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

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| IN RE: | : | Civil Action No. 08-259 |
| SCOTIA DEVELOPMENT LLC., *et. al.*, | : | Bankruptcy Case No. 07-20027-C11 |
| Debtors. | : | |

**REPLY IN SUPPORT OF MOTION OF APPELLEES MENDOCINO REDWOOD COMPANY, LLC AND MARATHON STRUCTURED FINANCE FUND L.P. TO DISMISS APPEAL FOR LACK OF SUBJECT-MATTER JURISDICTION OR AS EQUITABLY MOOT**


**HAYNES AND BOONE LLP**
John D. Penn
Trey A. Monsour
201 Main Street, Suite 2200
Forth Worth, Texas 76102
Telephone: (817) 348-6610
Facsimile: (817) 348-2300

**WINSTON & STRAWN LLP**
David Neier
Steven M. Schwartz
200 Park Avenue
New York, New York 10166-4193
Telephone: (212) 294-6700
Facsimile: (212) 294-4700

*Counsel to Appellee Marathon Structured Finance Fund L.P.*

**GOODWIN PROCTER LLP**
Allan S. Brilliant
Brian D. Hail
620 Eighth Avenue
New York, New York 10018-1405
Telephone: (212) 813-8800
Facsimile: (212) 388-3333

*Counsel to Appellee Mendocino Redwood Company, LLC*

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Appellees Mendocino Redwood Company, LLC ("MRC") and Marathon Structured Finance Fund L.P. ("Marathon") respectfully submit this reply in support of their Motion to Dismiss this appeal on the grounds of lack of subject-matter jurisdiction and equitable mootness. We show herein that the Opposition ("Opp.") submitted by Appellants Indenture Trustee and Noteholders (collectively, the "Indenture Trustee") fails to refute either of those grounds.

## I. THIS APPEAL SHOULD BE DISMISSED FOR LACK OF SUBJECT-MATTER JURISDICTION BECAUSE THE ISSUES RAISED BY THE SECTION 507(b) MOTION ARE INTERTWINED WITH THE CONFIRMATION ORDER NOW PENDING IN THE FIFTH CIRCUIT AND COULD HAVE BEEN HEARD IN THAT COURT.

In their Memorandum in Support of the Motion to Dismiss, MRC and Marathon demonstrated that this appeal should be dismissed for lack of subject-matter jurisdiction, *inter alia*, because: (1) the ruling denying the Indenture Trustee's Motion under Section 507(b) of the Bankruptcy Code [11 U.S.C. § 507(b)] is both expressly and necessarily a part of the Confirmation Order; (2) the Indenture Trustee's appeal from the Confirmation Order is currently pending in the Fifth Circuit; and (3) this Court cannot simultaneously entertain another appeal on an issue encompassed by that same Order. [MRC/Marathon Mem. at 10-18.] The Indenture Trustee makes various arguments as to why this Court nonetheless has subject-matter jurisdiction to hear this appeal, but most of those arguments are irrelevant to the issue of this Court's subject-matter jurisdiction and none of them justifies having intertwined appeals heard concurrently by two different courts.

### A. The Section 507(b) Motion and the Confirmation Order Were Not "Completely Separate."

The Indenture Trustee argues [Opp. at 9-10] that the "507(b) Motion Proceeding was completely separate" from the Confirmation proceeding. That position ignores what actually happened in the Bankruptcy Court. The inescapable core point demonstrated in MRC's and

Marathon's opening memorandum, and ignored by the Indenture Trustee in its Opposition, is that the ruling on the Section 507(b) Motion was an express, integral part of the Confirmation Order.

First, the Indenture Trustee's Opposition ignores the evidence set out in MRC's and Marathon's Memorandum [at 11-16] that the parties below, including the Indenture Trustee, and the Bankruptcy Court recognized that the MRC/Marathon Plan could not be confirmed until it was determined whether the Indenture Trustee had an allowable administrative expense claim under Section 507(b) for any significant amount because a valid Section 507(b) claim of a large magnitude would have rendered the MRC/Marathon Plan infeasible. Feasibility is a statutorily mandated requirement for confirmation [see 11 U.S.C. § 1129(a)(11)].

