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

IN RE:	§	JOINTLY ADMINISTERED
SCOTIA DEVELOPMENT LLC, ET AL,	§	Case No. 07-20027-C-11
Debtors.	§	Chapter 11

CALIFORNIA STATE AGENCIES' STATEMENT OF SUPPORT FOR MRC/MARATHON PLAN AND COMMENTS ON AND LIMITED OBJECTIONS TO CONFIRMATION OF PLANS

The California Resources Agency, the California Department of Forestry and Fire Protection, the California Department of Fish and Game, the California Wildlife Conservation Board, the California Regional Water Quality Control Board, North Coast Region, and the State Water Resources Control Board (collectively, the "California State Agencies") hereby file this statement of support for the MRC/Marathon Plan and comments and limited objections to confirmation of the Indenture Trustee's First Amended Plan ("Indenture Trustee Plan"), the Debtors' Second Amended Joint Plan ("Debtors' Plan"), the First Alternative Plan for the Palco Debtors (the "Palco Alternative Plan"), the First Alternative Plan for Scotia Pacific Company LLC (the "Scopac Alternative Plan"), and the MRC/Marathon First Amended Plan ("MRC/Marathon Plan"), based on the following.[1]

INTRODUCTION

1. As the Court and the plan proponents are all well aware, all of the approximately 211,000 acres owned by the Debtors, including the Scopac timberlands, are subject to state and federal regulation (the "Covered Lands"). This regulation, *inter alia*, raises issues of feasibility to varying degrees with each of the plans. For example, transfers of Covered Lands are subject to the approval of certain state and federal regulators. In addition, changes in activities on the Covered Lands are allowed only with the express, prior approval of certain state and federal

[1] Notwithstanding the Statement of Support for the MRC/Marathon Plan by California Governor Schwarzenegger and the California State Agencies, such support assumes the resolution of the issues raised herein.

regulators. The restrictions under the Agreement Relating to Enforcement of AB 1986 also are recorded on the Covered Lands as covenants, conditions, and restrictions ("CCRs"). As this Court has previously held, "[a] plan of reorganization cannot restructure the environmental laws and regulations of California and the United States." Memorandum Opinion and Order on Motion to Transfer Venue at page 14.

2. All of the proposed plans provide for the transfer of Covered Lands for their implementation. The Indenture Trustee Plan provides for the sale of the Commercial Timberlands and other Covered Lands to yet unknown third party or to the Indenture Trustee by credit bid. The MRC/Marathon Plan provides for the transfer of the Timberlands and other Covered Lands to Newco and Townco. The Debtors' Plan and the Palco Alternate Plan provide for the transfer of the town of Scotia (included in the Covered Lands) to Marathon. The Scopac Alternate Plan provides for the transfer of the Commercial Timberlands, but not the Marbled Murrelet Conservation Areas ("MMCAs"), to the Indenture Trustee, and then the development and sale of that portion of the Commercial Timberlands that are not transferred to the Indenture Trustee. Further, the Debtors' plans contemplate the sale of the MMCAs.

3. Each of these proposed transfers must be approved by the relevant state and federal agencies prior to the transfer as has been acknowledged in almost all of the plans. However, in some cases, it is unclear whether such approvals would be granted. For example, if the transfer(s) were determined to compromise the effectiveness of the Habitat Conservation Plan ("HCP") (such as by undermining the underlying biological goals and principles of the HCP and/or eroding the ability of the HCP to be administered or implemented effectively), such transfer(s) would not be approved. In addition, a proposed transferee may be found to be unacceptable if the transferee cannot ensure adequate funding to implement the HCP and any required monitoring. The Plans and the Confirmation Order should clearly provide that these prior approvals must be obtained by the successful plan proponent for any such transfer to be effective to ensure that the confirmed plan is feasible and is not "restructure[ing] the environmental laws and regulations of California and the United States."

4. In addition, all of the contemplated changes in activities on the Covered Lands are subject to the approval of certain state and federal regulators. The Court should be aware that some of the proposed changes in uses, such as the development of the Preserve Project contemplated by all of the Debtors' plans, will require incidental take permit amendments or new applications for incidental take permits. A permit amendment or issuance of a new permit would involve compliance with the California Endangered Species Act ("CESA") and federal Endangered Species Act ("ESA") permit issuance criteria and environmental review under the California Environmental Quality Act ("CEQA") and the National Environmental Policy Act ("NEPA") including public review. This process could be very lengthy (a minimum of 2-3 years) and there is no guarantee that proposed new uses would be permitted. To the extent that the Debtors' plans rely on the ultimate approval of proposed new uses, such plans involve an inherent risk that the plans may not be feasible and that the Debtors may need to revisit their business plans and/or restructure their debts in the future.

5. The California State Agencies have objections to other provisions of the various plans as detailed herein, including clarifications regarding the treatment of the so-called Headwaters litigation and post-confirmation jurisdiction issues to ensure that environmental matters are decided in the appropriate non-bankruptcy forum.

SUBJECT TO RESOLVING THE OBJECTIONS STATED HEREIN AND THE BANKRUPTCY COURT FINDING THAT THE MRC/MARATHON PLAN IS CONFIRMABLE, THE MRC/MARATHON PLAN BEST MEETS THE PUBLIC INTEREST

6. Filed concurrently herewith is the Statement of Support for the MRC/Marathon Plan by California Governor Arnold Schwarzenegger ("Governor's Statement"). The Governor's Statement finds that the MRC/Marathon Plan best meets the five principles articulated in his prior statement as indicative of the public interest in this case. While the other plan proponents pledge compliance with all Environmental Obligations and a willingness to obtain all environmental approvals required under the Environmental Obligations, those plans have inherent risks given the environmental regulatory scheme. For example, the Indenture

Trustee Plan has the inherent risk of the unknown future owner. While the identified potential purchasers are encouraging, there is no certainty of the identity of the winning bidder. The Indenture Trustee Plan also does not provide long term stability for the lumber mill. With respect to the Debtors' plans, all of them rely on the ultimate approval possibly years from now of new uses for the property that may not be approved. Such changes certainly would require the state and federal regulatory agencies to approve changes to the existing environmental scheme. The MRC/Marathon Plan is the plan that leaves the regulatory scheme intact.

7. The MRC/Marathon Plan most closely meets the intent of the California Legislature to maximize sustainable timber production while preserving and enhancing natural resource and environmental values consistent with the Legislature's intent expressed in the Forest Practice Act. Cal. Pub. Res. Code § 4513(b) ("The goal of maximum sustained production of high quality timber products is achieved while giving consideration to values relating to recreation, watershed, wildlife, range and forage, fisheries, regional economic vitality, employment and aesthetic enjoyment."). Watershed and wildlife protection is enhanced by MRC/Marathon's commitment to uphold and maintain the HCP and other environmental obligations and the commitment to obtain Forest Stewardship Counsel certification. Both of these considerations make the MRC/Marathon Plan the best opportunity by far to advance and protect both the economic and environmental value of these assets over the long term.

