

Transcript of the Testimony of

Date: July 10, 2008

Case: In Re: Scotia Pacific

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
CORPUS CHRISTI DIVISION

IN RE: SCOTIA PACIFIC, *
 * CASE NO. 07-20027
DEBTOR *

* * * * *

DAILY COPY
JULY 10, 2008

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On the 10th day of July, 2008, the above
entitled and numbered cause came on to be heard before
said Honorable Court, RICHARD S. SCHMIDT, United States
Bankruptcy Judge, held in Corpus Christi, Nueces
County, Texas.

Proceedings were reported by machine
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COURT RECORDER:

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CERTIFIED SHORTHAND REPORTER:

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1 THE CLERK: All rise.

2 THE COURT: Be seated. Send in the call.

3 Do we have the thing on so she can hear me? Now send in
4 the call. All right. Let's see. Isaac Pachulski.

5 MR. PACHULSKI: Good afternoon, Your
6 Honor.

7 THE COURT: All right. Michael Neville.

8 MR. NEVILLE: Good afternoon, Your Honor.

9 THE COURT: Matthew Barr.

10 MR. BARR: Good afternoon, Your Honor.

11 THE COURT: Demetra Liggins.

12 MS. LIGGINS: Present, Your Honor.

13 THE COURT: Jennifer White.

14 MS. WHITE: Present, Your Honor.

15 THE COURT: John Driscoll.

16 MR. DRISCOLL: Here, Your Honor.

17 THE COURT: Christopher Johnson. Wendy
18 Laubach.

19 MS. LAUBACH: Present, Your Honor.

20 THE COURT: Brian Metcalf. Alan
21 Tenebaum.

22 MR. TENEBaum: Present, Your Honor.

23 THE COURT: Richard Weiner.

24 MR. WEINER: Present, Your Honor.

25 THE COURT: Kyung Lee.

1 MR. LEE: Here, Your Honor.

2 THE COURT: Dean Zeale. Okay. We've got
3 the creditors committee? Ira Herman.

4 MR. HERMAN: Present, Your Honor.

5 THE COURT: Jeffrey Spiers.

6 MR. SPIERS: Present, Your Honor.

7 THE COURT: Dan Kamensky.

8 MR. KAMENSKY: Present, Your Honor.

9 THE COURT: Frank Bacik.

10 MR. BACIK: Good afternoon, Your Honor.

11 THE COURT: Mark Worden.

12 MR. WORDEN: Present, Your Honor.

13 THE COURT: Anna Acevedo.

14 MS. ACEVEDO: Present, Your Honor.

15 THE COURT: Clara Strand. Melissa Kahn.

16 MS. KAHN: Present, Your Honor.

17 THE COURT: Heather Muller.

18 MS. MULLER: Present, Your Honor.

19 THE COURT: Shaye Diveley.

20 MS. DIVELEY: Present, Your Honor.

21 THE COURT: Erin Ross.

22 MR. ROSS: Present, Your Honor.

23 THE COURT: Francine Montagna.

24 MS. MONTAGNA: Present, Your Honor.

25 THE COURT: Steven Church.

1 MR. CHURCH: Present, Your Honor.
2 THE COURT: Ephraim Diamond.
3 MR. DIAMOND: Good afternoon, Your Honor.
4 THE COURT: Emily Kuller.
5 MS. KULLER: Present, Your Honor.
6 THE COURT: Wei Wang.
7 MR. WANG: Present.
8 THE COURT: Matthew Covington. James
9 Delaune.
10 MR. DELAUNE: Present, Your Honor.
11 THE COURT: David McLaughlin. Joli
12 Pecht.
13 MS. PECHT: Present, Your Honor.
14 THE COURT: Nathan Rushton.
15 MR. RUSHTON: Present, Your Honor.
16 THE COURT: Alan Wright.
17 MR. WRIGHT: Present, Your Honor.
18 THE COURT: Jacob Cherner.
19 MR. CHERNER: Present, Your Honor.
20 THE COURT: Daniel Zazove.
21 MR. CRANE: He's not here, this is Ken
22 Crane in his place, Your Honor.
23 THE COURT: All right. Anyone else on
24 the call?
25 MS. METSUDE: Good afternoon, Your Honor,

1 my name is Laura Metsude, and I'm here on behalf of the
2 American Securitization Forum.

3 THE COURT: All right. Thank you. And
4 then we've got starting over here, Mr. Greendyke.

5 MR. GREENDYKE: Good afternoon, Judge,
6 Bill Greendyke, Fulbright & Jaworski on behalf of Bank
7 of New York, the indenture trustee to the timber
8 noteholders. I'm joined by my partners Richard
9 Krumholz, Zack Clement and Toby Gerber.

10 THE COURT: All right. And then certain
11 noteholders.

12 MR. DAVIDSON: Good afternoon, Your
13 Honor, Jeffrey Davidson, a member of Stutman, Treister &
14 Glatt appearing on behalf of certain noteholders.

15 THE COURT: Okay. Mr. Gibbs.

16 MR. GIBBS: Good afternoon, Your Honor,
17 Chuck Gibbs from Akin, Gump, Strauss, Hauer & Feld on
18 behalf of CSG Investments and its affiliate.

19 MR. PENN: Your Honor, John Penn, David
20 Neier, Steven Schwartz and Carey Schreiber all on behalf
21 of Marathon.

22 MR. NEIER: And all in suits, Your Honor.

23 THE COURT: He has a suit. Okay.

24 MR. FIERO: Good afternoon, Your Honor,
25 John Fiero and Max Litvak of Pachulski Stang for the

1 committee.

2 MR. BRILLIANT: Good afternoon, Your
3 Honor. Alan Brilliant and Brian Hail on behalf of
4 Mendocino Redwoods Company.

5 MR. STERBACH: Good afternoon, Your
6 Honor, Charles Sterbach for the United States Trustee.

7 MS. COLEMAN: Good afternoon, Your Honor,
8 Kathryn Coleman and Eric Fromme of Gibson Dunn &
9 Crutcher on behalf of Scopac.

10 MR. PASCUZZI: Good afternoon, Your
11 Honor, Paul Pascuzzi for the California State Agencies.
12 And Mr. Neville is on the phone from the Attorney
13 General's office.

14 THE COURT: Thank you. And Palco.

15 MR. HOLZER: Pete Holzer, Your Honor, for
16 the Palco debtors with Luckey McDowell from Baker Botts,
17 cocounsel.

18 THE COURT: No one is on the line for
19 Bank of America.

20 MS. KULLER: Your Honor, yes, Emily
21 Kuller and Ana Acevedo of O'Melveny & Myers.

22 THE COURT: Okay. Thank you.

23 MR. HOLZER: Your Honor, we're here on
24 the motions for stay pending appeal. Appeals have been
25 filed of the confirmation order and --

1 THE COURT: And direct appeal to circuit.

2 MR. HOLZER: And a request for
3 certification of the direct appeal. Before we get
4 started --

5 THE COURT: Did any of the people that
6 are appealing this not want it directly appealed to the
7 circuit? The people that have actually filed the
8 motion? I mean, do we have some that don't want it? Do
9 we have appellants that have different theories as to
10 the procedural posture of where we should go?

11 MR. GREENDYKE: I'm not aware of that,
12 Judge. This is Bill Greendyke.

13 THE COURT: Okay. I know Scotia Pacific
14 filed an appeal, didn't you?

15 MS. COLEMAN: Yes, Your Honor.

16 THE COURT: Are you asking for a direct
17 appeal, too?

18 MS. COLEMAN: Yes, Your Honor.

19 THE COURT: Okay.

20 MR. HOLZER: Your Honor, before we get
21 into that, I think it's a housekeeping matter. There
22 had been a motion filed before the confirmation to
23 approve the global settlement between Pacific Lumber,
24 Maxxam, MRC. My understanding is you said you would
25 sign that and approve that settlement after you entered

1 the confirmation order, if you did. And I do have that
2 order if that was in fact the Court's intention.

3 THE COURT: Okay. To be fair, though, I
4 would assume that you want to appeal that, too.

5 MR. GREENDYKE: Judge, we have not yet
6 made a determination of whether or not we want to appeal
7 that. Obviously we objected to it and continue to
8 object to it.

9 THE COURT: All right.

10 MR. HOLZER: I think it's Mr. Greendyke's
11 leading off.

12 THE COURT: All right. I kind of feel
13 like this might be one of those motions where if we're
14 going to put witnesses on, let's get them out of the way
15 first. Is there any reason to argue this first?

16 MR. KRUMHOLZ: Your Honor, I think it
17 would actually be much more efficient if we do not argue
18 it, but do a brief opening.

19 THE COURT: I agree.

20 MR. KRUMHOLZ: 30 minutes?

21 MR. PENN: Total?

22 THE COURT: Okay. So you-all are going
23 to spend 30 minutes to open?

24 MR. KRUMHOLZ: Yeah, I think 30. And
25 maybe five minutes or a couple of minutes follow-up by

1 certain of the noteholders counsel.

2 MR. BRILLIANT: Your Honor, did Your
3 Honor get the briefs? All the parties filed extensive
4 briefs. I don't know why opening would add to the Court
5 in any way.

6 THE COURT: I mean, if you want to hear
7 from me, I would really like to know what you think can
8 be done to protect the parties who won in this case if
9 there's a stay pending appeal.

10 MR. KRUMHOLZ: I think that's why I want
11 to -- I understand that's --

12 THE COURT: That's the -- what kind of
13 protection -- I mean, a bond isn't going to help.

14 MR. KRUMHOLZ: Your Honor, we have --

15 THE COURT: So what kind of protection do
16 you think you can provide that will protect these
17 parties?

18 MR. KRUMHOLZ: Your Honor, I understand
19 the question, and that's how we tailored our opening so
20 that you can understand the testimony better.

21 THE COURT: All right. That's a good
22 idea.

23 MR. GREENDYKE: Before we start that,
24 could I request the Court withhold signing the order
25 that Mr. Holzer gave you until we have a chance to

1 review it? It was sent to me some time ago and I
2 haven't had a chance --

3 MR. HOLZER: It's the form of order we
4 filed with the motion.

5 THE COURT: Okay. Well, I can tell you
6 that I have already signed it but I have not turned it
7 over for entry so I will withhold delivery until you
8 have had time.

9 MR. GREENDYKE: Thank you.

10 THE COURT: So go ahead with your
11 opening.

12 MR. KRUMHOLZ: Good afternoon, Your
13 Honor. Richard Krumholz for the indenture trustee.
14 Thank you for hearing our motion for stay pending appeal
15 and the request for direct certification for direct
16 appeal on an emergency basis.

17 Obviously we believe we're here yet again
18 for -- on a very important matter. And at the outset,
19 while the Court certainly knows that we haven't agreed
20 with a host of rulings that have been made of late, I
21 want, as an internal optimist, I want to focus on
22 something I don't think any lawyer in this courtroom or
23 any attorney, for that matter in this country, could
24 possibly disagree with in connection with Your Honor's
25 statements on Tuesday.

1 On Tuesday, Your Honor, you said that --
2 you highlighted, in fact, that the right to a meaningful
3 appellate review of courts decisions is not only a very
4 valuable right and an important right, but a vital right
5 in our judicial system. It's a constitutional right,
6 it's a due process right. It should be given great
7 weight. And that we all, particularly must be vigilant
8 to protect.