As the MRC/Marathon Plan was originally structured, any amount due to the Indenture Trustee on its 507(b) claim would have reduced, dollar-for-dollar, the amount due to the Indenture Trustee on its secured claim. But the Bankruptcy Court ruled that the MRC/Marathon Plan must provide that the Indenture Trustee be paid the $510 million value of its secured claim ***plus*** the amount of any allowed Section 507(b) claim.[1] As a result, and as the Indenture Trustee correctly notes [Opp. at 5-6], the amount of the Indenture Trustee's Section 507(b) claim therefore became a material issue affecting the feasibility and thus confirmability of the MRC/Marathon Plan. As a result, in order to determine if the Plan was feasible and, thus, confirmable, the Bankruptcy Court ***first*** had to determine the amount of the asserted 507(b) claim. Indeed, as Counsel for Marathon told the Bankruptcy Court immediately after the Confirmation Findings were issued:

[1] The Confirmation Findings required payments on the Indenture Trustee's secured claim of "at least $510 million." [R. 306; Appellant 113, at 5-6.] This meant that the MRC/Marathon Plan's "Class 6 Distribution Adjustment" could not be used, to any significant extent, to reduce payments to the Indenture Trustee on its secured claim by the amount of allowed administrative claims, such as that asserted by the 507(b) Motion. [See R. 355; Appellant 134, Exh. at § 4.6.2.1.]

> "[T]hey have filed a Super Priority Admin claim for close to $300 million—I think $290 million. That is the difference between 510 and 800 million. **We obviously cannot confirm a plan that would subject us to 290 million or potentially a 290 million-dollar potential admin claim**. And, you know, frankly, we can't go effective with such a claim either. **It really is a complete roadblock** ...." [R. 309; Appellant 207 at 14 (emphasis added)].

Marathon's counsel later reiterated: "[W]e're going to need to resolve this before we can confirm and go effective." [*Id.* at 31.]

Counsel for the Appellants did not dispute the conclusion that the Section 507(b) Motion had to be decided before the MRC/Marathon Plan could be confirmed. On the contrary, counsel for certain Noteholders told the Bankruptcy Court that "it is critically important for this administrative claim to be determined ***before*** a plan is confirmed." [R. 310; Appellant 208 at 43 (emphasis added).] Moreover, when the Court suggested that, "if you have a $200 million claim, there's no way that they can confirm a plan," counsel for the Indenture Trustee agreed, responding: "Correct." [R. 336; Appellant 210 at 45].

Likewise, the Bankruptcy Court agreed that the Plan could not be confirmed until the Section 507(b) Motion was resolved. For instance, the Court said: "If they [the Indenture Trustee] win on the administrative claim issue, **the plan is not confirmable**; if they lose on the administrative claim issue or if they win in part, it may not be confirmable." [R. 310; Appellant 208 at 9 (emphasis added).] As a result, even though the Confirmation Findings were entered on June 6, 2008, entry of the Confirmation Order was postponed until after the Court heard three days of testimony on the Section 507(b) Motion on June 30, July 1, and July 2, 2008 and after the Court orally entered its ruling on the 507(b) Motion on July 7, 2008 [R. 336, 350, 358; Appellant 210-12; R. 364; Appellant 213]. Only after all these additional steps were taken was the Bankruptcy Court able, on July 8, 2008, to enter the Confirmation Order.

Second, the Indenture Trustee's assertion [Opp. at 2] that the 507(b) Order and the Confirmation Order have "two separate evidentiary records" is, at best, misleading. Contrary to what the Indenture Trustee asserts [Opp. at 9], the Bankruptcy Court said that it "sort of treated the admin order as a reconsideration of my findings ...." [R. 374, Appellant 314 at 18.] As it prepared to enter the Confirmation Order, the Bankruptcy Court further stated: "Now we litigated [the 507(b) Motion], I thought it was part of confirmation." [R. 374; Appellant 214 at 159.] Moreover, as the Bankruptcy Court stated in its oral ruling on the Section 507(b) Motion, the Indenture Trustee at the 507(b) hearing "introduced evidence and took basically an approach that perhaps could be consistent with reconsidering the order of confirmation and perhaps trying the issue as though it were part of the confirmation case." [R. 364; Appellant 213 at 11.] Furthermore, and perhaps most importantly, the Bankruptcy Court specifically amended its Confirmation Findings in light of the decision it reached following the 507(b) hearing by raising the minimum amount that must be paid to the Indenture Trustee in order for the MRC/Marathon Plan to be confirmed from $510 million to $513.6 million, stating: "So therefore, **I will change my order** to say that [the reorganized entities] must pay [the Indenture Trustee] a minimum of 513.6 million in order to avoid any administrative claim. That'll be my order." [R. 364; Appellant 213 at 28 (emphasis added).]