8. The Court should consider the public interest in deciding which plan to confirm if faced with more than one confirmable plan. See e.g. *In re Holly Garden Apartments, LTD.*, 238 B.R. 488, 495 (Bankr. M.D.Fla. 1999) (noting reorganization preferable to liquidation, preservation of jobs in comparing plans). The Governor's Statement, the position of the California State Agencies as outlined herein, and the position of the federal and local regulators should guide the Court in its determinations of the public interest in this matter.

9. Regardless of which plan is confirmed by the Court, the California State Agencies will work with the Reorganized Debtor(s) to ensure environmental compliance.

THE TRANSFERS CONTEMPLATED BY ALL PLANS MUST BE APPROVED BY THE STATE AND FEDERAL AGENCIES BEFORE THE TRANSFERS OCCUR

A. Species and Habitat Conservation Regulation.

10. The California Endangered Species Act (Cal. Fish & Game Code, § 2050 et seq.) ("Act") prohibits the "take" of any species protected by the Act. The Act allows the "take" of species in the course of another lawful activity if the responsible person obtains an incidental take permit from the California Department of Fish and Game ("DFG"). DFG may issue an incidental take permit if all of the permit issuance criteria set forth in Fish and Game Code § 2081(b) and (c) are satisfied. There are similar provisions under the federal Endangered Species Act (16 U.S.C. §§ 1531 et seq.) for the issuance of an incidental take permit by the U.S. Fish and Wildlife Service ("FWS") and the National Marine Fisheries Service ("NMFS").

11. Pacific Lumber Company ("Palco"), Scotia Pacific Company, LLC ("Scopac"), and Salmon Creek Corporation ("Salmon Creek") applied for incidental take permits from DFG and FWS and NMFS to legally "take" state and federally listed species in the course of lawful timber harvesting activities. These applications were based upon a draft Habitat Conservation Plan and draft Implementation Agreement for the Habitat Conservation Plan. After negotiating the provisions of the draft Habitat Conservation Plan and the draft Implementation Agreement and conducting the requisite environmental review, revisions were made to the draft Habitat Conservation Plan and draft Implementation Agreement. Thereafter, DFG determined that the final Habitat Conservation Plan and Implementation Agreement embodied sufficient measures to meet the incidental take permit issuance criteria, as well as other requirements of the Fish and Game Code, e.g., avoidance of take of certain fully protected species. On or around March 1, 1999, DFG approved the Habitat Conservation Plan ("HCP") and Implementation Agreement ("HCP IA"), and granted the Incidental Take Permit ("ITP"). Similarly, FWS and NMFS approved the HCP and HCP IA and issued incidental take permits under the federal ESA.

12. The ITP requires the Debtors to comply with all applicable laws, the conservation measures in the HCP, all the terms of the HCP IA, all monitoring, and the reporting and other requirements in the Mitigation Monitoring and Reporting Program. These obligations arise from DFG's issuance of the ITP under the Act and are regulatory requirements the Debtors must follow as a condition of obtaining the ITP.[2]

13. Among other things, the HCP IA requires the Debtors to post $2 million as security to help ensure the performance of the Debtors' regulatory environmental obligations under the ITP and the federal ITPs. DFG, FWS and NMFS have access to this security to remediate if the Debtors do not fulfill their obligations under the ITPs. The Debtors must replenish and increase the security in accordance with the terms of the HCP IA. See Cal. Fish & Game Code § 2081(b)(4); Cal. Code Regs. Tit. 14 §§ 783.4(a)(4) and 783.6(a)(1); 16 U.S.C. § 1539(10)(a)(2)(B)(iii); 50 C.F.R. §§ 17.22(b)(2)(C), 17.32(b)(2)(C), and 222.307(c)(2)(v); and HCP IA § 3.3.

14. Assembly Bill 1986 ("AB 1986") appropriated $130 million of state public money for the purchase of the Headwaters Forest and related properties. The appropriation was conditioned upon certain requirements. AB 1986 expressly prescribes the minimum protections that must be included in the HCP, including but not limited to: a no-cut buffer of 100 feet on each class 1 watercourse; a no-cut buffer of 30 feet on each class 2 watercourse; and additional restrictions on class 1, 2, and 3 watercourses. Generally, these conditions are to remain in place until a watershed analysis for the particular watercourse(s) is completed, and site-specific prescriptions for that watercourse(s) have been established and implemented. In certain areas known as the marbled murrelet conservation areas ("MMCAs") on the Debtors' timber land; AB 1986 prohibits any activity that is detrimental to the marbled murrelet or its habitat. Additionally, the HCP stipulates no timber harvesting in these areas unless it is beneficial to the

[2] Environmental groups have challenged the state ITP in litigation that currently is pending before the California Supreme Court; therefore, the state ITP is stayed. However, the state ITP obligations remain applicable to the Debtors through determinations by DFG pursuant to Cal. Fish & Game Code § 2080.1 that the federal incidental take permits are consistent with the Act.

marbled murrelet and its habitat and approved by DFG and FWS. (Stats. 1998, ch. 615). The HCP also limits activities within 0.25 miles of the MMCAs to minimize disturbance to nesting habitat, and all activities within this buffer zone must be approved by the agencies. All the restrictions and requirements placed on the Debtors' timber harvesting activities are regulatory restrictions as they stem from this legislation and the state and federal ITPs.

15. The Agreement Relating to the Enforcement of AB 1986 ("Enforcement Agreement") enforces the requirements of AB 1986. The Enforcement Agreement, and all its restrictions and obligations related to land management, were recorded against approximately 211,700 acres of the Debtors' land as covenants, conditions, and restrictions ("CCRs") running with the land for a period of 50 years. Like the HCP IA, the Enforcement Agreement requires the Debtors to post a $2 million security accessible to the State, by and through DFG, the California Wildlife Conservation Board ("WCB"), the California Resources Agency ("Resources Agency"), and the California Department of Forestry and Fire Protection ("CDF"), for liquidated damages and/or any remediation costs incurred for restoration work the Debtors fail to perform. The Debtors must replenish and increase the security in accordance with the terms of the Enforcement Agreement.[3] The Enforcement Agreement requires the Debtors to pay liquidated damages in the amounts provided in the Enforcement Agreement for specific breaches of AB 1986, the Enforcement Agreement, the HCP, the HCP IA, the ITP, and any timber harvest plan ("THP"). These liquidated damages are monies owed to the State, by and through DFG, WCB, the Resources Agency, and CDF for the Debtors' failure to comply with the regulatory obligations. HCP IA § 3.3 and Enforcement Agreement § 7.

