTED RELIEF IS UNWARRANTED.

Seeking to avoid the dismissal of their appeal as equitably moot now that the Plan has been substantially consummated, the Noteholders' prayer (at 58) ask this Court to drastically and fundamentally change the Plan. As a threshold matter, in the Court below, the Noteholders never requested any relief other than denial of confirmation of the Plan. Moreover, as MRC and Marathon will more fully show in their reply in support of their motion to dismiss, such a course would be both

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[27] The Third Circuit reached that conclusion in the context of holding that the challenge to the exculpation provision was equitably moot, but that conclusion equally supports the inclusion of the exculpation provision in the plan.

unlawful and unfair. First, "[t]he Bankruptcy Code provides that a plan may not be modified or amended after substantial consummation has taken place." *In re Manges*, 29 F.3d 1034, 1043 n.13 (5th Cir. 1994), *citing* 11 U.S.C. §1127(b); see also *In re Winn-Dixie Store, Inc.*, 2008 U.S. App. LEXIS 13986, at *10-12 (11th Cir. July 1, 2008). Thus, such modifications are forbidden by law, especially because "[t]he provisions of the MRC/Marathon Plan … are non-severable and mutually dependent." R.12:002350. Moreover, the requested revisions constitute blatant overreaching. For example, the Noteholders ask to have their lien reinstated even though they have received $513.6 million in cash — thereby asking to have their unsecured deficiency claim transformed into a secured claim even though they admitted below that they were undersecured. See page 19 *supra*. Furthermore, the requested revisions not only would impose terms on MRC and Marathon that they never agreed to after they invested over half a billion dollars in reliance on the Court-approved terms, they would destroy the feasibility of the Plan and thereby severely harm still other third parties. See *In re Specialty Equipment Cos.*, 3 F.3d 1043, 1049 (7th Cir. 1993) (refusing to impose "a different plan of reorganization on the parties"). The invalidity of the prayer is yet another reason why the appeal should be rejected.

CONCLUSION

The appeal should be dismissed as moot. Alternatively, the Confirmation Order should be affirmed.

September 8, 2008

Respectfully submitted,

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STATUTORY ADDENDUM

RELEVANT PROVISIONS OF THE BANKRUPTCY CODE, 11 U.S.C. 101, *et seq.*

<u>Section 101(54)</u>:

In this title the following definitions apply:

(54) The term "transfer" means—

(A) the creation of a lien;

(B) the retention of title as a security interest;

(C) the foreclosure of a debtor's equity of redemption; or

(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary of disposing of or parting with—

(i) property; or

(ii) an interest in property.

<u>Section 363(k)</u>:

(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

<u>Section 506(a)(1)</u>:

(a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the

value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

Section 506(b):

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

Section 1111(b):

(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if—

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

Section 1122:

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

Section 1123(a)(5)(B):

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—

(5) provide adequate means for the plan's implementation, such as—

(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

Section 1123(a)(5)(D):

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—

(5) provide adequate means for the plan's implementation, such as—

(D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the

distribution of all or any part of the property of the estate among those having an interest in such property of the estate;

Section 1124:

Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—

(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or

(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—

(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title or of a kind that section 365(b)(2) expressly does not require to be cured;

(B) reinstates the maturity of such claim or interest as such maturity existed before such default;

(C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;

(D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and

(E) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.

Section 1129(a)(7)(B):

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

Section 1129(b):

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at

least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of the subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

CERTIFICATE OF SERVICE

I certify that, pursuant to Federal Rule of Appellant Procedure 25(d), that on September 8, 2008, I caused an original and seven copies of the foregoing brief, plus one CD containing the brief in PDF form, to be sent by Federal Express to the Clerk for next day delivery.

I certify that in accordance with the agreement of the parties, the foregoing was served on the following persons by e-mail delivery on this 8th day of September 2008:

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CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) and 5th Cir. R. 32.3 because it contains 13,955 words, excluding the parts of the brief exempt by Fed. R. App. P. 32(a)(7)(B)(iii).

I hereby further certify that the brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the typestyle requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2003 in Times New Roman 14-point font.

September 8, 2008

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