In addition, in preparing the records for these two allegedly separate appeals, the Indenture Trustee designated items from the confirmation hearing for the record in its 507(b) appeal and items from the 507(b) hearing for the record in its confirmation appeal.[2]

[2] See, *e.g.*, Appellants' Joint Designation of Record of Items to be Included in the Record of the Appeal of the Order Confirming the MRC/Marathon Plan (Bankr. Dkt. 3435), at 41 (designating for inclusion hearing transcripts for 507(b) hearing), at 54-59 (designing for inclusion 507(b) hearing exhibits) (excerpts attached as Ex. 1); Appellants' Joint Designation of Items to be Included in the Record of the Appeal of the Order Denying the Indenture Trustee's Motion for a Superpriority Administrated Expense Claim Pursuant to Section 507(b) (Bankr. Dkt. 3436) at 17-27 (designating hearing transcripts and exhibits from Confirmation Hearing) (excerpts attached as Ex. 2).

Significantly, the Indenture Trustee quoted from an exhibit from the 507(b) hearing in its brief to the Fifth Circuit attacking the Confirmation Order.[3] The Indenture Trustee even incorporated that exhibit into its Record Excepts in the Fifth Circuit.[4]

Third, the Confirmation Order was not just revised to incorporate the Court's findings on the Section 507(b) Motion by increasing the minimum required payment to the Indenture Trustee from $510 million to $513.6 million [R. 355; Appellant 134 at 23]. That Order also specifically incorporated the Bankruptcy Court's findings on the Section 507(b) Motion [*id.* at 12-13] and expressly ruled "based on the findings of fact and conclusions of law noted on the record in open court,...that **the Indenture Trustee does not have a 507(b) superpriority administrative claim as a result of the confirmation of the MRC/Marathon Plan.**" [*Id.* at 14 (emphasis added)].

In sum, the Bankruptcy Court's findings and conclusions on the Section 507(b) Motion were an express, integral part of the Confirmation Order. The Bankruptcy Court and all of the parties agreed that the MRC/Marathon Plan could not be confirmed if the Section 507(b) motion was granted because the asserted claim, if allowed, would render the Plan infeasible. And those findings and conclusion were expressly incorporated into the Confirmation Order.

### B. The Indenture Trustee Could Have Challenged Denial of Its Section 507(b) Motion in the Confirmation Order Appeal.

An appellate court has subject-matter jurisdiction to rule on the issues incorporated into an order or judgment before it. To take one example, the Supreme Court has held in interlocutory appeals under 28 U.S.C. § 1292(b) that a court of appeals "may address any issue fairly included within the certified order." *Yamaha Motor Corp., U.S.A. v. Calhoun*, 516 U.S.

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[3] See Brief for Appellants, 5th Cir. No. 08-40746, at 38 (quoting from IT 507(b) Hearing Ex. 160, which was Appellant 727 in the appeal from the Confirmation Order and Appellant 437 in this appeal.) (excerpt of brief attached as Ex. 3).

[4] See Ex. 4 hereto, which is the index to the Record Excerpt as submitted by the Indenture Trustee to the Fifth Circuit. Tab I is the exhibit from the 507(b) hearing.

199, 205 (1996). In this case, the Bankruptcy Court's rulings on the Section 507(b) Motion were not only "fairly included" in the Confirmation Order that was certified for direct appeal to the Fifth Circuit, they were expressly incorporated therein and were a necessary precondition to issuance of the Confirmation Order.

Indeed, the Indenture Trustee does not dispute that it could have invoked the Fifth Circuit's subject-matter jurisdiction for any matters contained in the Confirmation Order. Instead, its response is based on the mistaken premise that the ruling on its Section 507(b) Motion was not part of the Confirmation Order. Because—as just demonstrated—the ruling on the 507(b) Motion was an express and necessary part of the Confirmation Order, the Indenture Trustee could have challenged denial of the Section 507(b) Motion in its Fifth Circuit appeal from the Confirmation Order. Accordingly, it cannot pursue a separate appeal of that decision in this Court.

The Indenture Trustee contends that, if it had sought to the raise denial of its Section 507(b) Motion in the Fifth Circuit, that Court "would have refused to consider" it. [Opp. at 10-11.] But this is nothing more than rank speculation and the sole authority cited in support of this contention, *Quave v. Progress Marine*, 912 F.2d 798 (5th Cir. 1990), is inapposite. In *Quave*, the Fifth Circuit refused to hear appellant's challenge to an award of attorney's fees because that award had been made **after** the notice of appeal had been filed and the judgment on appeal made "no reference to attorney's fees." *Id.* at 801.[5] Here, in obvious contrast, the 507(b) Order was entered the same day as the Confirmation Order and therefore **before** the Indenture Trustee filed its notice of appeal from the Confirmation Order. Moreover, unlike in *Quave*, the Confirmation Order here expressly incorporates the Bankruptcy Court's rulings denying the Section 507(b)

[5] *Quave* thus was following the rule of *Budinich v. Becton Dickinson & Co.,* 486 U.S. 196 (1988) (page 8 *infra*), that separate notices of appeal must be filed when awards of attorney's fees are made in orders entered following judgment.