16. Sections 5.3.1 and 5.5 of the HCP IA require advance approvals by DFG, FWS and NMFS of any transfer of "covered lands" and an amendment to the ITPs to the extent such

[3] With respect to the $2 million security, the California State Agencies join in the federal agencies request that Confirmation Order provide, "The state and federal Wildlife Agencies interest in the at least $2,509,580 Certificate of Deposit issued by Bank of America shall not be impaired or adversely affected in any way by the confirmation of the Plan or the bankruptcy case."

transfer is not considered a minor modification.[4] Section 5.3.1(a) provides, in pertinent part, as follows:

> PALCO's transfer of ownership or control of Covered Lands, or portions thereof, other than in the MMCAs, which transfers are addressed in Section 5.5 of this Agreement, **will require prior approval by [DFG, FWS and NMFS]** and an amendment of the Federal and State Permits in accordance with Section 7.2 of this Agreement, except that transfers of such Covered Lands may be processed as minor modifications in accordance with Section 7.1 of this Agreement if: . . . .

(Emphasis added).

17. Section 5.5 of the HCP IA applies to transfers of the MMCAs. Section 5.5 provides, in pertinent part, as follows:

> PALCO may sell, exchange or otherwise transfer to a third person one or more of the MMCAs, or a portion thereof, so long as **PALCO demonstrates to the reasonable satisfaction of [DFG, FWS, NMFS]** that the protection to be afforded by such third party (and it successors) to the marbled murrelet and the habitat of the marbled murrelet in such MMCA(s) and to the other Covered Species is equal to or greater than that afforded under the HCP for a period of 50 years from the Effective Date. . . . Without limiting the generality of the foregoing, for purposes of this Agreement, the sale, exchange or transfer to a third party of an MMCA with legally binding restrictions running with the land and **reasonably approved by [DFG, FWS, NMFS], or other protection reasonably approved by [DFG, FWS, NMFS]**, which limit the uses of the MMCA proposed for transfer to those uses specified at Section 3.1.1 of this Agreement for a period of 50 years from the Effective Date shall be deemed to constitute protection afforded by such third party (and its successors) that is equal to or greater than that afforded under the HCP.

(Emphasis added).

18. In addition, Section 5.3.1(a) provides for processing certain transfers as minor modifications under Section 7.1 of the HCP IA. However, even a transfer that can be processed as a minor modification requires the prior approval of DFG, FWS, and NMFS. To be processed as a minor modification, a transfer of Covered Lands must meet one of the following: (a) be a

[4] Covered Lands is defined in the HCP IA. The definition essentially means the lands upon which the state and federal ITPs authorize incidental take.

transfer to an agency of the federal government and prior to the transfer DFG, FWS and NMFS determine that the transfer will not compromise the effectiveness of the HCP based on adequate commitments by the federal agency regarding management of the land; (b) be a transfer to a non-federal entity that has entered into an agreement acceptable to DFG, FWS, and NMFS to reasonably ensure that the lands will be managed in such a manner and for such duration so as not to compromise the effectiveness of the HCP; or (c) be a transfer to a non-federal entity that, prior to completion of the transfer, has agreed to be bound by the HCP and has obtained federal and state incidental take permits following normal permit procedures covering all Covered Species then identified in PALCOs ITPs which may be incidentally taken as a result of activities on the transferred lands. Under Section 7.1.1 of the HCP IA, a proposed minor modification is not effective until DFG, FWS, and NMFS approve it.

19. In addition to the HCP and the HCP IA, AB 1986 and the Enforcement Agreement (which is recorded as the CCRs) require prior DFG, WCB, Resources Agency and CDF approval of transfers of Covered Land. Section 9.1 of the Enforcement Agreement requires the Debtors to follow Sections 5.3, 5.4 and 5.5 of the HCP IA for the transfers of any Covered Lands. In addition, Section 9.1 of the Enforcement Agreement requires the Debtors to insure that the terms of the Enforcement Agreement remain on the transferred land as CCRs and that the transferee has assumed in writing the Debtors' obligations under the Enforcement Agreement.

B. Water Quality Regulation.

20. The California Regional Water Quality Control Board, North Coast Region ("RWQCB") is one of nine regional boards established by the Porter-Cologne Water Quality Control Act (Cal. Water Code § 13000 et. seq) to regulate water quality, and is, along with the California State Water Resources Control Board, the state agency with primary responsibility for the coordination and control of water quality in the North Coast region. Cal. Water Code § 13001. The United States Environmental Protection Agency ("USEPA") has authorized the State of California, through the State Water Resources Control Board and the regional water

quality control boards, to administer portions of the Clean Water Act (33 U.S.C. §§ 1251 et seq.). See 40 C.F.R. Part 123; Cal. Wat. Code § 13160. The North Coast region consists of all basins draining into the Pacific Ocean from the California-Oregon state line southerly to the southerly boundary of the watershed of Estero de San Antonio and Stemple Creek in Marin and Sonoma counties. Cal. Wat. Code § 13200(a). This area includes the 211,000 acres of land owned by Palco, Scopac and Salmon Creek.

21. The RWQCB adopts and implements a Water Quality Control Plan for the North Coast Region (hereinafter "Basin Plan") that designates beneficial uses, establishes water quality standards (33 U.S.C. § 1313) and objectives, and contains implementation programs and policies to achieve those objectives for all waters addressed through the plan. Cal. Wat. Code §§ 13240-47. The RWQCB's core functions also include issuing waste discharge requirements ("WDRs") (Cal. Wat. Code § 13263) and National Pollution Discharge Elimination System ("NPDES") permits (33 U.S.C. § 1342; Cal. Wat. Code § 13377), issuing clean up and abatement orders (Cal. Wat. Code § 13304), and taking other enforcement actions, including issuing administrative civil liability orders for violation of the Basin Plan, permits or other orders. See e.g. Cal. Wat. Code §§ 13323, 13350, and 13385. In addition, the RWQCB implements certain provisions of the California Health and Safety Code and other laws regarding the regulation of hazardous materials and hazardous waste. Most actions by the RWQCB, including Basin Plan amendments, must comply with CEQA to identify and mitigate where feasible any environmental impacts from projects subject to water board approval.

22. The Debtors' regulatory obligations administered and enforced by the RWQCB arise from three primary areas: (a) the Debtors' obligations under environmental laws administered by the RWQCB; (b) the Debtors' previous and, in some cases, ongoing violations of those environmental laws and administrative orders; and (c) the Debtors' obligation to investigate and/or remediate property or waters affected by the Debtors' discharges of waste.