9 The rules and the law govern stays
10 pending appeal are built on this fundamental premise.
11 Indeed, the federal rules contemplate stays to advance
12 appeals without serving as an obstacle to justice and
13 without the necessity of even posting bonds when
14 appropriate. You only need to look at bankruptcy rule
15 8005 to see the rules expressly permit this court stay
16 orders affecting appeals without posting of any type of
17 bond and alternate security whatsoever. Of course, we
18 know that rule 3020-E provides for standard ten-day stay
19 without the posting of any bond whatsoever.

20 I do want to focus the Court, though, on
21 the four factors that it must focus on when hearing from
22 the witnesses on that witness stand in the coming hours.
23 The Fifth Circuit employs a four part test in
24 determining whether to grant a stay pending an appeal.
25 The first of which is whether the movant has made a

1 showing of the likelihood of the success on the merits.
2 The second is whether the movant has made a showing of
3 irrefutable injury if the stay is not granted. The next
4 is whether the stay would serve the public interest; and
5 last, whether the granting of the stay would
6 substantially harm the other parties.

7 All of the courts acknowledge these
8 factors should not be applied in any sort of rigid or
9 mechanical fashion. And even the case law cited by the
10 MRC and Marathon and unsecured creditors attorneys admit
11 that it doesn't need to be fashioned, that it meets
12 every single requirement, but that the Court weighs all
13 of the evidence against these factors.

14 Now, Your Honor, the first thing I'd like
15 to discuss is what the evidence will show with respect
16 to whether the IT has made a showing of the likelihood
17 of success on the merits. It is very important to know
18 that the Fifth Circuit has been very clear that, of
19 course, Your Honor is not having to be put in the
20 position of saying it's the likelihood of success on the
21 merits on the very rulings that you obviously made
22 inconsistent with the positions that the appellants
23 would take. It's simply -- the test is simply whether
24 or not the movant has presented substantial case on the
25 merits when a legal serious question is involved and

1 shows that the balance of the equities weighs heavily in
2 favor of granting the stay.

3 Of course, the Arnold court and the
4 Greece court have expressly stated such. As the Court
5 is aware, the IT has alleged 11 different grounds upon
6 which it believes the Court has erred. Each of those
7 grounds are addressed extensively in the motion. I'm
8 not going to go into any great detail here. It is
9 important to note, however, that any one of those
10 grounds is sufficient to reverse the Court's rulings in
11 connection with the confirmation order and sufficient to
12 give rise to a stay pending appeal. And obviously,
13 while you may think success is -- you may not think
14 success is probable given your rulings, a substantial
15 case has undoubtedly been made here.

16 The next issue is whether IT will suffer
17 irreparable harm if the stay is not granted. It's no
18 secret from this middle table from MRC/Marathon
19 attorneys what they intend to do if the stay is issued.
20 They intend to close immediately. We heard that from
21 Mr. Neier, we heard that from Mr. Dean himself on
22 several occasions from each, if allowed to consummate
23 the sale, there is no doubt they will argue that the
24 issues have become moot, the lands will be transferred,
25 the regulatory hurdles will have been jumped through and

1 indeed the State of California's counsel has told you in
2 his papers the necessary permits are ready to be
3 transferred.

4 The third element that granting of a stay
5 is in the public interest is vitally important here,
6 Your Honor. There is a strong public interest in
7 preserving the integrity of the indenture trustee's
8 statutory right of appellate review which will
9 potentially be eviscerated if a stay is not granted.
10 The precedent set by this Court's willingness to allow
11 Scopac's bankruptcy case to be driven by the needs of
12 Palco, a debtor which the indenture trustee -- the
13 noteholders is not a creditor to, and allow the
14 diversion and the tapping and the access as Mr. Dean has
15 put for Marathon to tap into Scopac's value threatens to
16 disrupt the financial markets as a whole.

17 As this Court is well aware, extensive
18 steps have been maintain the separateness in connection
19 with the indenture. Scopac is a special purpose entity.
20 It's a vehicle the financial markets use routinely to
21 protect just the sort of interest the noteholders have
22 here. Indeed it's the only reason that the hundreds of
23 millions of dollars that were loaned in this case to
24 Scopac were able to be issued and obtained. And the
25 noteholders would simply have not invested such

1 significant funds if it thought there would ever be a
2 risk of it being treated in any other way as a separate
3 entity. Needless to say that --

4 THE COURT: There's no provision in the
5 bankruptcy code that says you can't reorganize a special
6 interest corporation.

7 MR. KRUMHOLZ: We believe there is a
8 significant public interest issue here, Your Honor. As
9 you know, special purpose entities are used routinely in
10 the financial markets.

11 THE COURT: Sure.

12 MR. KRUMHOLZ: For a very obvious reason,
13 and the reason we all know, including of course, Your
14 Honor is that noteholders like those in this case would
15 not invest if they didn't have some degree of certainty
16 that they were -- the value of the timberlands here or
17 the corpus would not be tapped into, which we believe
18 has absolutely occurred here. We understand your order.

19 THE COURT: Let me ask you this. How
20 many bankruptcies are there where equity is wiped out,
21 just wiped out? I can think of the big ones I've had,
22 most of them wipe out equity. Now, would you say that
23 people invest in corporations -- I mean, if you're going
24 to say -- that would be almost like saying well, in the
25 bankruptcy code because you can wipe out equity that

1 people will never invest in the stock market again. I
2 mean, bankruptcy code allows you to re -- to --

3 MR. KRUMHOLZ: I don't believe this is a
4 foreseeable risk frankly, Your Honor. I think that what
5 you're asking is the foreseeability issue. There may be
6 a foreseeable risk if a company's equity falls far below
7 what you ever expected it to be or thought it would be
8 in the stock market.

9 THE COURT: All right.

10 MR. KRUMHOLZ: But to suggest the value
11 of your collateral would somehow be tapped by creditors
12 of a wholly separate entity without some sort of
13 substantive consolidation which we believe has
14 effectively occurred here, I don't believe it's
15 foreseeable and I don't believe it's consistent with the
16 law.

17 THE COURT: I mean, you could have
18 elected under 1111(b) to take payments over the life of
19 the plan equal to the amount of your claim. You could
20 have done that. That would have been one way to protect
21 from this happening. The other thing you could have
22 done is do your own plan because you've got way more
23 equity. Even if we use the word equity in the Dean
24 sense of the word, you don't have equity but you've got
25 a way better position than Marathon did in this

1 particular case. I mean, there's a lot of protection to
2 stop that from happening if you want to have a separate
3 corporation.

4 MR. KRUMHOLZ: And one such protection we
5 thought, Your Honor, was the indubitable equivalent and
6 the right --

7 THE COURT: Okay. So you would prefer
8 they give you a note for \$513.6 million payable over 20
9 years at a reasonable interest rate rather than cash of
10 \$513.6 million.

11 MR. KRUMHOLZ: Your Honor, I don't
12 believe we -- I understand the Court's position but I
13 simply don't believe that we're operating under the same
14 logic or understanding of the law. And I completely
15 understand and am respectful of the Court's decision,
16 but with that said, there's a significant gap --

17 THE COURT: Okay. All right.

18 MR. KRUMHOLZ: -- in terms of belief of
19 what the law stands for.

20 THE COURT: Okay. Go ahead.

21 MR. KRUMHOLZ: But regardless, it is our
22 position, Your Honor, and we believe the credit market's
23 position that the ruling will have a significant and
24 chilling effect throughout the credit markets and will
25 impact the extent to which this sort of financing will

1 be available in the future.

2 Simply stated, the timber noteholders
3 chose to become creditors of Scopac, and not Palco. And
4 Scopac is now, we believe, being stolen and we don't
5 believe the law allows for that, regardless of when
6 exclusivity is terminated to accommodate the needs of a
7 separate entity with a separate creditor constituency.

8 Now, the fourth factor, whether other
9 interested parties in the Scopac case will not suffer
10 substantial harm if the stay is granted. With respect
11 to this factor, Your Honor, I want to bring us back to
12 your question that you specifically asked me a few
13 moments ago. And that is, a bond won't do it here.
14 Under the normal cases you have a judgment, you have a
15 monetary judgment and the litigators in this room have
16 seen that.

17 THE COURT: Get a bond and away you go.

18 MR. KRUMHOLZ: And away you go.

19 THE COURT: In fact, most jurisdictions
20 provide it's 125 percent or whatever the jurisdiction
21 provides.

22 MR. KRUMHOLZ: But you're right in
23 distinguishing this case. This is not a damage type of
24 case. And I believe you're going to hear from
25 Marathon's and MRC's counsel that you --

1 THE COURT: On your side you've got 513.6
2 reasons that you can give to protect the other side if
3 you choose to do that. Now, I don't know how you want
4 to do that. But there are 513.6 million reasons that
5 you have in your arsenal there that without spending a
6 dime that you can protect the other side.

7 MR. KRUMHOLZ: We believe we have -- and
8 frankly, Your Honor, I think it's -- while there's going
9 to be disagreement and certainly it's going to be
10 controverted based upon the briefing I just saw, we
11 believe that the evidence will, frankly, conclusively
12 establish that these debtors can continue to operate
13 based upon what we are proposing without any harm or
14 damage as suggested, without the --

15 THE COURT: So are you so sure about that
16 that you're willing to guarantee that with your \$513.6
17 million?

18 MR. KRUMHOLZ: Your Honor, I don't know
19 exactly what that means, but --

20 THE COURT: Neither do I, but let's start
21 with that.

22 MR. KRUMHOLZ: Say that again? I'm
23 sorry?

24 THE COURT: I said I agree with you. I
25 don't know exactly what that means either but let's

1 start with that provision. Are you willing to put up
2 your claim to support the operations of the business
3 while we're under the appeal?

4 MR. KRUMHOLZ: Your Honor, obviously --

5 THE COURT: So that if the downside of
6 the operation of the business is that there's a loss,
7 that's your problem if you lose the appeal. If there's
8 not a loss, of course, you don't have a problem.

9 MR. KRUMHOLZ: We would have to see the
10 reason for loss, frankly, because under our paradigm we
11 don't think it's possible unless it is the choice,
12 frankly, of this middle table.

13 THE COURT: I don't think it's possible
14 that the forest is going to go down in value, although
15 lots of fires in Northern California. From data
16 confirmation, big fire, forest goes down in value,
17 Marathon and Mendocino back out of the deal. So there
18 are two kinds of losses that I think you've got to
19 protect. I'll just start off with that and maybe you're
20 going to tell me how this is going to work.

21 MR. KRUMHOLZ: I am.

22 THE COURT: During the appeal, which we
23 don't know how long that will take but let's assume it
24 takes six months to a year. During the appeal, there is
25 going to be operations of the business or it's going to

1 crater and then there's going to be all kinds of
2 problems. There's public problems because there are
3 environmental things that don't get done. There are
4 people laid off work. There are all kinds of
5 bankruptcies in Northern California, whatever. So
6 there's the operation of the business. We know that
7 there is a DIP available that might allow Scopac to
8 continue and operate. It may well be that -- but that
9 DIP then starts putting people behind. In other words,
10 it raises the cost. I mean, I don't know what the DIP.
11 Maybe the DIP will fully be paid for out of operations,
12 but if it's not, who pays the difference? Certainly it
13 shouldn't be the people who won the lawsuit. The
14 difference should be paid by your client.

15 MR. KRUMHOLZ: We have taken into account
16 all of those issues that you've just addressed and
17 believe me, we have completely erased those as concerns.