Motion; indeed, it had to incorporate those rulings because otherwise the MRC/Marathon Plan was unconfirmable.[6]

In short, it is clear that the Fifth Circuit could have heard the Indenture Trustee's challenges to the 507(b) Order if it had chosen to raise them in that appeal. Given that simple fact, none of the Indenture Trustee's other arguments as to why this Court nevertheless has subject-matter jurisdiction to hear a duplicative appeal challenging the 507(b) Order holds water.

### C. The Fact That Other Administrative Claims Could Have Been Filed Post-Confirmation Does Not Give This Court Subject-Matter Jurisdiction Over This Administrative Claim, Which Was Resolved Pre-Confirmation.

The Indenture Trustee points out that the MRC/Marathon Plan allowed administrative claims to be filed up to 30 days after the effective date. [Opp. at 2.] That is so, and is standard in bankruptcy plans of reorganization. The reason why run-of-the-mill administrative claims can be filed after confirmation is that they typically include requests for professional fees and other costs that cannot be finalized until after the work is completed, *i.e.*, until after the plan becomes effective, and are not of a size that would destroy the Plan. The fact that these basic administrative claims can be finalized after confirmation does not mean that the Indenture Trustee's 507(b) claim at issue here can be separately appealed when: (i) all the parties and the Bankruptcy Court agreed that resolution of this particular administrative claim was a prerequisite to Confirmation because of the need to determine whether the MRC/Marathon Plan was feasible;

[6] Nor, contrary to the Indenture Trustee's contention (Opp. at 12-13), does *In re TransTexas Gas Corp.*, 303 F.3d 571 (5th Cir. 2007), support the Indenture Trustee's argument that the Fifth Circuit has no subject-matter jurisdiction to review the 507(b) Order as part of the appeal of the Confirmation Order. In *TransTexas*, the appeal was dismissed because the Bankruptcy Court had no subject-matter jurisdiction to issue the order on appeal because it was entered while the case was on appeal. In this case, the Bankruptcy Court plainly had subject-matter jurisdiction to enter the Confirmation Order, which incorporated the findings and conclusions of the 507(b) Order, and thus the Indenture Trustee could have asserted its Section 507(b) contentions as part of its appeal of the Confirmation Order. Rather than supporting the Indenture Trustee, *TransTexas* supports the proposition that this Court lacks subject-matter jurisdiction because the Indenture Trustee seeks review of an order that is incorporated into the Confirmation Order now on appeal in the Fifth Circuit.

(ii) it was, in fact, resolved before Confirmation; and (iii) the ruling was expressly incorporated into the Confirmation Order.[7]

In that regard, analogous authority involving awards of attorney's fees in general civil litigation shows that the issues raised in the instant appeal had to have been raised in the appeal from the Confirmation Order. When attorney's fees are sought and awarded after a district court enters an otherwise final judgment, that award of fees must be separately appealed. See *Budinich v. Becton Dickinson & Co.,* 486 U.S. 196 (1988). On the other hand, when a district court delays entering final judgment until after it awards attorney's fees, then the award of fees is appealable as part of the judgment. See *Harbor Ins. Co. v. Trammel Crow Co.*, 854 F.2d 94 (5th Cir. 1988) (appeal from judgment not untimely because district court delayed entry of judgment until after award of fees); see also Fed. R. Civ. P. 58(e) (authorizing district court to extend time for filing notice of appeal when timely motion for attorney's fees is pending). The latter principle applies here: Because the Section 507(b) Motion was ruled upon prior to Confirmation, its denial must be raised in the appeal from Confirmation. This is especially so given that resolution of the Indenture Trustee's Section 507(b) Motion was, in fact, a prerequisite to determining whether the MRC/Marathon Plan could even be confirmed.[8]

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[7] The Indenture Trustee asserts [Opp. at 13-14] that *In re Enron Corp.*, No. 01-16034, 2006 Bankr. LEXIS 4294 (Bankr. S.D.N.Y. Jan. 17, 2006), supports its position, but that decision is plainly irrelevant because it concerns the power of the Bankruptcy Court to estimate claims while its ruling on allowance is pending on appeal. The issue here is not whether the Bankruptcy Court had the authority to resolve some other set of administrative claims while appeal from the Confirmation Order is pending. (In fact, that Bankruptcy Court has been resolving other administrative claims.) Rather, the issue is whether this Court has appellate subject-matter jurisdiction over the Bankruptcy Court's ruling on the 507(b) Motion when that ruling was incorporated into the Confirmation Order.