23. Pursuant to Water Code section 13304, the RWQCB has issued a number of clean up and abatement orders ("CAOs") against the Debtors for discharges into the waters of the state

caused by the Debtors' timber harvest-related activities. These include CAO No. 98-100 (North Fork Elk River), CAO R1-2004-0028 (South Fork Elk River and Mainstream Elk River Watersheds), CAO R1-2006-0046 (Freshwater Creek Watershed), and CAO R1-2006-0055 (North Folk Elk River Watershed).

24. The RWQCB also has identified four sites in the North Coast Region owned and/or operated by the Debtors at which significant petroleum and/or hazardous waste remediation is necessary. These sites are located as follows: 121 Main Street in Scotia (Palco Ademars Scotia Chevron/Company Garage), 511 Highway 36 in Carlotta, 1440 Newburg Road in Fortuna, and 125 Main Street in Scotia. See SWRCB Resolution No. 92-49 (Policies and Procedures for Investigation and Cleanup and Abatement of Discharges); Cal. Code of Regs., Title 23 (containing regulatory requirements for hazardous waste).

25. The Debtors' instream activities, including stream crossings and gravel extraction, are subject to water quality certification orders issued pursuant to section 401 of the Clean Water Act (33 U.S.C. § 1341; Cal. Wat. Code § 13160) and the RWQCB's general waste discharge requirements (WDRs) for gravel and sand extraction. The Debtors' point source discharges to surface waters from the Scotia wastewater treatment facility and steam electric power plant are subject to requirements under NPDES permits. 33 U.S.C § 1342; Cal. Wat. Code §13370 et seq. The Debtors also are subject to WDRs and Monitoring and Reporting Orders (Cal. Wat. Code § 13267) for their operations on land disposal sites. See Cal. Code of Regs., Title 27 (containing regulatory requirements for wastes other than hazardous waste). Storm water discharges from the Scotia Mill, Tank Gulch SWDS, and Yager Camp are subject to the requirements of the general Stormwater NPDES permit. State Water Board Water Quality Order No. 97-03-DWQ.

26. Further, there are numerous WDRs issued to the Debtors for their timber operations that establish water quality requirements, technical report requirements, and reporting requirements. The WDRs include Order Nos. R1-2004-003 (General Waste Discharge Requirements), R1-2006-0041 (Watershed-Wide Waste Discharge Requirements for Freshwater Creek Watershed), and R1-2006-0039 (Watershed-Wide Waste Discharge Requirements for Elk

River Watershed). The general WDRs, *inter alia*, prohibit the discharge of waste (including, for example, sedimentation resulting from timber harvest-related activities) to waters of the state in violation of water quality standards and other requirements and require the Debtors to submit technical reports that identify discharge sources, the measures that address each source, and a schedule implementing these measures. The two watershed-wide WDRs for the Freshwater and Elk River watersheds limit the overall disturbance that may result in waste discharges from timber harvest operations and require compliance with the Water Quality Control Plan for those discharges. The watershed-wide WDRs require, *inter alia*, the Debtors to submit technical reports to the RWQCB, including annual pre-harvest planning reports, compliance monitoring plans and data, spill prevention control and countermeasure plans for petroleum, erosion control plans, and treatment and implementation schedules.

27. The RWQCB's Water Quality Control Plan contains specific requirements and prohibitions that apply to discharge of waste from timber harvest-related activities. In addition, Section 303(d) of the federal Clean Water Act requires the RWQCB to further amend its Water Quality Control Plan to promulgate total maximum daily loads (TMDLs) for Freshwater Creek, Elk River, and other watersheds that are listed as impaired due to excessive sediment and/or elevated water temperatures. These TMDLs will be accompanied by Implementation Plans (Cal. Wat. Code § 13242) that will utilize a variety of regulatory mechanisms to ensure restoration of beneficial uses and attainment of water quality standards.

28. With respect to the transfers of lands subject to the CAOs, the WDRs and the contaminated sites, all of the plans specifically provide for the satisfaction and compliance with Environmental Obligations, including but not limited to the CAOs, WDRs, and remediation on contaminated sites. However, there is no automatic "transfer" provision for enrollments under general WDRs and watershed-wide WDRs. Any new owner must submit an application package in accordance with the WDR to be authorized to discharge. An owner who sells property covered by the watershed-wide WDRs must inform the new owner of the duty to file an application and shall provide the new owner with a copy of the WDRs. Failure to inform the

new owner does not release the buyer or the seller from any potential liability for failure to comply with any WDRs, or other provisions of the Porter-Cologne Water Quality Control Act. Moreover, if any HCP provisions are changed or eliminated because of changes in uses on Covered Lands, the WDRs would need to be revised because the WDRs are premised upon, and rely upon continued compliance with, HCP provisions that are intended to conserve cold water fisheries.

29. With respect to CAOs and site remediation, when a new owner acquires property on which a discharge of waste is occurring or has occurred, that new owner becomes responsible for the remediation, in addition to the former owner.

30. A change in ownership of NPDES permits and water quality certifications requires various administrative procedures and in some cases requires RWQCB action amending the permit.

C. Timberland Management Regulation.

31. CDF is the California state agency that is responsible for forest protection and for managing, maintaining, and enhancing California's forests. Cal. Pub. Res. Code § 713. CDF meets its statutory duties through administering and enforcing the Z'Berg-Negedly Forest Practice Act of 1973 (the "Forest Practice Act") (Cal. Pub. Res. Code § 4511 et seq.) and its implementing regulations (the "Forest Practice Rules") (Cal. Code Regs., 14 tit. §§ 895-1112), among other laws. As required by the Forest Practice Act and Forest Practice Rules, CDF reviews and approves timber harvesting plans ("THPs"), which govern timber harvesting of non-federal lands in California. Thus, with certain exceptions, a THP must be submitted and approved by CDF before any timber is harvested in California. Cal. Pub. Res. Code § 4581. It is important to recognize that a THP is considered a "functional equivalent to an environmental impact report ("EIR") as described in the California Environmental Quality Act ("CEQA"). Cal. Pub. Res. Code § 21080.5. As such a functional equivalent, a THP must meet the substantive requirements of CEQA as part of a legally sufficient EIR such as an accurate project description, an alternatives analysis and an analysis of potential cumulative impacts. Each Palco THP relies

heavily upon analyses and mitigation measures contained in both the HCP and its accompanying certified EIR/EIS. Thus, CDF relies upon the HCP and the EIR/EIS in order to approve a THP as containing complete and accurate information to meet CEQA's substantive requirements.