18 THE COURT: One problem is is there a way
19 to continue the operation of this business in such a way
20 that Mendocino and Marathon are happy with the operation
21 of the business, I guess you're happy with the operation
22 or you agree to it. And it continues to operate. And
23 to the extent -- I mean, of course, that's going to mean
24 we're still in bankruptcy, there's going to be some
25 lawyers and there's going to be administrative claims

1 that continue to accrue that are caused by the extension
2 of the case. So to the extent that that runs up a
3 bigger bill, if you figure that the forest stays the
4 same, you can basically take the other assets, and to
5 the extent they go down, or the claims go up, that's a
6 problem during the course of the -- course of the appeal
7 and some way that's got to be taken aware of. That's
8 one problem you have.

9 The second problem you have is the harm
10 caused by what happens if you lose a year from now, but
11 Mendocino and Marathon back out. They don't have to go
12 forward.

13 MR. KRUMHOLZ: That's a self-inflicted
14 wound, Your Honor.

15 THE COURT: Whether it's self-inflicted,
16 if something goes down I can assure you they're going to
17 back out. Why should they pay for when they're not
18 operating it whatever happens in this year? Maybe they
19 want to stay on. Something could happen to their other
20 business to cause them to have to back out. Something
21 could happen to Marathon to cause them to have to back
22 out. I mean, so somehow the rest of the public, the
23 State of California, the agencies, the people that work
24 there, all of those people have to be protected from
25 what might happen if the passage of time craters the

1 deal. If the passage of time craters the deal, then
2 we've now got at the end of that time period, we either
3 have to hope that continued administration of the case
4 will result in some other plan or something else or you
5 have succeeded in being able to foreclose even though
6 you won the case.

7 MR. KRUMHOLZ: Can I just address your
8 issue, Your Honor?

9 THE COURT: Sure. At least in my own
10 thinking, I think that's where we are.

11 MR. KRUMHOLZ: I think they are excellent
12 questions, Your Honor. I think everyone in this room
13 understands --

14 THE COURT: I think to talk about -- I
15 mean, there's no question your appeal is going to get
16 mooted if we don't stay a pending appeal. Okay. You
17 lose that valuable right, the right of appeal because
18 it's going to get mooted. I think that's probably true.
19 But I think it's just equally true that there's no case
20 that if we stay it that the plan is going to get mooted.
21 So let's -- let's hear about all of that.

22 MR. KRUMHOLZ: But to your first question
23 on the operations, first of all, there's great
24 discretion given to you to tailor or fashion a bond or
25 other source of funding or security and not in the form

1 of a bond to enable you to assure that a cloak of
2 security --

3 THE COURT: Are you willing to pay off
4 Bank of America as a part of a bond? I mean --

5 MR. KRUMHOLZ: Am I willing to pay off
6 Bank of America?

7 THE COURT: We've got that one problem.
8 They're going to continue to have administrative costs.
9 They're going to continue to have -- they're going to
10 have --

11 MR. KRUMHOLZ: Can I address -- maybe it
12 would be helpful if I took a step back because you asked
13 the question, Your Honor. There's also these other
14 risks that are unforeseeable, a forest fire, an act of
15 God, even a further crater in the economy that all the
16 testimony to date has been that despite the value has
17 gone way up because of some sort of demand. But despite
18 all of that testimony, they're not going to get --

19 THE COURT: I don't think the value has
20 gone up. I said that the --

21 MR. KRUMHOLZ: That's what they have
22 said.

23 THE COURT: No. They have said that the
24 discount rate has gone down, which would have a bigger
25 impact on any temporary lumber price in the economy.

1 MR. KRUMHOLZ: Your Honor, the testimony
2 and the argument of counsel has been and I will show you
3 the transcript in the meantime --

4 THE COURT: Well, that's not what I
5 asked.

6 MR. KRUMHOLZ: There is no question that
7 they have taken the position that it has increased in
8 value as a result of the discount rate and the discount
9 rate is that such, according to them, not because of any
10 market risk or specific risk as to the timberlands but
11 rather because there's all this demand for commodities
12 because of the dollar falling.

13 THE COURT: Right.

14 MR. KRUMHOLZ: That is the reality. And
15 they have argued to you despite the crisis in the credit
16 markets, despite the crisis in the real estate market,
17 the housing crisis, the subprime prices, etcetera.

18 THE COURT: There's no question the price
19 of gold has gone up.

20 MR. KRUMHOLZ: Despite that testimony
21 that only metals, that only healthcare and energy, this
22 has continued to go up.

23 THE COURT: I understand that you
24 disagree with all of that but let's get back to the
25 point.

1 MR. KRUMHOLZ: But the point is this,
2 Your Honor. Take a step back. What we have to bond
3 against or fund is the status quo. That's what we must
4 do. And that is, we need to continue the operations and
5 we need to provide insurance and we need to provide
6 taxes.

7 THE COURT: You can't provide insurance
8 for the forest. I mean, there is no insurance available
9 for this forest. I mean, I agree with you that absent
10 some extraordinary act of God the value of this forest
11 is not what you need --

12 MR. KRUMHOLZ: So do we need to bond
13 against some nuclear attack? Is that what the law must
14 be then? Do we need to -- I mean, that is simply not
15 the law. That is not the law. The law is we have to
16 keep the status quo and protect it from reasonable and
17 foreseeable events and we can't presume, I believe, A,
18 either self-inflicted wounds such as the one the Court
19 suggested. Or B --

20 THE COURT: Okay. Well, you agree that I
21 can't make a condition of stay pending appeal that
22 Marathon and Mendocino don't back out of their deal.

23 MR. KRUMHOLZ: That's their decision to
24 make.

25 THE COURT: That's their decision to

1 make. They can back out at any time if they want to.

2 MR. KRUMHOLZ: And I'll get to that. And
3 I can talk about the case that they suggest supports
4 that notion, the Adelpia case in a moment. But the
5 first point is, of course, we believe we're creditors of
6 Scopac and don't believe we should be required to bond
7 for anything else. But we understand the order of the
8 Court. And we will provide testimony through John Young
9 of Scopac exactly how we can fund the operations of the
10 debtors in a manner that keeps it operating as is, that
11 does so in a manner that protects the interest of all
12 those concerned. And there's a couple of things that
13 are going to happen in that regard if it's approved by
14 the Court. One would be a \$20 million DIP facility at
15 Scopac.

16 THE COURT: Is that DIP facility going to
17 be -- I mean, are you going to subordinate your claim to
18 that DIP facility?

19 MR. KRUMHOLZ: The DIP facility will --
20 as I understand it, will come right out of the \$513.6
21 million if and when --

22 THE COURT: You're willing to say that in
23 the event you lose your appeal that any deficiency in
24 the DIP will be paid out of your claim.

25 MR. KRUMHOLZ: Yes, and it gets better

1 from there, Your Honor, in terms of what we're willing to
2 do.

3 THE COURT: Okay. Let's hear it.

4 MR. KRUMHOLZ: Because then the question
5 is, okay, Palco, which we don't believe we should have
6 to bond but if for some reason the Court decides that a
7 creditor of Scopac and Scopac alone must bond or fund
8 Palco between now and the end of any appeal, we have
9 come up with a formula that absolutely works according
10 to everyone most knowledgeable of the businesses. Okay.
11 And the way that money is going to get to Palco without
12 even creating an additional claim at that point is that
13 the logs, that they need to operate, that they need to
14 sell in order to continue to operate are going to be
15 given free.

16 THE COURT: Excuse me, somebody on the
17 phone needs to either mute their mic or not laugh. Go
18 ahead.

19 MR. KRUMHOLZ: And those logs, Your
20 Honor, are going to be 5 million board feet what they
21 have been currently receiving.

22 THE COURT: Give what to who?

23 MR. KRUMHOLZ: Scopac is going to provide
24 the delivery of logs at the amount of 5 million board
25 feet per month which is what it currently provides to

1 Palco without any payment terms other than to the extent
2 that Palco provides roads and reforestation services to
3 Scopac which it must do to keep the status quo, that it
4 is offset against that amount. And maybe offset is not
5 the appropriate word, but essentially it would be a net
6 \$24 million benefit to Palco during the course of
7 through December 31, 2008.

8 And you will hear from John Young, you
9 will hear from Jeff Barrett that this is not only
10 workable, but this will make the business be able to
11 operate just as it does now. And indeed, it will even
12 improve operations in many respects.

13 THE COURT: That's another issue. Should
14 the business continue to operate the way it is or should
15 it operate in accordance with the Mendocino philosophy
16 of sustainable growth?

17 MR. KRUMHOLZ: Well, Mendocino doesn't
18 own it.

19 THE COURT: I understand that. But if
20 we're not appealed, they own it. If we appeal it, they
21 don't get to own it for a year. Now, during the period
22 of that year if you clearcut a bunch of stuff, that
23 could impact the value of what they get to buy at the
24 end of the year.

25 MR. KRUMHOLZ: Your Honor, the case law

1 in Texas, and they cite a couple of Second Circuit cases
2 that we can talk about, but if you look at the Fifth
3 Circuit where we live and where this case belongs or at
4 least is, the --

5 THE COURT: I'll agree with you that it
6 belongs.

7 MR. KRUMHOLZ: But if you look for
8 specific law on corporations holding assets such as
9 this, the factors are clear, and one of the factors is
10 exactly what you said. Okay. How does MRC -- what is
11 the value lost here during the interim? The normal case
12 are rental values or other appreciations of that sort.
13 Here it's not. We can look to the Mendocino/Marathon
14 plan to determine exactly what was going to happen over
15 the next 12 months. They were expecting to lose \$1.7
16 million.

17 In addition to that, the undisputed
18 testimony and documents will demonstrate that they
19 planned on taking on \$325 million in the form of a
20 bridge loan of debt. And that -- and the interest on
21 that debt, which was going to be interest only at live
22 order plus 225 basis points. That would no longer be
23 necessary.

24 THE COURT: But it will be necessary
25 whenever it closes.

1 MR. KRUMHOLZ: But during the period they
2 have not lost that. That is a benefit. They will not
3 have lost the \$1.7 million. And that's the question,
4 according to the courts. During the appeals --

5 THE COURT: The potential that they have
6 to lose is that instead of having a forest that starts
7 today with their philosophy of how you harvest the
8 forest, you have a forest a year later that's had
9 another year of, I guess, Dr. Barrett's philosophy or
10 whoever is making the decisions.

11 MR. KRUMHOLZ: Well, my belief is, Your
12 Honor, that that's not required under the law. But to
13 the extent it is, I guess we can talk to Dr. Barrett and
14 others about how that might be accommodated. But what
15 we do know is that the law does suggest --

16 THE COURT: I guess the argument is sort
17 of like this. You've got a car and somebody -- you've
18 got two people that are fighting over the ownership of
19 the car. One is grandma and the other is teenager. And
20 grandma wins but teenager has possession. If he gets to
21 drive that car for a year and then give it back to
22 grandma, grandma isn't getting the same thing as what
23 she would have had had she had at the beginning. I'm
24 not saying that necessarily that Scopac is a teenager
25 and Marathon is grandma but I'm saying there are two

1 different philosophies. I mean, are you willing to
2 impose some sort of a plan and I don't know whether
3 there's even a way we can to do that to where the
4 philosophy for cutting the timber during this period and
5 for reforestation and for doing the roads and for -- is
6 the philosophy that would have been imposed had they put
7 it in there, that way there's no change in the value of
8 the forest but for some act of God like we were talking
9 about, a nuclear war or a big fire.

10 Now, fire is less -- is more of a concern
11 now, although I don't think -- I think the testimony was
12 that these are areas that aren't really hit by fires as
13 much because they're -- because of the water and because
14 of the humidity and all that sort of other stuff.

15 MR. KRUMHOLZ: Your Honor, I feel like
16 I'm boxed in. You know, it's this double-edged sword
17 thing. We were told by Marathon and MRC all last week
18 that with 74 million board feet harvested, and almost 74
19 million board feet cut, the growth still increased
20 value.