[8] The Indenture Trustee argues [Opp. at 5-6] that MRC and Marathon "assumed the risk" that the reorganized entity would have to pay any administrative claims allowed following Confirmation by the Bankruptcy Court. While in theory true, this contention has no relevance to the present question of which court should hear the Indenture Trustee's appeal from the denial of its 507(b) Motion, which the parties agreed had to be resolved prior to Confirmation.

### D. The Appellants Previously Asserted That the Denial of the Section 507(b) Motion Was One of Their Grounds for Appealing the Confirmation Order.

Further disproving their current position, Appellants previously repeatedly cited denial of the Section 507(b) Motion as one of the grounds for their appeal from the Confirmation Order. First, some of the Noteholders listed, among the issues to be raised in their appeal from the Confirmation Order, "whether the Bankruptcy Court erred as a matter of law in concluding that the Marathon/MRC Plan satisfies 11 U.S.C. § 1129(a)(9) because it does not adequately provide for payment in full of the Indenture Trustee's superpriority claim asserted under 11 U.S.C. § 507(b)." [Motion Ex. D at 3, Issue No. 11.] Second, the Indenture Trustee's request that its appeal from the Confirmation Order be certified for direct appeal to the Fifth Circuit listed among the issues to be raised on appeal that "the MRC/Marathon Plan fails to comply with Section 1128(a)(9) [*sic*] because it does not make provision for the payment of the Indenture Trustee's superpriority administrative claim of over $20 million based on the failure of adequate protection."[9] Third, the Indenture Trustee argued for a stay of the Confirmation Order pending appeal in part on the ground that it was likely to prevail on the merits of its argument that the Bankruptcy "Court erred in confirming the MRC/Marathon Plan because it fails to provide for the payment of the Indenture Trustee's superpriority administrative claim in violation of sections 1129(a)(9) and (11)."[10] These submissions flatly contradict the Indenture Trustee's current position [Opp. at 12] that there is "no overlapping of the *legal* issues" between its appeal from the Confirmation Order and its purported separate appeal from the 507(b) Order.

Strikingly, the Indenture Trustee [Opp. at 17] only tries to argue away the first of these, ignoring the latter two. But the Indenture Trustee's effort to explain away even that one prior

[9] Indenture Trustee's Emergency Request for Certification Pursuant to 28 U.S.C. § 158(d)(2) and Interim Rule 8001(f) of the Federal Rules of Bankruptcy Procedure at 39, ¶ 80 [R. 360].

[10] The Indenture Trustee's Emergency Motion for Stay Pending Appeal at 1 [R. 361].

submission by drawing a distinction between "treatment" of administrative claims (reviewable as part of the Confirmation Order appeal) and "allowance" of claims (allegedly only reviewable by separate appeal) is utterly unconvincing. [Opp. at 14-18.] First, the Indenture Trustee does not even attempt to explain what the alleged "treatment" issue was. This is not surprising because no such issue was raised in its Fifth Circuit appeal. Moreover, as a matter of law, the MRC/Marathon Plan could not have been confirmed unless it provided for the payment of allowed administrative claims in full on the Effective Date of the Plan. [See 11 U.S.C. § 1129(a)(9).] In other words, there was never a real issue over the "treatment" of the asserted 507(b) claim. The Indenture Trustee's so-called "treatment" issue was really one of feasibility inasmuch as there was no way to pay the Indenture Trustee $510 million for it secured claim ***plus*** its purported 507(b) claim in the approximate amount of $200 million. This, again, demonstrates the inexorable link between the Confirmation Order and the Bankruptcy Court's decision on the Section 507(b) Motion.

Second, the submissions quoted above in which the Indenture Trustee identified the 507(b) issue as an appealable issue from the Confirmation Order did not purport to challenge the "treatment" of its 507(b) claim; rather, each, in slightly different terms, contended that this claim had not been paid in full. That necessarily involves both "treatment" of the claim in terms of feasibility of payment and "allowance" of the claim.

Finally, and more fundamentally, the distinction between "treatment" of a claim and "allowance" of a claim has no relevance to the question at hand: whether the Fifth Circuit or this Court has appellate subject-matter jurisdiction over any appeal from denial of the Section 507(b) Motion. Appellate subject-matter jurisdiction does not turn on whether a particular ruling is characterized as being one of allowance of a claim or treatment of a claim.