32. CDF issued the THPs under which the Debtors operate. THPs result in timber harvesting permits that typically require measures to mitigate the adverse effects of harvesting. These mitigation measures often include erosion control, prescribed maintenance for erosion controls, restocking requirements, and repairs to roads, bridges and culverts. See e.g. Cal. Pub. Res. Code §§ 4562.5, 4562.7, and 4562.9; Forest Practice Rules 923.1, 923.2, 923.3, 923.4, and 923.6). These important measures are required by law as part of the Debtors' approved timber harvesting plans.

33. Consistent with the HCP IA, the requirements of the HCP are incorporated into each of the Debtors' THPs. The failure of the Debtors to comply with THPs approved by CDF also may constitute a violation of the HCP or the HCP IA, as well as create the potential for significant adverse environmental impacts in violation of CEQA. Cal. Pub. Res. Code § 21000 et seq.; Cal. Code of Regulations Title 14, Chapter 3, Sections 15000-15387. THPs require the landowner to comply with all other regulatory agency requirements. Thus, failure to comply with the requirements in a THP also may constitute violations of other environmental statutes.

34. To process a transfer of lands subject to a THP, certain requirements must be met. If a THP has been submitted to and approved by CDF but a notice of completion has not yet been issued by CDF, Forest Practice Rule 1042 requires a change of ownership to be filed with the Director of CDF. The timberland owner must inform the new owner that the new owner must comply with the incomplete THP, the stocking standards of the Forest Practices Act, and all rules of the Board of Forestry. This means that all mitigations that are a part of a THP become the responsibility of the new owner.

35. In addition to the THP requirement, any timberland owner must demonstrate that it meets the sustained yield requirements of the Forest Practice Act, Public Resources Code § 4551 et seq. and Forest Practice Rule 1091.1. To meet this requirement, Palco has elected to

provide CDF with a document known as an Option A pursuant to FPR 1091.4.5(a). This document must demonstrate that Palco will achieve maximum sustained yield production of high quality timber products consistent with the protection of soil, water, air, fish and wildlife resources. Specifically, the Option A must demonstrate that average projected harvest over any rolling ten year period shall not exceed the long term sustained yield estimate for the ownership. This is significant because, in the event Palco divests itself of land currently counted in its sustained yield projections, its Option A must be revised to reflect the change in available trees for harvest. This may reduce the amount of timber available for harvest on the remainder of the property.

D. Any Confirmation Order Should Specifically Provide that the Transfers Contemplated by the Confirmed Plan are Subject to the Prior Approval of State and Federal Regulators.

36. While in bankruptcy, 28 U.S.C. § 959(b) requires debtors-in-possession to "manage and operate the property in [their] possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof." Consistent with this requirement, Bankruptcy Code section 1129(a)(3) provides that debtors may not propose plans that are "forbidden by law." See also, *In re Texas Extrusion Corp.*, 844 F.2d 1142, 1160 (5th Cir. 1988) (court reviews assertion that plan was "forbidden by law" because it would violate antitrust laws); *In re Cajun Electric Power Co-op, Inc.*, 150 F.3d 503, 519 (5th Cir. 1998) (Plan may not propose "independent illegality"); see also *Collier on Bankruptcy* § 1129.03[3][b][ii] (plan that would violate other regulatory law would be "forbidden by law" and would preclude confirmation even if no provision of title 11 was violated). Just as a debtor-in-possession must comply with applicable approval requirements relating to its property under environmental law, *a fortiori*, a reorganized debtor must comply with the same requirements, and any plan that suggested otherwise would be "forbidden by law" and not confirmable. Indeed, the Fifth Circuit has emphasized the limited role of bankruptcy courts once a debtor emerges from chapter 11. See *In re Craig's Stores of Texas, Inc.*, 266 F.3d 388 (5th Cir. 2001).

37. Moreover, a plan must provide adequate means for its implementation. See 11 U.S.C. § 1123(a)(5) (requiring a plan to provide adequate means for its implementation). This requirement has been interpreted to prevent confirmation of plans that violate non-bankruptcy law. See, *Pacific Gas & Elec. Co. v. California*, 350 F.3d 932 (9th Cir. 2003) (Congress did not intend section 1123(a)(5) to permit the debtor to make transfers of assets in violation of state laws).

38. To ensure that the confirmed plan provides for adequate means for its implementation and compliance with environmental laws, regulations, orders, permits and agreements, any Confirmation Order must state the following, "Nothing in the Plan or this order relieves the [Plan Agent, Palco or the Reorganized Development Company, Scopac or Reorganized Scopac, the Debtors, the Reorganized Entities, Newco or Townco, as the case may be] from complying with any and all applicable terms and conditions of Environmental Obligations, Federal or State Incidental Take Permits, including, without limitation, the Habitat Conservation Plan and Implementation Agreement for the Habitat Conservation Plan, the Agreement Relating to Enforcement of AB 1986, and all WDRs, CAOs, and THPs." Given the representations of the plan proponents in the Disclosure Statement regarding environmental compliance and the lack of any effect on the regulatory environment, none of the plan proponents should object to this request.[5]

39. In addition, to ensure that disputes involving Environmental Obligations are not improperly brought into the Bankruptcy Court, the Confirmation Order must state the following, "Notwithstanding anything to the contrary in the Disclosure Statement, the Plan or this order, any disputes involving the Environmental Obligations, regulatory approval of any transfers

[5] The California State Agencies also join in the request of the Federal Wildlife Agencies that the Confirmation Order provide: "Nothing in this Plan or this Order authorizes any transfer of Covered Lands or permits by the Reorganized Debtor prior to obtaining any applicable regulatory approval. Covered Lands shall mean any property covered by the Debtors' permits or the Habitat Conservation Plan and Implementation Agreement." See Federal Wildlife Agencies' Comments On and Limited Objections to Proposed Plans of Reorganization.

contemplated by the Plan, or the amendment or issuance of any environmental permit shall be resolved in the appropriate non-bankruptcy forum. Paragraph ___ [providing for jurisdiction in the Southern District of Texas] of the Plan shall not apply to any Environmental Obligations to governmental entities."

E. The Palco Alternative Plan and Scopac Alternative Plans Do Not Specifically Provide that the Transfers Contemplated by Those Plans are Subject to the Prior Approval of the State and Federal Agencies.

40. The Disclosure Statement with respect to the Palco Alternative Plan and the Scopac Alternate Plan states that "[e]ach plan proposed by the Debtors is specifically conceived and shall be implemented in a manner which complies with the California state and federal ITPs and consistency determinations under CESA, including the associated HCP and IA, as well as AB 1986, including the Agreement Relating to Enforcement of AB 1986 and the associated, recorded CC&Rs." See Amended Joint Disclosure Statement § 8.15 (Docket No. 2401).