21 THE COURT: Equal to or --

22 MR. KRUMHOLZ: Increased value. Equal to
23 or greater than value. They didn't say equal to, they
24 said greater than value.

25 THE COURT: Well, you said Sandy Dean

1 said it at one time.

2 MR. KRUMHOLZ: Well, what I said was that
3 the testimony wasn't credible or believable which I
4 think was demonstrated. But with that said, Your
5 Honor --

6 THE COURT: I agree with you, the forest
7 is going to be worth about the same. But how do we
8 protect the worst case scenario? If your guy decides to
9 cut the 100 million board feet, there's nothing to stop
10 them from doing that, is there, other than the State of
11 California. I don't know what they -- they have cleared
12 out new areas, maybe they can cut 100 million.

13 MR. KRUMHOLZ: I'm sure Dr. Barrett will
14 tell us exactly what he plans to do and what will occur
15 during this year period. And if the Court would like to
16 make it a part of the order such that it wouldn't go
17 above a certain amount except with Court -- except upon
18 request of the Court, it can do so. And by the way, the
19 order can be fashioned as such. And you have great
20 discretion to retain jurisdiction over funding or bond
21 issues such as that. So that can be worked out.

22 THE COURT: Okay. Well, I guess what I'm
23 trying to ask you is not to think of what's the most
24 likely thing to do. You've got to think in terms of
25 you're representing the other side and we've got to

1 protect against what the worst that can happen.

2 MR. KRUMHOLZ: And Your Honor, I don't
3 think there's been an issue raised that we can't --

4 THE COURT: And I'm not smart enough to
5 come up with all that but I'm hoping you are because if
6 you convince me you've got a plan that can protect them
7 from the worst thing that can happen, then there's no
8 issue here.

9 MR. KRUMHOLZ: So Your Honor, at the end
10 of the day we believe through the assumptions that I
11 just told you and we'll go into a little more detail in
12 terms of the assumptions that have been made and be very
13 forthright and discuss all of the issues that you've
14 raised, we believe we can operate without significant
15 risk. And we think we can tie up any concerns that the
16 Court may have, at least those that are based upon what
17 the Court should consider according to the case law, we
18 believe that we certainly can cover any of those issues.

19 Nevertheless, if the Court were to
20 require the indenture trustee to fund Palco, which
21 obviously you know our position in that regard, this
22 Court should include additional protections. It ought
23 to retain jurisdiction to assure that if there's an
24 emergency and we need to change course and an additional
25 bond or additional funding are necessary, we can revisit

1 that issue. You have that discretion to do so. To
2 conduct a hearing, Your Honor, for the end of the year,
3 which is the farthest out that our forecast can go at
4 this point such that we can determine if additional
5 funding is necessary, allow the IT another point, to
6 allow the IT to file a notice of any intent to
7 discontinue pursuant to an appeal because of -- either
8 because there's not been an emergency appeal granted to
9 the Fifth Circuit or they don't accept it or some delay
10 that wasn't foreseeable, then we can have notice and the
11 plan goes effective immediately and the appeal is
12 dropped. We want to have some protection in there that
13 we can go ahead and take down the funds and terminate
14 the DIP to the extent that it hasn't been used with some
15 notice.

16 And then if Scopac is unsuccessful on
17 appeal, any requirement to fund availability under the
18 DIP shall terminate obviously automatically upon entry
19 of the order.

20 There is only one other issue that I'll
21 get to in closing probably, and that is, under the
22 forecast that has been prepared by Mr. Young and,
23 frankly, by a host of others, Palco and Scopac, with
24 input at least from all, there is going to be some back
25 payments made in connection with the professional fees

1 and we would just say that any fees and expenses
2 incurred that would otherwise have been incurred by
3 Marathon and Mendocino under their own plan, to the
4 extent that they're somehow paid by the DIP facility or
5 some other funding source that they be compensated for
6 at the end of the day back to the indenture trustee
7 because those are fees or expenses that otherwise would
8 have been borne by others anyway.

9 So Your Honor, you know, that's kind of
10 the framework for the evidence that we believe you'll
11 hear in connection with the motion for stay pending
12 appeal, and with that I'll briefly summarize the motion
13 for direct certification to the Fifth Circuit.

14 You've already heard the elements in
15 connection with this. You had a previous motion, as I
16 understand, was filed and it was similar in nature.
17 Only one of the three -- there are three circumstances
18 or factors that must be present to mandate
19 certification, just one of the three, it must be that
20 the order involves a question of law as to which there
21 is no controlling decision, involves a matter of public
22 importance.

23 Two, the order involves a question of law
24 requiring resolution of conflicting decisions; or three,
25 an immediate appeal on the order may materially advance

1 the progress of the case. Here all three are present.
2 Obviously we've talked about the grave effects of the
3 financial markets that we believe exist and are,
4 frankly, we believe readily apparent.

5 Second, we contend that at minimum, the
6 order stretches, and at maximum contravenes decades of
7 well settled bankruptcy jurisprudence and overlooks the
8 flaws and legal inadequacies inherent in the Mendocino
9 and Marathon plan which IT believes creates a conflict
10 on several key questions of law.

11 And finally, a decision from the Fifth
12 Circuit will instill a sense of confidence in the order
13 or on the other hand, a reversal of that order that will
14 effectively end the contentious litigation of the
15 debtors bankruptcy cases which of course involves some
16 of the most priced natural resources according to
17 Mr. Pascuzzi. I think we all agree that they are prized
18 natural resources in the second largest state.

19 So with that, Your Honor, the only other
20 thing that I would state is that --

21 THE COURT: Are you forgetting Alaska or
22 Texas, which one?

23 MR. KRUMHOLZ: I'm not forgetting Texas,
24 Your Honor. Your Honor, I did want to address one
25 thing. We just got the brief and I did glance at it and

1 I noticed that they cite Adelpia. With the Court's
2 permission I just briefly would like to summarize what
3 we believe the Adelpia decision really stands for and
4 what it doesn't stand for, importantly.

5 There are certain things it does stand
6 for consistent with the IT's position. And there's no
7 question about that. But it is a New York bankruptcy
8 decision. It's not a Fifth Circuit case and I've
9 already told the Court what we believe is the applicable
10 law with respect to real estate, companies that hold
11 real estate, the greatest asset they have anyway is the
12 real estate and how those cases treat the factors
13 associated with this issue.

14 Now, one thing that you ought to note is
15 that the court, the New York court did grant the motion
16 for stay pending appeal. The court also set the bond to
17 cover a total of 7 months for all of the appeals in the
18 case. And we believe that that's on force with what
19 should occur here. It also balanced all the factors and
20 didn't apply any sort of rigid test and specifically
21 stated that the court shouldn't apply a rigid test, just
22 as the Fifth Circuit has told us.

23 But one thing that the appellant -- the
24 appellees are suggesting in their briefing is that we'll
25 back out of the deal and somehow like Adelpia that

1 matters and somehow like Adelpia we should have to bond
2 for that unforeseeable, or even foreseeable --

3 THE COURT: You'll back out of what deal?
4 I didn't -- they say that you'll back out of the deal?

5 MR. KRUMHOLZ: They may back out of the
6 plan.

7 THE COURT: They have a right to back
8 out. But I think that works in your favor.

9 MR. KRUMHOLZ: The issue is whether or
10 not we have to fund it or bond for that. Okay. And so
11 here's the issue, Your Honor. The bottom line is I
12 guess this. It was a far different paradigm that
13 existed in the Adelpia decision. The buyer, Time
14 Warner in Adelpia was not an appellee and was not the
15 one who was claiming hard. The debtor was the appellee.
16 And so the time based contingency which would require
17 the loss inducing IPO, and the Court is probably
18 familiar with that caused the concern about the loss of
19 funds or value that would be created by the debtor if
20 this IPO went forward was something that was under the
21 control of the buyer, not a proponent of any plan, and
22 not the appellee. Here it's a far different
23 circumstance. Far different.

24 What they are essentially saying is, Your
25 Honor, despite what we said last week about the rise in

1 value, despite all those things we just discussed and I
2 know you don't want to hear over again, despite all of
3 that, we could have a self-inflicted wound and, by the
4 way, if we do, you should fund it. That is a far cry
5 from anything close to Adelpia. And I have the benefit
6 of being able to talk to Mr. Pachulski who, of course,
7 was involved in that matter and there's just no question
8 that it involved far different facts, far different
9 circumstances, and frankly, a far different application
10 of the law and can't be relied on for the purposes that
11 they -- the appellees seem to be relying on it.

12 THE COURT: So you think that the bond
13 that you need to provide doesn't have anything to do
14 with protecting the public interest caused by this
15 potential delay?

16 MR. KRUMHOLZ: I don't believe --

17 THE COURT: We can only protect the
18 buyers' interest? I agree with you, if this were just
19 Marathon and Mendocino versus the indenture trustee, the
20 fact that they might back out of it later is not
21 something that I should protect. But this is not just
22 them against you. I mean, they may well be the people
23 that are pursuing the majority of it, but there's also
24 the creditors committee, there's Palco, there's the
25 state agencies, there Alan Tenebaum.

1 MR. KRUMHOLZ: Your Honor, if they back
2 out, the DIP facility still funds the operations. It's
3 still in place and Your Honor still has jurisdiction to
4 hear continued funding to the extent necessary.

5 But to suggest that they have a right to
6 say king's X, we're going to self inflict this wound and
7 there's -- and because we say it, it's so, it
8 contravenes -- just think of all the case law that's out
9 there, Your Honor, that says you can't -- you can't
10 suggest, based upon interested party statements about
11 what they intend to do in the future that are purely
12 subjective in nature. What does the case law, the
13 federal case law say about the weight given that
14 evidence? It isn't any evidence at all. It's legally
15 insufficient under any standard anywhere in any court in
16 any state in this nation.

17 You cannot just suggest, oh, we intend to
18 crater the plan, we can't cross-examine you on it
19 because it's our intent and it's somehow probative
20 enough that we need to respond to it.

21 THE COURT: Let's go back to our car. If
22 you were going to keep a car pending an appeal, there is
23 no question that I'd require you to have a -- have
24 insurance on it. Even though there's no -- nothing for
25 sure that anything is going to happen in the future but

1 it's certainly foreseeable that something might happen
2 in the future and it's certainly reasonable to require
3 you to have insurance.

4 MR. KRUMHOLZ: And under the plan, we
5 keep the same insurance that this company has always
6 kept, and probably, as I understand the testimony, to
7 the fullest extent. There is insurance, but it's
8 limited. I understand that from other testimony. But
9 with that said, Your Honor, it's the same insurance they
10 would have if they owned it. It's the fullest extent
11 that can be gotten.

12 THE COURT: I'm not worried about that.
13 I agree with you. I'm only worried about the damage
14 caused by them backing out of the deal. And the passage
15 of time, it certainly is foreseeable that a party that
16 wants to buy something in 2008 might not want to buy it
17 in 2009.

18 MR. KRUMHOLZ: I just don't think it's an
19 appropriate bond to allow essentially Marathon and
20 Mendocino --

21 THE COURT: It depends on which one it
22 is. If I told you that bond was just a small amount,
23 you wouldn't have any problem with it. I don't know.
24 That's why I'm asking you, what is the potential damage?

25 MR. KRUMHOLZ: If I thought the error --

1 it may be error to rule that but that if it was a
2 diminimus amount that we might, you know, go ahead and
3 swallow that issue, that may be true, but that's not to
4 suggest that we rule out analysis of the logic.