The Indenture Trustee asserts [Opp. at 16] that the Bankruptcy Court "recognized this distinction" when it entered, at the request of the Indenture Trustee, a separate order denying the Section 507(b) Motion. As an initial matter, the Bankruptcy Court does not have the authority to establish the parameters of this Court's appellate jurisdiction. In any event, the Indenture Trustee reads far too much into the Bankruptcy Court's decision to issue two orders. In granting the Indenture Trustee's request to enter a separate 507(b) Order, the Bankruptcy Court made clear that it believed the 507(b) ruling was part of the confirmation proceeding and that the issue of one versus two orders was not a significant one: "Now we litigated [the 507(b) Motion], **I thought it was part of confirmation. I don't see the difference between having a separate order and other one [*sic*],** but I will sign a separate order if there's no objection."[11] [R. 374; Appellant 214 at 159 (emphasis added).]

* * * * *

In sum, the Indenture Trustee has failed to provide any convincing reason why it could not have raised the denial of the Section 507(b) Motion in its pending Fifth Circuit appeal. There is simply no good reason to allow the Indenture Trustee to have two bites at the appellate apple by permitting overlapping appeals from inexorably intertwined orders entered the same day to be heard concurrently in two different courts when all of the Indenture Trustee's arguments could have been raised in its appeal to the Fifth Circuit from the Confirmation Order. The Fifth Circuit and other courts have declined to "set up a system where there would be duplicative appeals, one to the district court and one to the Court of Appeals." *Resolution Trust Corp. v. Nernberg*, 3 F.3d 62, 67 (3d Cir. 1993) (citing with approval *In re Meyerland Co.*, 960 F.2d 512 (5th Cir. 1992) (en banc)). While the procedural posture of those cases was different from that here, the

[11] It should also not be forgotten, moreover, that the decision to enter a separate order was made before the Confirmation Order was certified for direct appeal to the Fifth Circuit under 28 U.S.C. § 158(d)(2).

same principle—that duplicative appeals should not be heard in both the District Courts and the Courts of Appeals—applies with equal force. This appeal should be dismissed for lack of subject-matter jurisdiction.

## II. THIS APPEAL IS EQUITABLY MOOT BECAUSE THE REQUESTED RELIEF WOULD ADVERSELY AFFECT THIRD PARTIES AND THE SUCCESS OF THE MRC/MARATHON PLAN

As set forth above and in the opening brief of MRC and Marathon, the Bankruptcy Court and all of the parties recognized that the MRC/Marathon Plan could not be confirmed if the Indenture Trustee prevailed on its Section 507(b) Motion because the new company, Humboldt Redwood Company LLC ("HRC"), would be rendered economically unsound and, hence, the MRC/Marathon Plan would not be feasible. For that very same reason, the Indenture Trustee's appeal is now equitably moot. The after-the-fact allowance of the Indenture Trustee's Section 507(b) claim as sought on this appeal similarly would render the new company economically unsound causing injury to numerous third parties and destroying the success of the Plan. As MRC and Marathon now show, the Indenture Trustee's contrary arguments are meritless.

### A. The Applicable Test Is Not Whether This Court Can Grant Any Relief, But Whether Granting the Relief Would Injure Third Parties and the Plan.

The Indenture Trustee misstates the legal standard for determining equitable mootness when it suggests [Opp. at 18] that the issue is whether this Court has the power to fashion any relief. That, however, is the test for Article III constitutional mootness. By contrast, "[e]quitable mootness is a prudential, not a constitutional, doctrine that evolved in response to the particular necessities surrounding consummation of confirmed bankruptcy reorganization plans." *In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008). "In this context, 'mootness' is not an Article III inquiry as to whether a live controversy is presented; rather, it is a recognition by the appellate courts that there is a point beyond which they cannot order fundamental changes in reorganization

actions." *In re Manges*, 29 F.3d 1034, 1038-39 (5th Cir. 1994). Thus, as demonstrated in MRC's and Marathon's Memorandum [at 19-20], an appeal from a consummated bankruptcy plan is moot if the relief requested would affect the rights of third parties not before the Court or the success of the Plan.

The Indenture Trustee also erroneously asserts [Opp. at 18] that Circuit Court authority suggests that appeals from orders disallowing claims in bankruptcy may not be subject to dismissal on equitable mootness ground. But the cited cases suggest no such thing; rather, they are simply cases in which reversal of the bankruptcy court order would not have injured third parties or the success of the plan. By contrast, as the MRC/Marathon Memorandum showed [at 23-24], a directly applicable Third Circuit decision held that an appeal from the denial of 507(b) claim like the one at issue here is equitably moot when post-consummation allowance would injure third parties who relied on the plan. *In re Continental Airlines*, 91 F.3d 553, 561 (3d Cir. 1996) (en banc).