41. However, neither the Palco Alternative Plan or the Scopac Alternative Plan specifically provide that the transfers of Covered Lands not included in the Development Project or Preserve Project will be implemented in compliance with the HCP, the HCP IA and the Enforcement Agreement, including but not limited to the prior approvals from DFG, FWS, and NMFS. In fact, the Palco Alternate Plan provides at § 7.5 that the entry of the Confirmation Order constitutes authorization for Palco to implement the plan "without further act or action under any applicable law, order, rule or regulation . . . ."

42. Under the Palco Alternate Plan, the Palco Town Assets and the Scotia Mill are transferred to Marathon. Under the Debtors' Plan, the Palco Town Assets are transferred to Marathon. Under the Scopac Alternative Plan, the Commercial Timberlands are transferred to the Noteholders. Each of these transfers must comply with the HCP, the HCP IA, and the Enforcement Agreement, including but not limited to the prior approvals from DFG, FWS and NMFS.

43. To remedy this defect, the Palco Alternative Plan or Confirmation Order must provide as follows: "The Plan contemplates the transfer of the Palco Town Assets and the Scotia

Mill which shall be implemented in accordance with and in compliance with all applicable non-bankruptcy law requirements, terms, conditions, permits, plans, approvals, restrictions and covenants. In other words, Palco or the Reorganized Development Company as the case may be shall implement the Plan, including the transfers of the Palco Town Assets and the Scotia Mill, by obtaining all non-bankruptcy law approvals and permits for the transactions contemplated by the Plan as if no bankruptcy case was filed."

44. The Scopac Alternate Plan or Confirmation Order must provide as follows: "The Plan contemplates the transfer of the Commercial Timberlands which shall be implemented in accordance with and in compliance with all applicable non-bankruptcy law requirements, terms, conditions, permits, plans, approvals, restrictions and covenants. In other words, Scopac or Reorganized Scopac as the case may be shall implement the Plan, including the transfer of the Commercial Timberland, by obtaining all non-bankruptcy law approvals and permits for the transactions contemplated by the Plan as if no bankruptcy case was filed."

THE DEBTORS' PLANS ALL CONTEMPLATE THE POSSIBILITY OF MULTIPLE OWNERS OF COVERED LANDS WHICH RAISES SIGNIFICANT FEASIBILITY ISSUES

45. The Debtors Plan, the Palco Alternate Plan, and the Scopac Alternate Plan, all contemplate the possibility of multiple owners of Covered Lands by virtue of the implementation of the Preserve or Development Project. The prospect of an unknown number of owners of the Covered Lands causes the California State Agencies grave concerns. Not only will the processing of multiple requests for approval for many transfers cause significant costs and take a substantial amount of time, the prospect of multiple owners of the Commercial Timberlands or MMCAs may cause significant risks to the protection provided by the ITPs, including the HCP and the HCP IA, and the Enforcement Agreement. To the extent the effectiveness of the ITPs, the HCP, the HCP IA and the Enforcement Agreement are compromised in any way, the WDRs, CAOs and THPs also are potentially compromised because of their reliance on the protections in the ITPs. These risks include, but are not limited to, the following:

- Loss of protection to species covered by the HCP.

- Loss of landscape level protections.
- Loss of coordinated road management plan.
- Loss of coordinated landscape level monitoring (e.g., aquatic trend, amphibian, effectiveness, northern spotted owl, marbled murrelet, bald eagle, roads).
- It is unclear how the required 108 northern spotted owl activity sites will still be maintained across the original ownership as required by the HCP and ITP. Also, if the HCP mandated northern spotted owl pair and reproductive rates are not met, it is uncertain that additional mitigation measures (as per HCP) would be available (e.g., additional northern spotted owl sites).
- The HCP and HCP IA direct that 10% of each watershed shall be maintained in late seral habitat (older forest). It is uncertain how this requirement would be maintained across multiple owners. Development within or around late seral habitat may significantly impair the habitat value rendering it unusable by late seral species.
- Change in land use surrounding MMCAs may have serious negative consequences on the continued viability of the MMCAs as mitigation and protection for the marbled murrelet.

46. To assess these potential issues will take a substantial amount of time and study such that the approval of transfers to multiple owners in the near future is unlikely if at all. Assuming the Debtors fix the defect in the Palco Alternate Plan and the Scopac Alternate Plan, the Debtors plans all provide that the appropriate non-bankruptcy approvals, permits, procedures and Environmental Obligations will be complied with, obtained and followed. However, the California State Agencies raise these issues to inform the Court of the potential feasibility issues involved with the plans.

ANY CHANGE IN THE ACTIVITIES TO BE CONDUCTED ON COVERED LANDS IS SUBJECT TO DFG, FWS AND NMFS PRIOR APPROVAL

47. In addition to prior approvals of any transfers of Covered Lands, in the event any new activity is proposed on lands either transferred or retained under any plan, DFG, FWS and NMFS will need to determine whether the new activity can be permitted in accordance with the State and Federal Endangered Species Acts and their implementing regulations, which also require assurances of adequate funding to carry out applicable requirements. See HCP IA §§ 3.1.5 (No Increase in Take), 3.2 (Covered Activities), and 7.2 (Permit Amendments). As noted above, if any HCP provisions are changed or eliminated because of changes in uses on Covered

Lands, the WDRs would need to be revised because such permits rely upon HCP provisions. Whether DFG, FWS and NMFS will permit new activities cannot be determined at this time.

48. For example, the Debtors Plan and the alternate plans seek to implement the Preserve or Development Project. Included within the Preserve Project is the Redwood Preserve Development which is described as a "carefully designed master-planned development." Residential housing is not a covered activity under the HCP. Therefore, the effect on the environment, including but not limited to threatened and endangered species listed under the State and Federal Endangered Species Acts, of such activity was not considered or analyzed in connection with the approval of the incidental take permits and the HCP. Housing development can have different and/or additional impacts on the incidental take of covered species that DFG, FWS, and NMFS would need to analyze based on the specifics of proposed uses, including but not limited to: (1) increases in water withdrawal for domestic purposes from watercourses supporting wildlife and fish; (2) increases in road densities and usage that could impact sediment levels in streams which can affect wildlife and fish; (3) the risk of landslide activity that would impact streams, wildlife, and fish; (4) increases in the delivery of nutrients and pesticides to streams that would threaten wildlife and fish; (5) impact on wildlife and fish of increased human activity, including noise, light and domesticated animals; (6) conversion of foraging, nesting and resting habitat for wildlife at building sites; (7) attraction of nuisance species (e.g., corvids) thereby increasing predation on nesting birds (e.g., marbled murrelets); (8) introduction of invasive weed species; (9) conversion of rare plant habitat at building sites; and (10) increased fragmentation of older forest habitats. Whether DFG, FWS and NMFS would approve coverage of residential housing under the ITPs cannot be determined at this time.