5 THE COURT: That's not what I'm
6 suggesting to you. I mean, there is no question that
7 nothing can bind Marathon -- I mean, Marathon is pretty
8 much in this deal. They got a lot to lose. Mendocino
9 has put a lot into this deal so they have plenty to
10 lose, too, not as much as Marathon. And so it's not
11 likely that they're going to back out, assuming that
12 this forest is run properly for a year while you appeal
13 it. Assuming that their price is the same.

14 And in fact, if they don't have to pay
15 the interest for a year, it's a bargain to them to get
16 to look at it for a year. It's to their advantage to
17 have a year to look at it and see that it's run
18 correctly and done all that sort of stuff. I don't know
19 how they're harmed other than if something happens.

20 Now, if something happens at the end of
21 the year, what is the measure of what the delay has
22 caused us? We don't have a deal. Would it be
23 reasonable to think that in another six months we'd have
24 a deal so that you ought to have to fund the operations
25 for another six months? Would it be reasonable that

1 another year we'd have a deal? Would it be -- I mean,
2 are the creditors, are the state agencies, is Palco, is
3 everybody else involved other than the noteholders
4 entitled to another reasonable opportunity to reorganize
5 it? Or if they back out after you lose on this deal,
6 are you entitled to foreclose? I mean, that's what has
7 to happen. Either you foreclose or we have to
8 reorganize it somehow. And we have no more money to
9 reorganize it. And we've got nobody to buy it.

10 MR. KRUMHOLZ: I simply don't believe
11 that we should be put in a position -- and I don't know
12 of any case law to suggest that we should to fund or not
13 fund.

14 THE COURT: How much would it be?

15 MR. KRUMHOLZ: How much would it be if
16 what you're saying is they back out? How much should
17 the bond be? We believe the bond should be set based
18 upon the DIP facility that we've suggested, Your Honor.
19 And we believe the bond should be set at what we are
20 giving logs to Palco at.

21 THE COURT: You will have some testimony
22 to suggest that that DIP facility will fund these
23 corporations for the time of the appeal, plus if you
24 lose the appeal, the time it will take to reorganize
25 again?

1 MR. KRUMHOLZ: The testimony will be
2 through December of this year, six months. It was five
3 months in connection with the SAR motion. And that Your
4 Honor, under our order, would be allowed certainly and
5 we would certainly come down here and request review of
6 the extending the funding to the extent necessary and to
7 the extent an appeal has not been decided upon. And you
8 could have jurisdiction over that. There's no question
9 you have the flexibility to do so.

10 THE COURT: So you are willing to agree
11 that to the extent that this corporation loses money
12 during the appeal process, not occasioned by something
13 that occurred before the appeal, that to the extent that
14 that happens, that you will use your claim to fund that
15 in the end if you lose your appeal?

16 MR. KRUMHOLZ: We will -- we will -- we
17 have committed to fund it to \$20 million through the DIP
18 facility and the -- and the free logs that are -- that
19 are being delivered to Palco. And to the extent we
20 decide that somehow we should not fund it any longer
21 because the price tag has been too costly or for
22 whatever unforeseen reason there may exist between now
23 and the end of December, their plan goes into effect --

24 THE COURT: And how will we allocate the
25 normal cost of administration with the cost of the

1 appeal, for instance? I mean --

2 MR. KRUMHOLZ: How will we allocate the
3 normal cost of the administration? I believe the \$20
4 million DIP --

5 THE COURT: Or are you just willing to
6 take all the costs from here on out?

7 MR. KRUMHOLZ: I believe that through the
8 end of December those costs are going to be borne by,
9 where appropriate, under the \$20 million DIP facility
10 that's proposed.

11 THE COURT: Okay.

12 MR. KRUMHOLZ: And outside of that, I
13 guess I need to ask others what that might look like.

14 THE COURT: What are you going to do with
15 Bank of America in the meantime?

16 MR. KRUMHOLZ: Well, Bank of America, as
17 I understand it, under the \$20 million DIP and the
18 continued operations continues to receive what they
19 would ordinarily receive. What they have been
20 receiving.

21 THE COURT: So the Bank of America debt
22 is going to stay where it is, but all the expenses and
23 fees associated with it are going to continue to be
24 paid?

25 MR. KRUMHOLZ: Let me get to another

1 course that answers that, not only with respect to Bank
2 of America but all creditors. One of the factors that
3 these Fifth Circuit cases that involved real estate
4 companies actually looked to is the delays that the
5 creditors have to have to get their money. And we have
6 calculated that amount, it's an exhibit to Mr. Young's
7 proffer. It's the last page of the proffer, the
8 attachments if the Court would like to look at it. It's
9 \$1 million using the federal rate, the federal interest
10 rate, judgment rate. And Your Honor, that will be paid.

11 THE COURT: Okay.

12 MR. KRUMHOLZ: So that's -- so I think
13 we've covered all the factors. And through the
14 evidence, I think we'll show you that, and we'll
15 certainly summarize it to the extent the Court allows in
16 closing.

17 THE COURT: All right. Thank you.

18 MR. PACHULSKI: Your Honor, this is Isaac
19 Pachulski representing certain noteholders. May I have
20 less than ten minutes to make a point?

21 THE COURT: Go ahead.

22 MR. PACHULSKI: First, I would like to
23 answer a couple of questions that Your Honor asked
24 specifically. You asked about harvest rate and
25 harvesting. This isn't where I intended to start but

1 the answer is really in Your Honor's findings 103 and
2 104. Your Honor found that the only difference between
3 Mr. Yerges's harvest rate for the first ten years, you
4 recall he was the debtor's witness, and Mr. LaMont's was
5 that they used the same harvest rates for redwood. It's
6 not as if the debtors contemplated that they were going
7 to slash and burn and harvest 100 million board feet a
8 year. I'm sorry, what was that?

9 THE COURT: I don't know.

10 MR. PACHULSKI: Anyway, Your Honor, the
11 point I want to make is that Fleming, Yerges, and LaMont
12 all assumed, according to Your Honor, the same harvest
13 rates for redwood over this next ten years. The
14 difference had to do with Douglas fir and profitability.
15 So I respectfully submit that in terms of what people
16 plan to harvest, they're the same for the next year as
17 to redwood. And the difference as to Douglas Fir simply
18 has to do with harvestability and value.

19 Second, with respect to this whole issue
20 of fires, two points I would like to make briefly on
21 this. First, because I happen to live in Southern
22 California so I know about the current fires. The
23 current fires are in the area of Southern California
24 known as Goleta, which is known as a notoriously dry
25 area. There were years in the past where they actually

1 had to impose water rationing and there are limits on
2 the ability to build because of water limits. As Your
3 Honor knows, this is very different from Northern
4 California where it's the very dampness and unique
5 conditions there that permit redwood to grow. I'd also
6 like to --

7 THE COURT: Aren't there fires up by
8 Sacramento also right now? Where is Paradise? Where is
9 Paradise, California?

10 MR. PACHULSKI: I don't know where
11 Paradise is. It's not in my office.

12 MR. PASCUZZI: Your Honor, it's about an
13 hour and a half north of Sacramento.

14 THE COURT: Okay. Paradise is an hour
15 and a half north of Sacramento. It's the one that's
16 been threatened now in the past two weeks twice.

17 MR. PACHULSKI: How far is Humboldt
18 County from that?

19 MR. NEIER: Your Honor, everybody here
20 knows that there's a fire in the redwood forest in
21 Mendocino County.

22 THE COURT: At the present time.

23 MR. NEIER: At the present time on MRC's
24 lands.

25 MR. BRILLIANT: We have 22,000 acres.

1 MR. PACHULSKI: Your Honor, may I answer
2 to this, if I may. May I argue?

3 THE COURT: Go ahead.

4 MR. PACHULSKI: Your Honor, if the
5 indenture trustee had come in on the first day of the
6 case and asked for relief from the automatic stay saying
7 we're not adequately protected because there may be a
8 forest fire that wipes out the forest and so you ought
9 to give us the forest today so we can sell it, I
10 honestly don't believe that Your Honor would have ever
11 have granted that because Your Honor would have said,
12 that's to speculative. And that's what's going on here.
13 But that leads me to a more fundamental --

14 THE COURT: There's a little difference
15 there. That's early in the case. That's a motionless
16 stay. I mean, you would -- if you had done that and I
17 didn't grant it because there wasn't going to be a deal,
18 there would be, as we know, an administrative claim
19 potential. All that sort of stuff. This is a person
20 who has won the case.

21 MR. PACHULSKI: But Your Honor, with all
22 due respect, the administrative claim against Scopac
23 where we have all the collateral anyway would have been
24 meaningless in the real world. It's only meaningful
25 because there's a plan by someone else.

1 THE COURT: I agree.

2 MR. PACHULSKI: Okay. So in the real
3 world you could not have protected us. Now, there's a
4 more fundamental point here. With respect -- Your Honor
5 is in somewhat at an awkward position here that 99
6 percent of the courts that deal with stay motions don't
7 stay, and that is this: The other side is asking you to
8 imposed bonds that is so prohibitive that it will
9 insulate Your Honor's words on appeal. Nobody can dance
10 around and they can say what they want. But most courts
11 that are dealing with stays pending appeal, if you don't
12 grant the stay, yeah, some bad things happen to the
13 appellant because the order is enforced, but the
14 appellant doesn't lose the right to appeal.

15 And in dealing with a whole new
16 speculative probabilities, and I'll go into another one
17 in a minute. We have to bear in mind the context here.
18 Your Honor is being asked to insulate your own order
19 from appeal because, as Your Honor and everyone in the
20 courtroom knows, nobody is going to put up \$513 million
21 on a bond. It would be prohibitive. Anything close to
22 that is prohibitive. Now, I would like to talk about --

23 THE COURT: The 513 isn't not a bond,
24 it's your claim.

25 MR. PACHULSKI: But it's dollars, Your

1 Honor, as you pointed out whether it's a bond or it's a
2 claim. In the real world everyone knows that that would
3 not happen and that would kill the appeal, which of
4 course, is what MRC and Marathon want to do is kill the
5 appeal from the confirmation order.

6 Now, let's talk about the -- I'm sorry.
7 I'd like to talk about the asset that we're dealing
8 with, Your Honor. There's this issue that has been
9 raised, what if they walk. Your Honor, I think you have
10 to do more than speculate before you impose a bond that
11 kills an appeal. And let's look at the reality. The
12 reality is over the last few weeks the appellees argued
13 successfully that in 18 months, not 6 months, not 12
14 months, in 18 months when we have had the worst crisis
15 in the residential housing market since the Great
16 Depression, when we have had the worst drop in the
17 market for this company's product, timber, the
18 residential housing market, the worst drop in that
19 market since the Great Depression, at a time when the
20 evidence was undisputed that looking at the capital
21 markets as a whole, credit costs have gone up and
22 discount rates have gone up.

23 Despite all that, they argued and
24 convinced the Court that despite this economic
25 catastrophe, these timberlands were so unique, so stable

1 and so impervious to economic factors that Marathon
2 actually, and MRC argued, their appraiser swore that the
3 value went up. And Your Honor didn't find that, but
4 Your Honor found in 18 months, despite an economic
5 catastrophe the value of these assets didn't go down.