### B. Reversal of the Section 507(b) Ruling Would Adversely Affect Many Third Parties and the Success of the Plan.

The Indenture Trustee simplistically and erroneously asserts [Opp. at 20] that reversal of the Section 507(b) claim would not injure third parties because no third parties who have received distributions would have to return those funds; instead, reversal "would simply result in HRC being obligated to pay that claim." This argument, once again, is refuted by the fact that, as the Bankruptcy Court and all parties acknowledged when they addressed the Section 507(b) Motion prior to Confirmation, HRC would not be an economically viable company if it were obligated to pay the Indenture Trustee's Section 507(b) claim. And, as the MRC's and

Marathon's Motion demonstrates,[12] if HRC becomes non-viable, that would adversely affect the many third parties that have come to rely on HRC, including its employees, customers, new creditors, and new owners, as well as the regulatory agencies and the public at large.

The Indenture Trustee fails in its effort [Opp. at 20-21] to distinguish the Third Circuit's decision in *Continental Airlines*, which found a similar appeal from an order denying an administrative claim to be equitably moot. The Indenture Trustee argues that the Third Circuit's decision turned on a provision of the plan at issue there which capped the amount of administrative claims. But, as the extended quote from the opinion set forth in MRC's and Marathon's Memorandum [at 24] shows, the Third Circuit's ruling was expressly based on the fact that "investors and other third parties consummated a massive reorganization plan in reliance on an unstayed confirmation order that, explicitly and as a condition of feasibility, denied the claim for which appellate review is sought." 91 F.3d at 565. That is ***precisely*** the situation here. As shown above, the Bankruptcy Court's Confirmation Order explicitly, and as a condition of feasibility, denied the Indenture Trustee's Section 507(b) claim, and the investors and others consummated the MRC/Marathon Plan in reliance on that unstayed Confirmation Order.[13]

The Indenture Trustee's effort to distinguish the decision in *In re GWI PCS 1 Inc.*, 230 F.3d 788 (5th Cir. 2000), on the ground that MRC and Marathon are "parties" to this appeal and, therefore, any injury to them should be ignored is likewise unavailing. First, the record establishes that numerous other entities who unquestionably are not parties to this appeal have

[12] MRC/Marathon Memorandum at 22-25; MRC/Marathon Motion, Ex. A. at 13-17, Ex. C. at 5-10. The Declaration of Alexander L. Dean, Jr., which was cited in the Motion's Exhibits, is attached hereto as Ex. 5.

[13] The Indenture Trustee's reliance [Opp. at 21] on the *dissent* in *Continental Airlines* is entirely misplaced. Not only is that dissent not even the law in the Third Circuit, it is contrary to controlling authority from the Fifth Circuit, which holds that bankruptcy appeals are equitably moot where granting the requested relief would injure third parties or the success of the reorganization plan. See *In re Grimland, Inc.*, 243 F.3d 228, 231 (5th Cir. 2001); *In re Manges*, 29 F.3d at 1039.

acted in reliance on the Confirmation Order and on HRC's continued economic viability—including HRC's employees, customers, new creditors, and other affiliated persons and entities.[14] Thus, even setting aside the injury to MRC and Marathon, reversal of the 507(b) Order would severely injure many individuals and entities that are not parties to this appeal. Moreover, the caselaw makes clear that the equitable mootness doctrine is intended to protect those like MRC and Marathon who invest new funds in reliance on the Confirmation Order. For example, as quoted above, the *Continental Airlines* decision expressly sought to protect "investors and other third parties [who] consummated a massive reorganization plan in reliance on an unstayed confirmation order." 91 F.3d at 565.[15]

The Indenture Trustee also argues [Opp. at 19] that, because the MRC/Marathon Plan permitted administrative claims to be asserted after the Plan's Effective Date, allowance of their Section 507(b) claim, by definition, could not lead to the unraveling of the Plan or injure third parties. That is a complete non-sequitur. As set forth above, the Bankruptcy Court and parties all recognized that allowance of the Indenture Trustee's Section 507(b) claim would render the Plan infeasible because it would render the new company economically non-viable. As such, the fact that the Plan permitted small, garden-variety administrative claims to be asserted for a short time post-confirmation does not in any way undermine the fact that allowance of the Indenture Trustee's Section 507(b) claim would devastate the Plan and thereby severely injure the many third parties who have taken actions in reliance on the Plan.

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[14] See note 12 *supra*.