49. The Debtors Plan, the Palco Alternate Plan and the Scopac Alternate Plan all expressly provide that the Preserve Project, which includes the Redwood Preserve Development, shall be undertaken in compliance with all applicable statutory and regulatory land use, resource protection and environmental laws**,** including the California Endangered Species Act, the California Environmental Quality Act, the California Forest Practices Act, the California Porter-

Cologne Water Quality Control Act, and AB 1986. See Debtors Plan § 8.6, Palco Alternate Plan § 7.6, and Scopac Alternate Plan § 7.6.

50. Notwithstanding the plan terms acknowledging and requiring compliance with non-bankruptcy law to implement the Preserve Project, the California State Agencies believe the Court should be aware of the potential issues involving the Preserve Project when considering feasibility and other confirmation issues. Allowing other uses of the Covered Lands, such as development, would require a permit amendment or new applications for incidental take, as take associated with the new use, such as development, may be quite different than take associated with the Covered Activities for commercial timber management. A permit amendment or issuance of a new permit would involve compliance with the federal Endangered Species Act and the California Endangered Species Act (Cal. Fish & Game Code § 2081(b) and (c); Cal. Code Regs., Tit. 14, 783.4) permit issuance criteria and environmental review under the National Environmental Policy Act (42 U.S.C. § 4321 et seq.) and the California Environmental Quality Act (Cal. Pub. Res. Code § 21000 et seq.), including public review. This process could be very lengthy (a minimum of 2-3 years) and there is no guarantee that proposed new uses would be permitted. To the extent the Debtors' plans rely on the ultimate approval of proposed new uses such as the Preserve Project, it involves an inherent risk that the plan may not be feasible and that the Debtors may need to revisit their business plans and/or restructure their debts in the future.

51. Further complicating the matter is the reliance on the existing HCP by the RWQCB and CDF for the issuance of WDRs and THPs. As indicated, to the extent the effectiveness of the ITPs, the HCP, the HCP IA and the Enforcement Agreement are compromised in any way, the WDRs and THPs also are potentially compromised because of the reliance on the protections in the HCP.

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THE FTI CONSULTING EXPERT REPORT REGARDING THE LITIGATION IS INADMISSIBLE

52. The Debtors have listed as an expert FTI Consulting for the purpose of valuing the alleged damages in the Debtors lawsuit pending in Fresno Superior Court, California. The Debtors presumably intend to ask the Court to admit the FTI report as evidence of a potential asset of the estate. The California State Agencies object to the admissibility of the FTI report on the following grounds: (a) that it is not relevant under Federal Rule of Evidence 402 ("Evidence which is not relevant is not admissible."); (b) that it is not based on sufficient facts or data under Federal Rule of Evidence 702; (c) that it is not the product of reliable principles and methods; and (d) that the witness has not applied the principles and methods reliably to the facts.

53. First, the FTI report is irrelevant because it merely states a present value of alleged damages without any attempt whatsoever to match those alleged damages with the probability of success on the merits. In the deposition of Mr. Lumsden, he admitted that the scope of FTI's task in creating the report did not include an assessment of the merits of the litigation, that its report does not discuss the merits, and that FTI is not qualified to give such an opinion.[6] As this Court is well aware, the likelihood of success on the merits is a primary factor in determining the value or amount of any litigation claim. See e.g. *In re EagleBus Mfg., Inc.*, 158 B.R. 421 (S.D. Tex. 1993) (in estimating litigation claims court properly took into consideration likelihood of success on merits, time and costs of litigation, among other factors). The mere fact of alleging an amount of damages alone does not mean the litigation has any value whatsoever. See e.g. *Maxwell v. KPMG LLP*, 2008 U.S. App. LEXIS 5896, __ F.3d __ (7th Cir. March 21, 2008) (noting the disconnect in trying to ascertain "expected value" of litigation by considering large damage claims with little or no probability of success).

54. For the same reasons, the FTI report is not based on sufficient facts or data, is not the product of reliable principles and methods, and such principles and methods have admittedly

[6] This testimony was a bit surprising because in the Debtors' Emergency Motion for a Protective Order, the Debtors represented to this Court that the FTI report "candidly discusses the claims the Debtors hold against the State Agencies, the Debtors' litigation strategies, *the merits of the claims* and the value of the causes of action asserted." Docket No. 2509, paragraph 3.

not been applied in the report for it to be admissible under Federal Rule of Evidence 702. The California State Agencies request the Court strike the FTI report as inadmissible.

ANY TRANSFER OF THE SO-CALLED HEADWATERS LITIGATION MUST BE SUBJECT TO ANY RIGHTS OF THE DEFENDANTS RELATED TO THE LITIGATION

55. Both the MRC/Marathon Plan and the Indenture Trustee Plan provide for the transfer of the so-called Headwaters Litigation free and clear of claims. The MRC/Marathon Plan provides for the transfer of all of the assets that are not being transferred into the Litigation Trust, including the Headwaters Litigation, to the Reorganized Entities "free and clear of all Claims, Liens, charges, other encumbrances and Interests." MRC/Marathon Plan § 7.1, page 13. Similarly, the Indenture Trustee Plan provides for the transfer of the Debtor's Lawsuit Against Regulators to a litigation trust "free and clear of all Claims, interests, liens and encumbrances." Indenture Trustee Plan § 16.2.3.

56. However, the prosecution of that lawsuit by the Debtors post-petition and then by any party post-confirmation could subject the prosecuting party to costs and attorneys' fees in the event the trial court makes such an award in favor of the defendants. It is improper for a plan to disallow a legitimate claim by the confirmation process and not by the claim objection procedures provided by the Bankruptcy Code and Federal Rules of Bankruptcy Procedure. *In re Dynamic Brokers, Inc.*, 293 B.R. 489, 497 (9th Cir. BAP 2003) (chapter 11 plan provision cannot trump procedures for objections to claims in Rule 3007). To remedy this defect, any confirmation order should state as follows, "Notwithstanding anything in the Plan to the contrary, the confirmation of the Plan does not affect the rights of the defendants in the Headwaters Litigation to enforce any order issued by the court in the Headwaters Litigation against the post-confirmation entity that owns the Headwaters Litigation."