6 And now they're asking you to find that
7 in the next six months, because we're talking about
8 going to the end of the year with revisiting at that
9 time, they're saying in the next six months there is a
10 realistic probability that Marathon, who has said that
11 their mill, you know, God knows what happens to their
12 mill and town if this doesn't go through. That MRC who
13 has spent months pursuing this asset and a fortune that
14 they're going to walk. You know what that reminds me
15 of, Your Honor? There are bidders who show up in court
16 and they will say to the Court, Judge, if you don't give
17 me what I want today, I'm going to walk. And most
18 courts say --

19 THE COURT: Walk.

20 MR. PACHULSKI: -- say walk. And they
21 don't walk, and they stick around typically. But the
22 main point is, Your Honor, with respect, especially in a
23 case where you're being asked to insulate your own order
24 from appeal, a bond cannot be imposed upon irrefutable
25 possibilities, whether it's the possibility that after

1 what happened in the last 18 months something would
2 happen in the last six months that would cause an
3 economically rational person, and MRC and Marathon are
4 the quintessential economic irrational person, that
5 these people would walk from a deal that they have
6 fought so hard and when they have convinced Your Honor
7 that this asset is one of the most stable assets on
8 earth. That's like saying, Your Honor, there could be a
9 nuclear war, there could be an invasion from Mars.

10 THE COURT: Wait a minute. Why should --
11 why should I require the creditors in this case to
12 guarantee that they won't walk rather than you guarantee
13 that they won't walk?

14 MR. PACHULSKI: Because Your Honor has --
15 in balancing, Your Honor, there's a right to appeal
16 which is fundamental and there's the issue of a
17 probative bond, and most importantly, Your Honor --

18 THE COURT: How do we know that it's
19 prohibitive? I mean, first of all, it only comes into
20 play if they walk, so right off the bat you don't think
21 they're going to walk so it's sort of an illusive right
22 to begin with, but to the extent we have creditors out
23 there and the State of California and other people that
24 want to be protected, if they walk, they're going to be
25 harmed.

1 MR. PACHULSKI: Your Honor, again, it
2 goes back to the fact that that's still speculation.
3 Based on this record, based on what Your Honor found
4 happened over the last 18 months.

5 THE COURT: I don't think the forest is
6 going to go down in value.

7 MR. PACHULSKI: Well, as far as harvest
8 rates go, Your Honor, as I just explained, Your Honor
9 found based on the testimony that everyone had the same
10 harvest rates for redwood over the last ten years, much
11 less next year. I understand Your Honor was worried
12 about the operations. Also, Your Honor, because in the
13 case of a stay, parties can come back. If someone is
14 doing something stupid to the forest like, for example,
15 if the debtor were to start harvesting 100 million
16 rather than what the debtor projected, which was a lower
17 amount than the debtor is harvesting and, as I said, the
18 differences are redwood, people can come back to court
19 if there are operating issue --

20 THE COURT: Okay. But we've got the
21 debtor as one of the appellants. Why can't they, as
22 part of the appeal bond, agree not to harvest more than
23 Mendocino says to?

24 MR. PACHULSKI: Your Honor, in principal,
25 because I don't know what the number is --

1 THE COURT: I don't either but we can
2 find out when they get up here.

3 MR. PACHULSKI: Your Honor, and this is
4 the difference, and it's a critical difference. It's
5 one thing to say that people can come up with reasonable
6 operating limits.

7 THE COURT: Right.

8 MR. PACHULSKI: Okay. It's another to
9 try to do what they're doing. And I want to be clear.
10 I'm not saying that the Court is doing this, I'm saying
11 this is what Marathon and MRC are doing. It's another
12 to try and insulate an order of appeal by requesting
13 something prohibitive that involves multiple noteholders
14 and putting up -- and basically putting up their entire
15 distribution. It isn't -- you know, everyone knows --

16 THE COURT: Okay. Well, let's don't put
17 up your entire distribution, let's put a reasonable
18 limit on it. I mean, what's the limit on what can
19 possibly happen during this time? I agree with you.
20 The forest isn't going to go down. But there's no
21 question that the other collateral is probably going to
22 go down. It happened during bankruptcy. And the odds
23 are it will continue to happen.

24 MR. PACHULSKI: Excuse me, Your Honor.
25 Your Honor, with respect, the other collateral, let's be

1 clear, other than the timber we're talking about the
2 Palco assets. As Mr. Krumholz explained to the Court,
3 even though we believe -- and I want to be clear for the
4 record -- that creditors of Scopac don't have to bond
5 creditors of a separate estate, okay, so we're
6 preserving that legal issue, no question about that,
7 there will be sufficient lumber provided to Palco so
8 that it continues to operate and it will be provided in
9 a way that Palco can pay for it and continue to operate.

10 Therefore, through the end of this year,
11 Palco will be able to continue to operate. And at that
12 point, one of two things will happen. Either the stay
13 will not -- either we'll have lost the appeal, in which
14 case when the deal is closing, they get an operating
15 Palco mill. And Marathon and MRC can do whatever they
16 were going to do to the mill but it will be operating.
17 So as far as this horrible liquidation scenario, it's
18 not going to happen.

19 Or at the end of that time, we're going
20 to be in a position where the appeal hasn't been
21 resolved, we're going to be back before Your Honor and
22 you're going to basically, look, I need some way that
23 Palco keeps operating, or noteholders, indenture
24 trustee, I have a serious problem. We believe that the
25 appeal -- we will push for an expedited appeal. We're

1 not interesting in delaying anything and you will get an
2 expedited appeal, hopefully at the Fifth Circuit, and
3 this will be resolved before the end of the year and
4 there will be a full and fair appellate review so that
5 all appellate rights are heard. Or at that time if
6 there is a risk that Palco isn't going to continue
7 operating unless a similar arrangement is continued and
8 we're not prepared to continue it, the Court will do
9 what's appropriate at that time. But in the meantime,
10 the value of the collateral, not only the timberland but
11 the value of Palco will be preserved.

12 Now, there's one other point I'd like to
13 make on the appeal, and it's only briefly and I think if
14 Your Honor has correctly not focused on trying to decide
15 whether Your Honor's order is going to get reversed or
16 not. It's kind of an awkward position for the Court.
17 But there's something the State said in his brief that's
18 wrong and I think it's important to be put on the
19 record. The issues on appeal are not just factual
20 issues subject to clearly erroneous.

21 There are pure legal issues. And I'm
22 simply going to use code words for them because I don't
23 want to spend a lot of time arguing on this because I
24 know the Court is focused on them. But it's very
25 important for the Court to understand that what we're

1 talking about are pure legal issues with the standard to
2 review de novo. These include the absolute priority
3 issue, the substantive consolidation issue, the issue
4 that the plan does not provide for the payment of all
5 administrative claims in cash. It provides for one of
6 the company administrative claims to be paid through
7 this rather bizarre classics distribution adjustment.
8 And because it's our position that as a matter of law,
9 within the meaning of the statute, a sale occurred; and
10 that when you have a sale free and clear of liens,
11 subdivision Roman Numeral III of indubitable equivalent
12 does not trump subdivision II.

13 Now, I understand Your Honor's position
14 on this issue, and I'm not here to reargue them today.
15 But the point is, these are all legal issues, they're
16 not just findings of fact.

17 THE COURT: I understand.

18 MR. PACHULSKI: So given that situation
19 and given the fact that we're dealing with the most
20 stable asset anyone has ever described based on what
21 Your Honor found, it would be inappropriate to destroy
22 our appellate rights for the prohibitive bond. Thank
23 you, Your Honor.

24 THE COURT: All right. Are you going to
25 make -- oh, you want to make a statement, too.

1 MR. FROMME: Your Honor, Eric Fromme from
2 Gibson, Dunn & Crutcher on behalf of Scopac. I won't
3 get into closing argument issues. I just want to
4 apprise the Court of Scopac's position and what Scopac
5 has done for this hearing. Your Honor, Scopac filed a
6 very simple joinder to the motion, to the indenture
7 trustee's motion for a stay simply joining in the relief
8 requested. Scopac believes that the indenture trustee
9 is entitled to a meaningful appeal. In order to have a
10 meaningful appeal, it must have two things, a stay
11 pending appeal and a certification of an expedited
12 appeal to the Fifth Circuit. The issue --

13 THE COURT: Okay. Those are two separate
14 issues but go ahead.

15 MR. FROMME: I understand, Your Honor.
16 The issue, as Your Honor put it, is whether the company
17 dies because of the stay or whether the appeal dies
18 because there is no stay. And to answer that question,
19 the indenture trustee asked us what could Scopac and
20 Palco do, what do they need to continue to operate and
21 could they continue to operate. Another way to look at
22 it is Scopac was asked what it would take to maintain
23 the status quo of the two companies. The answer to
24 those questions that Scopac came up with are contained
25 in the declarations of Mr. Young and Mr. Barrett.

1 THE COURT: Do I have those?

2 MR. FROMME: Those were -- you should
3 have been provided -- those should have been provided to
4 you.

5 MR. HOLZER: Your Honor, the declarations
6 are in the exhibit list that has been handed up.

7 THE COURT: It's not in this?

8 MR. HOLZER: No, Your Honor. And just
9 for the record, those are all together. Those are both
10 Palco exhibits, Marathon exhibits and Scopac exhibits,
11 all together, just for convenience.

12 THE COURT: What about IT exhibits?

13 MR. HOLZER: I think they have a
14 separate.

15 THE COURT: Those are the IT and these
16 are all the rest, okay.

17 MR. CLEMENT: They're up there, Your
18 Honor.

19 MR. FROMME: I just want to talk very
20 briefly about the exhibits -- I'm sorry, the
21 declarations by Mr. Barrett and Mr. Young quickly. We
22 worked hard to prepare those declarations on a shortened
23 time. As requested by MRC's counsel this week and the
24 Court, you wanted to see declarations. We worked hard
25 to do that. We circulated the declarations of both

1 Dr. Barrett and Dr. Young late at night last night.
2 Recognizing that that was short notice, we offered to
3 meet with MRC and Marathon to discuss the declarations.
4 Yesterday I talked to Mr. Hail of MRC, previewed what
5 the declarations would say. I met -- Mr. Young and I
6 met with Mr. Hail. Mr. Hail of MRC was able to
7 interview Mr. Young today before his testimony and
8 Dr. Barrett and I met with Mr. Neier of Marathon for the
9 same purpose and they were able to ask him questions.

10 We wanted to make that clear to Your
11 Honor because the bottom line is Scopac performed its
12 fiduciary duties to its creditors and provided all
13 parties as much notice as reasonably possible during a
14 short period of time.

15 Now, Dr. Barrett's testimony --
16 Dr. Barrett's declaration will address whether Scopac
17 will continue to operate during the appeal and during
18 the pendency of the appeal. And you came up with
19 several questions that -- during these opening
20 statements by the counsel for the noteholders, and I
21 wanted to identify a couple of those. One was the issue
22 about fires in Mendocino County and Humboldt County, up
23 in Northern California. I'm not going to testify about
24 that. Dr. Barrett is going to take the stand and you
25 can ask him or any other party can ask him all the

1 questions about the fire risk on Scopac's lands.

2 You also asked some questions about the
3 harvest rate and going forward. And I'm not going to
4 testify about that either because Dr. Barrett will get
5 on the stand.

6 THE COURT: You don't plan to testify at
7 all, do you?

8 MR. FROMME: No, thank goodness.

9 MR. NEIER: He's on our witness list,
10 Your Honor.

11 THE COURT: Okay.

12 MR. FROMME: I make a great witness. But
13 Your Honor, I do want to preview some prior testimony of
14 Dr. Barrett. Look, the company is going to harvest 75
15 million board feet this year. Scopac does not do
16 traditional clearcutting, just like MRC. Scopac could
17 adopt some of the MRC plans, for example, it could adopt
18 an old growth policy. I believe that that could
19 potentially harm Palco because Palco wouldn't get the
20 valuable wood from that harvest. But it could pursue
21 and it has begun to pursue SFC certification, just like
22 MRC does.