[15] The decisions in *In re Grimland*, 243 F.2d 228 (5th Cir. 2001), and *In re Equinox Oil Co.*, No. 00-3320, 2001 U.S. Dist. LEXIS 8165 (E.D. La. June 11, 2001), *aff'd*, 300 F.3d 614 (5th Cir. 2002), which the Indenture Trustee cites [at 21-22], are factually inapposite. In both cases the appeal sought recovery against a third party, not the reorganized debtor. Here, by contrast, the Indenture Trustee seeks to impose new obligations on the reorganized company. As such, this appeal is moot under Fifth Circuit law because it would adversely affect both the success of the plan and third parties that are relying on the reorganized company.

### C. The Indenture Trustee's Reliance on Its Supposed "Sub-Claims" Fails to Save Its Appeal From Equitable Mootness.

The Indenture Trustee's opening merits brief in this appeal explicitly prayed for a judgment "in an amount not less than $170 million." [Dkt. No. 10 at 50.] Now, after MRC and Marathon filed their motion to dismiss establishing that that requested relief would destroy the Plan and injure numerous third parties, the Indenture Trustee seeks to change course by asserting in its merits reply brief [Dkt. No. 23 at 24-25] and in its mootness opposition [Opp. at 4, 23-24] that its 507(b) Motion should be considered to consist of three "Sub-Claims"—for $18 million, $8.9 million, and not less than $136 million—that should be analyzed separately. This attempted change of position comes far too late in this appeal.[16] Nor is it a genuine change: The Indenture Trustee still seeks to pursue all three "Sub-Claims" and, hence, mootness must be gauged based on the sum of those claims—an amount (at least $162.9 million) that unquestionably would destroy the Plan and harm many third parties.

Moreover, even if the three newly-minted "Sub-Claims" were separately considered, the Indenture Trustee has failed to rebut the basis for equitable mootness. As set forth in the accompanying declaration from the Chairman of the Board of Directors of HRC submitted in response to the Indenture Trustee's changed argument, HRC does not have sufficient cash to pay even an $8.9 million judgment. [Declaration of Alexander L. Dean, Jr., January 29, 2009, ¶ 4 (Ex. 6 hereto).] As a result, such a judgment would lead to a default under HRC's credit facility, thereby destroying the Plan and severely injuring HRC's employees, customers, and other affiliated persons and entities. [*Id.* ¶ 5.]

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[16] See *Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 594 (2001) (statement made in appellate reply brief "comes too late"); *Sanders v. UNUM Life. Ins. Co.*, No. 07-51216, 2008 U.S. App. LEXIS 27087 at *12 (5th Cir. Dec. 29, 2008) ("[a]n argument first supported in a reply brief comes too late"); *Taita Chem. Co. v. Westlake Styrene Corp.*, 246 F.3d 377, 385 n.9 (5th Cir. 2001) ("We do not consider issues raised for the first time in a reply brief.") (citation omitted).

Finally, the Indenture Trustee's citation [Opp. at 24] to the Second Circuit's decision in *In re Chateaugay Corp.*, 10 F.3d 944 (2d Cir. 1993), is unavailing. That decision *affirmed* the confirmation order and, hence, the court found no need to remand for the bankruptcy court to determine whether granting the requested relief would have adversely affected the plan. *Id*. at 954. Moreover, as explained above, the Bankruptcy Court in this case specifically found that granting the Indenture Trustee's 507(b) claim would render the plan infeasible because the reorganized debtor would be overwhelmed with debt. As such, this appeal is equitably moot.

## CONCLUSION

For the foregoing reasons, as well as those set out in MRC's and Marathon's Memorandum in Support of the Motion to Dismiss, this appeal should be dismissed on the grounds of lack of subject-matter jurisdiction and/or equitable mootness.

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Respectfully submitted,

**HAYNES AND BOONE LLP**

*/s/ John D. Penn*
John D. Penn
Texas State Bar No. 15752300
Trey A. Monsour
Texas State Bar No. 14277200
201 Main Street, Suite 2200
Fort Worth, Texas 76102
Telephone: (817) 347-6610
Telecopy: (817) 348-2300

-and-

**WINSTON & STRAWN LLP**

*/s/ David Neier*
David Neier (attorney-in-charge)
(Admitted *pro hac vice*)
Steven M. Schwartz
(Admitted *pro hac vice*)
200 Park Avenue
New York, New York 10166-4193
Telephone: (212) 294-6700
Telecopy: (212) 294-4700

*Counsel to Appellee Marathon Structured Finance Fund L.P.*

**GOODWIN PROCTER LLP**

*/s/ Allan S. Brilliant*
Allan S. Brilliant (attorney-in-charge)
(Admitted *pro hac vice*)
Brian D. Hail
620 Eighth Avenue
New York, New York 10018-1405
Telephone: (212) 813-8800
Facsimile: (212) 388-3333

*Counsel to Appellee Mendocino Redwood Company, LLC*