ALL PLANS HAVE OVERBROAD RETENTION OF JURISDICTION PROVISIONS

57. Moreover, all plans have overbroad retention of jurisdiction provisions that might improperly be interpreted to grant the Bankruptcy Court jurisdiction over the Headwaters Litigation. See e.g. Indenture Trustee Plan § 19.1.6 (hear, determine and adjudicate any

litigation involving the Avoidance Actions, Recovery Rights, or other claims or causes of action constituting Estate Property); Debtors' Plan § 12.1.2 (court retains "exclusive" jurisdiction to hear and rule upon all Causes of Action retained by the Debtors and commenced and/or pursued by the Debtors or Reorganized Debtors, provided that such Causes of Action are properly before the Bankruptcy Court); Palco Alternative Plan § 11.2.1 (same); Scopac Alternative Plan § 11.2.1 (same); MRC/Marathon Plan § 12.1.2 (hear and rule upon all Causes of Action retained by the Reorganized Entities and the Litigation Trust and commenced and/or pursued by the Debtors, the Reorganized Entities or the Litigation Trust, as the case may be, provided that such Causes of Action are properly before the Bankruptcy Court).

58. Further, the MRC/Marathon Plan, the Debtors' Plan and Scopac Alternative Plan impose the consent to jurisdiction on any party that has filed a claim or votes to accept that plan in the United States District Court for the Southern District of Texas, Corpus Christi Division and to venue in Nueces County, Texas. MRC/Marathon Plan § 12.2; Debtors' Plan § 12.2 (only on parties voting to accept the plan); Scopac Alternative Plan § 11.2 (only on parties voting to accept the plan).

59. A plan or confirmation order cannot confer jurisdiction on the bankruptcy court or any other court that does not exist by statute. See e.g. *In re Resorts Int'l*, 372 F.3d 154, 161 (3d Cir. 2004) ("if a court lacks jurisdiction over a dispute, it cannot create that jurisdiction by simply stating it has jurisdiction in a confirmation or other order"); *Harstad v. First Am Bank.*, 39 F.3d 898, 902 n.7 (8th Cir. 1994) (a provision in a plan "cannot and does not confer jurisdiction upon the court, as only Congress may do that."). If there is no jurisdiction under 28 U.S.C. §§ 157 or 1334, retention of jurisdiction provisions in a plan of reorganization or trust agreement are fundamentally irrelevant. *In re Resorts Int'l*, 372 F.3d at 161.

60. In the Fifth Circuit, post confirmation jurisdiction of the bankruptcy court is severely limited. After a debtor's reorganization plan has been confirmed, the debtor's estate, and thus bankruptcy jurisdiction ceases to exist, other than for matters pertaining to the implementation or execution of the plan. *In re Craig's Stores of Texas, Inc.*, 266 F.3d 388, 390

(5th Cir. 2001); see also, *Matter of U.S. Brass Corp.*, 301 F.3d 296, 304 (5th Cir. 2002) (following *Craig's* and rejecting the expansive view of post confirmation jurisdiction).

61. As to the Debtors' Plan and alternate plans, a bankruptcy court does not have "exclusive" jurisdiction over "related to" matters. 28 U.S.C. § 1334(b) (the district courts, and by referral under 28 U.S.C. § 157 the bankruptcy court, shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.) Those plans attempt to create exclusive jurisdiction where it does not exist and cannot be confirmed.

62. The language regarding jurisdiction over Environmental Obligations proposed for the Confirmation Order in paragraph 38 herein will ensure that the confirmed plan does not violate jurisdiction principles: "Notwithstanding anything to the contrary in the Disclosure Statement, the Plan or this order, any disputes involving the Environmental Obligations, regulatory approval of any transfers contemplated by the Plan, or the amendment or issuance of any environmental permit shall be resolved in the appropriate non-bankruptcy forum. Paragraph ___ [providing for jurisdiction in the Southern District of Texas] of the Plan shall not apply to any Environmental Obligations to governmental entities."

63. All plans should provide that the Headwaters Litigation shall not be transferred to the Bankruptcy Court, or at the very least provide that the Plan does not create jurisdiction in the Bankruptcy Court or District Court where it would not otherwise exist. The California State Agencies object to any imposed jurisdiction in Texas, including that contained in the MRC/Marathon Plan.

OTHER OBJECTIONABLE PROVISIONS

64. With the exception of the Indenture Trustee Plan, all the plans use an improper definition of Governmental Unit that may imply approval of a vigorously contested issue in the so called Headwaters Litigation; namely, that the State of California is not a unitary executive. To rectify this problem, the definition of Governmental Unit should be amended, as in the Indenture Trustee Plan, to add the following, "; provided however, that the use of the term

Governmental Unit shall not imply or constitute any admission or finding that the State of California is a unitary executive."

65. All of the plan proponents have filed their lists of executory contracts and unexpired leases in their plan supplements. Such lists include many of the regulatory permits and agreements that are included in the defined Environmental Obligations. All plans provide that the Environmental Obligations "pass through" the bankruptcy unaffected and that any order entered in connection with Confirmation of the plan shall not constitute a finding that any Environmental Obligation is an executory contract. Given these plan provisions, the plan supplements that list the Environmental Obligations as executory contracts must be qualified by footnote or provision in the Confirmation Order that the listing on the plan supplement of any of the Environmental Obligations shall not constitute a finding that any Environmental Obligation is an executory contract.

66. Finally, the Court should be very clear in any Confirmation Order that any findings in connection with confirmation of a plan are for the purposes of confirmation of the plan only and cannot be used in any other court for any other purpose.

WHEREFORE, the California State Agencies respectfully request the Court to properly address the regulatory issues raised herein in the Confirmation Order regarding: (1) prior regulatory approvals of all transfers of Covered Lands; (2) prior regulatory approval of changes in uses on Covered Lands; (3) the FTI report is inadmissible; (4) any transfer of the Headwaters Litigation must be subject to any rights of the Defendants related to the litigation; (5) the overbroad retention of jurisdiction provisions in all of the plans should not be approved unless modified; (6) correcting the defined term Governmental Unit; (7) clarifying the listing of the

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Environmental Obligations in the plan supplements; and (8) clarifying that any findings for confirmation are for that purpose only.

Dated: April 4, 2008

Respectfully submitted,

/s/ Michael W. Neville

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CERTIFICATE OF SERVICE

I, Karen L. Widder, declare:

I am a resident of the State of California and over the age of eighteen years, and not a party to the within action. I am an employee of Felderstein Fitzgerald Willoughby & Pascuzzi LLP and my business address is 400 Capitol Mall, Suite 1450, Sacramento, CA 95814-4434.

On April 4, 2008, I served the foregoing:

CALIFORNIA STATE AGENCIES' STATEMENT OF SUPPORT FOR MRC/MARATHON PLAN AND COMMENTS ON AND LIMITED OBJECTIONS TO CONFIRMATION OF PLANS

☑ (By Electronic Mail) I caused to be transmitted the above described document(s) via electronic mail to the electronic addresses as indicated on the attached list.

I declare under penalty of perjury, under the laws of the State of California and the United States of America that the foregoing is true and correct.

Executed on April 4, 2008, at Sacramento, California.

/s/ Karen L. Widder
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