23 The issue, the one issue I believe -- and
24 we can ask Dr. Barrett about this -- is that the
25 selection harvesting on Scopac's land, and limiting

1 harvest to only selection cut in certain areas, that
2 Scopac cannot do, I believe, and Dr. Barrett can testify
3 to that. Because I believe what happens with selection
4 cutting is that it slows the growth of the forest. And
5 by slowing the growth of the forest, it could reduce the
6 value of the forest. But you can ask Dr. Barrett those
7 questions and so can the other parties.

8 Now, Mr. Young's declaration goes through
9 the financial requirements to operate these two debtors.
10 And he walks through it. And I see Your Honor hasn't
11 had an opportunity to look at that. And let me just
12 preview it for you basically how it works. And we did
13 this with the other parties as well.

14 THE COURT: Is Young going to testify as
15 to Scopac and Palco or just Scopac?

16 MR. FROMME: Both, Your Honor. What
17 Mr. Young did was he prepared a consolidated cash flow
18 forecast to the end of the year for both entities. And
19 the way that works is that Scopac will be funded by a
20 debtor in possession financing from Lehman subject to
21 bankruptcy court's approval in the amount of \$40
22 million. Scopac will then deliver logs at the same rate
23 it always has to Palco. Scopac will not demand payment
24 for those logs. Scopac will bear the harvest cost of
25 those logs. In exchange, Scopac will not reimburse

1 Palco for the roads and reforestation work that Palco
2 does for Scopac.

3 The issue then is Scopac will -- Scopac
4 will have a debtor in possession loan of approximately
5 \$20 million and Palco will have logs delivered to it for
6 free. The issue arises whether now Palco has an
7 administrative payable to Scopac and what happens with
8 Scopac, this DIP loan at Scopac. We have been -- it's
9 been represented to and told to Scopac by the indenture
10 trustee that Scopac can waive payment to the logs.
11 Basically Palco gets logs for free. As Mr. Hail
12 represented, it the logs for free program.

13 And the DIP loan, my understanding, is
14 covered from the indenture trustee's and the noteholders
15 recovery. Now, they can go through the details of that
16 and they can confirm that for you but that was what was
17 represented to Scopac. And that's how Mr. Young
18 prepared the budget. That's the nuts and bolts how it
19 works. How does it end? It's summarized in his
20 declaration. The ending cash level at Palco actually
21 increases up to \$4 million. I think it's actually \$3.9
22 million. So that's how -- that's the nuts and bolts of
23 how Mr. Young's cash flow works and we can ask him
24 questions about that.

25 It's basically an attempt to maintain

1 status quo in a sense that no new claims will accrue at
2 either of the debtors and the DIP fees are -- no new
3 payments --

4 THE COURT: Will Mr. Barrett or anyone on
5 your side testify as to how long they think it will take
6 to reorganize the debtor in the event that the deal
7 doesn't close?

8 MR. FROMME: We did not address that
9 specific issue, Your Honor. We can ask the witness a
10 question about that.

11 THE COURT: Or what it's thought to be
12 during that time?

13 MR. FROMME: What we did was, we did --
14 Mr. Young did testify in his declaration that this
15 six-month period of how much it costs to continue to
16 operate Palco and Scopac serves as a proxy for another
17 six-month period. So it's about the same. So it would
18 cost about the same. It could not -- could not get --
19 it's difficult to create projections going beyond --
20 going into next year, so we stop at the end of the year.

21 MR. KRUMHOLZ: I hate to interject but
22 Eric and I have spoken on that subject. Less than \$5
23 million in professional fees that otherwise have to be
24 paid. That is the amount that's needed to the end of
25 the year. So another six-month period, less than the \$5

1 million that are going to be paid.

2 MR. FROMME: Right, Your Honor. Just to
3 be clear, as part of lien -- and it's clear in the
4 declarations -- \$5 million is paid to Gibson Dunn to
5 catch up on unpaid professional fees. And that wouldn't
6 be included as a proxy.

7 THE COURT: All right.

8 MR. FROMME: And if there is not a close,
9 Your Honor, of the deal -- I'm sorry, if there's not a
10 close of the deal, Scopac does have -- to remind you,
11 Scopac does have a backup 363 sale motion that we
12 believe would only take approximately 60 days to sell
13 the assets.

14 It's become clear to -- and I think we
15 agreed with the Court's statement earlier that MRC has
16 been -- it's been clear from prior testimony as well
17 that MRC has been pursuing Scopac's assets for a long
18 time. We don't think that they're going to walk away.
19 But if there is a stay, Scopac and its foresters and
20 scientists will continue to be good stewards of the land
21 and maintain the value of Scopac's timberlands, Your
22 Honor.

23 And I think that addresses your concern
24 about some diminution of value and I think you've
25 already expressed that you don't think the timberlands

1 will decline in value. I want to reemphasize that
2 Scopac is committed to maintain the land as good
3 stewards. We will maintain and comply with the HCP and
4 all environmental regulations during this period. Thank
5 you, Your Honor.

6 THE COURT: Does Palco want to say
7 something?

8 MR. McDOWELL: Good afternoon, Your
9 Honor, Luckey McDowell of Baker Botts on behalf of the
10 Palco debtors. Your Honor, the Palco debtors are here
11 today in a different position perhaps than anyone else
12 in the courtroom. Under the current proposal, whether
13 the indenture trustee wins or loses the appeal, I think
14 the Palco debtors lose. If the increase to Palco, the
15 potential risk for harm is exponentially greater during
16 this time period of greater uncertainty as a period of
17 stay would continue. I believe you've read
18 Mr. O'Brien's proffer. He goes into it. I'm not going
19 to repeat it.

20 But there are potential problems with
21 respect to the mill, the employees. If the mill has to
22 close, it has a trickle down effect radiates out
23 throughout the community. It starts in the mill, goes
24 to the town, expands eventually out into the estate.
25 Water supplies, electricity, etcetera. No one contests

1 that.

2 What people have contested is whether or
3 not the mill would, in fact, have to close. Now,
4 Mr. O'Brien's proffer has been circulated among the
5 parties for almost two weeks now. And last night at
6 midnight we saw the first criticism of it. And it was
7 from Mr. Barrett. And I think we're going to hear in
8 part of the cross that Mr. Barrett, again, doesn't
9 challenge -- or Dr. Barrett, excuse me, doesn't
10 challenge all of the bad things, all of the catastrophes
11 that will happen to all the parties mentioned.

12 Dr. Barrett rather only challenges
13 whether the mill, in fact, will close. And the theory
14 behind Dr. Barrett's testimony is that we're going to
15 forego repayment of loss. And that alone, according to
16 Dr. Barrett's testimony, will keep the mill open at
17 Palco.

18 And there are a lot of if's to that
19 proposal. If that proposal has been approved by the
20 Scopac Board of Directors. I haven't heard. It's not
21 in the proffer whether that proposal has been, in fact,
22 approved by the Scopac Board of Directors. I'm glad
23 that the indenture trustee has consented but the
24 indenture trustee does not make the final vote on
25 whether to turn over millions of board feet of logs for

1 free. That's a first step. That's a Board of Director
2 decision. Second step, that's a decision for this
3 bankruptcy court, neither of which has been sought, to
4 my knowledge, and certainly we don't have any evidence
5 as to whether they have been approved. So at this point
6 I still question whether the offer that has been
7 presented to the Court is even a viable offer.

8 Second, the offer is silent, completely
9 silent as to the existing deferred administrative
10 expenses. The Palco debtors have deferred all the
11 payments for the -- since I believe April, all payments
12 on interest for the Palco debtor and all payments to
13 professionals, not just Palco's professionals, many of
14 these professionals, secured lenders professionals. And
15 that adds up. It's \$11 million standing here today. A
16 couple weeks ago it was less. A few weeks from now our
17 13 week budget says it will be up to \$16 million.

18 Now, if this log proposal comes through
19 and if everybody approves it and if everything goes just
20 as Dr. Barrett predicts, it's a savings from about --
21 over the next 13 weeks it's a savings of about \$12
22 million, offset again as they said by the -- because
23 Palco will no longer be receiving reimbursements for the
24 roads. There again, they're still silent on the
25 administrative expenses that it were deferred for a

1 limited period of time with the goal of confirmation
2 being a week away. When we approved these, we were at
3 the end of confirmation hearings. We had findings of
4 fact, conclusions of law. Going effective was around
5 the corner. Palco does not have the assurance regarding
6 this \$11 million, soon to be 16 by the end of the
7 current budget that these fees and expenses and
8 administrative expenses would continue to be deferred.

9 But Dr. Barrett's testimony and the
10 indenture trustee do nothing to address that issue at
11 the Palco side. Similarly, it's a little more clear
12 now. When we reviewed the proffer we weren't clear
13 whether it was a deferment, whether it was subordination
14 or whether it was a gift regarding the free logs. I
15 think the record is clear, we'll get it out in cross
16 that it is, in fact, a gift. But even then, it's
17 conditioned on the approval of the Lehman DIP, which the
18 Court has previously said I'm not sure whether I'm going
19 to approve it or not. This whole deal forces the hand
20 so we have to approve a \$20 million DIP.

21 Lastly, the deal that they propose is
22 only good for six months. I believe Mr. Pachulski said
23 they were not prepared to extend it at this time. I
24 don't know what happens after six months or at the end
25 of the year. Certainly it's not conditioned on the

1 appeal being finished by then. I don't know if the
2 appeal can be finished by then. I don't think anyone
3 here in the courtroom can tell you if the appeal will be
4 finished by then. It doesn't resolve the uncertainty
5 that Mr. O'Brien, CEO of Palco has testified to in his
6 proffer. The CEO of Palco has had 20 years of
7 experience in executive levels.

8 The gist of his proffer is that even if
9 you can stop -- you can resolve the financial issues of
10 Palco and even if you can keep the cash flow going, the
11 level of uncertainty is so high they have lost employees
12 just since confirmation, lost six more employees since
13 confirmation hearings began, and that looked like a
14 relatively certain period of time and now we're going to
15 indefinitely increase it for -- extend the uncertainty
16 for another six months? Customers are tightening their
17 credit terms. They are going to continue to do so. And
18 vendors continue to remain nervous about whether or not
19 their next bill will be paid.

20 This free logs program is a last ditch
21 effort at what the noteholders can give without costing
22 themselves a dime or without really -- it's no money out
23 of their pocket. This is a last ditch effort. It's a
24 free pass for them and they're trying to see if the
25 Court will buy it. I don't think that -- again, from

1 Palco's perspective, win or lose the appeal, Palco is in
2 a worse off position because if the appeal -- if the
3 indenture trustee eventually wins, there's no plan on
4 the table for Palco. The Court has asked how long will
5 it take to reorganize Palco? No one has that answer
6 because it took us 18 months to get here and that was
7 only through a lot of litigation and a package deal. I
8 don't think we could do it again. Whether we had the
9 cash, whether we had the funding, I don't think it can
10 be done again.

11 The other point that people have been
12 arguing is, well, if MRC and Marathon walk away, isn't
13 that their problem? Why should we post a bond to cover
14 their walk away. Marathon, bless them, is in this to
15 their neck. They're not walking away. They're in the
16 position at this point of good money after bad but they
17 are here. The question is whether MRC walks away.
18 Palco debtors have a serious concern about that. There
19 are other investment opportunities. Opportunity costs
20 attention. All they have invested in this at this point
21 is lawyer time. If you extend it for another year and
22 the credit markets the way they are, the way the
23 uncertainty is, Palco debtors have no assurance that MRC
24 will still be here. But if MRC were to walk, even
25 without Marathon's consent, Marathon is harmed, yet the

1 indenture trustee provides no assurances on how to bond
2 that harm to Marathon because Marathon right now has a
3 deal that they're happy with, but if MRC walks, that's a
4 source of \$500 million that was essential to this
5 reorganization that Marathon, again, loses out on. So
6 from the Palco's perspective and standing here in a
7 different position perhaps than certainly Scopac and
8 certainly from the indenture trustee and various other
9 parties, Palco needs certainty and they really need the
10 certainty now and fully resist a stay pending appeal.

11 THE COURT: All right. Yes, sir.

12 MR. BRILLIANT: Your Honor, Alan
13 Brilliant on behalf of Mendocino Redwood. I'm going to
14 try to be brief and reserve most of the comments for the
15 closing. Mr. Neier, on behalf of Marathon, also asked
16 for a few minutes. And I'll try to keep my time brief
17 and give him the time that he asked. The first thing,
18 Your Honor, I think that you really need to focus on,
19 you know, prior to hearing the evidence really is what
20 the real legal standard is here.

21 Now, from Mr. Krumholz and
22 Mr. Pachulski's statements, you know, they're
23 effectively arguing that the mere potential here that an
24 appeal that they would have would become moot is
25 irreparable injury. You know, the majority of courts

1 who have dealt with the issue, especially in connection
2 with confirmation hearings and your bankruptcy ruling
3 8005 have found the opposite.

4 THE COURT: I think the big question for
5 your client is if I can find a way to assure that the IT
6 pays for whatever losses that are occasioned by the
7 appeal, if they lose, why would that harm your client?

8 MR. BRILLIANT: Your Honor, if it's an
9 amount of money and it deals with all the things that
10 we're entitled to, then I guess it wouldn't.

11 THE COURT: So why wouldn't I stay a
12 pending appeal if, in fact, it helps your client because
13 they don't have to fund the deal. They can wait until
14 it's over. Now you'll be the one dragging your feet
15 instead of them dragging their feet. So it will be to
16 their interest to move the case along and it will be to
17 your interest to just sit back and wait.

18 MR. BRILLIANT: Well, Your Honor, I
19 think --

20 THE COURT: Assuming you don't want to
21 grab the --

22 MR. BRILLIANT: No, no, no, it's a very
23 good question and I want to answer it but it's a
24 complicated answer. I guess the first thing is, Your
25 Honor -- and Mr. McDowell, you know, mentioned this --

1 is obviously, you know, Mendocino wants to acquire this
2 property. Now, they have plans to immediately change
3 the mill, deal with certain customers and do various
4 other things. A stay pending appeal will --

5 THE COURT: Will stop all that.

6 MR. BRILLIANT: Stop us from doing that.
7 That's number one.

8 THE COURT: Okay. Well, are there some
9 of those plans that are so important that I ought to put
10 them in the order?

11 MR. BRILLIANT: Well, they are, you know,
12 important. But I don't think that we want to share our
13 customers with Palco. I don't think that -- we don't
14 want -- I don't think we want to manage the property.

15 THE COURT: I didn't think you -- quite
16 honestly, as I thought about this, I thought there's no
17 way to put you-all in charge of it. That would be
18 ridiculous and then we would have to -- what
19 compensation are you going to get and all that sort of
20 stuff. That's not going to work. The debtors have to
21 stay in possession. They have to run it. But it might
22 well be that there are certain things that are important
23 enough to this whole thing that they ought to be in the
24 order. I don't know.

25 MR. BRILLIANT: So I guess the first

1 thing is, Your Honor, you know, we're at risk in not
2 closing immediately, that the key employees leave. The
3 testimony is going to be that the company in the last
4 couple of weeks lost a key employee. I believe you
5 heard yesterday before we -- or two days ago before we
6 started that the company is very concerned about losing
7 other key employees.

8 THE COURT: Who did they lose?

9 MR. BRILLIANT: Somebody named Dave
10 Carter. You know, they're at risk of losing additional
11 other key employees. Also the testimony is going to be
12 that it's very hard to replace the key people here. So
13 we have -- we have that risk. We have the loss -- the
14 potential loss of key customers. And I think most
15 importantly, and Your Honor mentioned this a little bit,
16 you know, there's a risk, you know, financing risk. We
17 right now have a commitment on a loan. If the deal is
18 closed -- you know, closes later, you know, the interest
19 rates will be what it will be on the date of closing.
20 We could be out millions of dollars in additional
21 interest costs.

22 The other thing is, you know, Your Honor,
23 it's not a threat, it's just a reality. As Your Honor
24 said, you might want to buy something this year, you
25 might want to buy something different next year. Right

1 now, you know, this is something we want to do. It
2 might not be something that we want to do six months
3 from now. And the legal standard is the -- you know,
4 protecting the interest of all the parties here, which
5 includes Marathon, the unsecured creditors, the
6 administrative creditors, and other public interest
7 creditors, you know, which includes the -- you know, the
8 state agencies and various other parties.

9 The -- Your Honor, quite frankly, you
10 know, only a very large bond will protect Mendocino and
11 Marathon from losses that we may have because of lost
12 customers, employees, problems at the -- you know,
13 fires, other things. There are fires, you know, on
14 these acres from time to time. And as I was saying
15 earlier, Mendocino actually, unfortunately which is one
16 county away, has 22,000 acres of its acres on fire
17 currently from the dry thunderstorms a couple months ago
18 that we have all been reading about in the paper. So
19 only a large bond would be able to protect all the
20 parties here from harm.

21 Now, as for this new plan about the DIP,
22 you know, Your Honor, it's not in writing. No one from
23 our side has seen it. The only thing we know about it
24 is what we have been told by Mr. Barrett and Mr. Young
25 and what's contained in their proffers. We don't know

1 whether or not all of the bondholders have approved it,
2 whether the indenture trustee has the agreement for it,
3 whether there's any problems with this.

4 Obviously from Mendocino and Marathon's
5 perspective, the last thing that we're going to be
6 agreeable is to close six months from now and have to
7 pay back the Lehman DIP in addition to all the other
8 obligations.

9 THE COURT: Well, there's no way that
10 you're going to have to pay back the Lehman DIP if you
11 win. I mean, I don't think they believe that's going to
12 happen. I think they may want to think that that's the
13 minimum that they have to do, is to cover the Lehman
14 DIP. I don't know. They made an argument. I think
15 what I need to hear from you is what kinds of things
16 need to be protected against that are reasonable. I'm
17 not sure that a forest fire is reasonable.

18 I think it's a totally separate test for
19 me to consider, you know, just because they didn't file
20 a motionless stay doesn't mean I shouldn't put it in
21 some sort of order that's conditioning stay pending
22 appeal. I mean, but I'm not sure. I don't think -- I
23 don't think -- this forest has been there for a long
24 time, especially the grandfather trees. So I don't know
25 that Mother Nature is the thing we worry about. I

1 suspect it's the other issues that we need to worry
2 about. And so I think that you are certainly should be
3 concerned about any potential costs that might come up
4 or additions to the cost of your purchase between now
5 and the end to either make what you're buying worth less
6 or to make under the plan you have to pay more.

7 MR. BRILLIANT: That's right.

8 THE COURT: Between now and the end of
9 the appeal. And you need to tell me -- that's -- I
10 mean, you know, courts want to stay a pending appeal. I
11 mean, I look forward to the Fifth Circuit saying what a
12 great job I did on this case. Right. But I mean, I
13 don't really have any interest in stopping an appeal.
14 And I suspect that you probably -- your client would
15 love to do that, but I'm not suggesting that's what
16 you're trying to do. But I think you should focus on if
17 there is some things that need to be protected, I need
18 to know what they are.

19 MR. BRILLIANT: Yeah.

20 THE COURT: Otherwise, and if there's no
21 way to protect them, then I can't stay a pending appeal.
22 But if there is a way, if it's just dollars -- see, I
23 think there are two separate issues here. Between you
24 and them -- and more specifically Marathon and them,
25 it's just dollars. These are creditors fighting over

1 each other and that's, you know, two different creditors
2 fighting it, the kind of thing we do and it really is
3 sort of thing that rarely would a case like that not be
4 a stay pending appeal because you would figure out the
5 dollars and you figure out what it is and boom, you go.

6 Now, there's another issue and that's
7 maybe his issue, the State of California, maybe the
8 people that live in Mendocino County, maybe some of the
9 creditors on the small -- the smaller creditors on the
10 creditors committee. There is a public interest in
11 getting this thing taken care of, put to bid, operated,
12 maintained, all the environmental problems that go along
13 with this, make certain that those are protected into
14 the future.

15 The plan provides a way to protect them
16 into the future that everyone is comfortable with. The
17 cratering of the plan does not. So there isn't that
18 issue, that public policy sort of issue is an issue that
19 I don't know whether there's a way to bond that on. But
20 that's probably not you and them versus them. I think
21 that's the sort of public issue, which I think you can
22 represent if you want to, but I suspect the creditors
23 committee or somebody else is going to talk about that.
24 Right. Go ahead.

25 MR. BRILLIANT: Yeah, Your Honor, I think

1 you'll hear from Mr. Fiero, you'll hear from the State,
2 they can talk about the other parties here, and I think
3 you've already heard from Mr. McDowell about Palco's
4 interest. Because I think the one thing that is clear
5 is they're talking about at best a six-month program
6 that potentially, if for some reason the
7 Mendocino/Marathon deal didn't close, it will affect
8 everybody direct, even if the appeals were denied.

9 But I think from our perspective, Your
10 Honor, it's not that you can just enter an order and say
11 the key employees have to stay, that the customers have
12 to stay, that the mill can -- that the mill has to run,
13 you know, properly and can't, you know, break down and
14 that there can't be fires. The only way to deal with
15 that, Your Honor, is through a large bond that protects
16 the buyers from getting less than what they would have
17 had if we would have closed today, something that
18 protects us against changes in the capital markets and
19 having to pay higher interest.

20 That's the only thing that works, you
21 know, and that would have to be a very large bond
22 because although the land itself, if operated properly,
23 you know, may not change in value, you know, the mill,
24 the business, the customers, all of that, you know, will
25 change. The employees will leave, the customers will

1 leave, the uncertainty that exists here will cause
2 diminution in the value of this business to the buyers.
3 Our inability to get in there and effectively change
4 immediately and start changing the relationship with the
5 customers and dealing with that will harm us. There's
6 no doubt that that will harm us. And that can only be
7 protected, you know, through a large bond.

8 Your Honor, I'm going to just say a few
9 more things and then I'm going to --

10 THE COURT: What are you suggesting?

11 MR. BRILLIANT: I think it has to be a
12 very large bond. I think to protect us, I think it has
13 to be well in excess of \$100 million and to protect all
14 the other parties, I think it would have to be a very
15 large amount as well. Your Honor --

16 THE COURT: Well, if carved out -- in
17 other words, you're saying is you're willing to have
18 some sort of an order that protects the losses
19 occasioned by the delay in closing if you win that is
20 limited to \$100,000 of their claim.

21 MR. BRILLIANT: I didn't say of their
22 claim.

23 THE COURT: What difference does it make,
24 they're dollars. You have to pay them those dollars and
25 you wouldn't have to pay -- you would have to prove what

1 they are up to the amount of what they are, but you're
2 willing to limit it to \$100 million?

3 MR. BRILLIANT: \$100 million just for us,
4 not for other third-parties. In other words, Marathon
5 would have its own issues, the unsecured creditors, the
6 others would have their own issues as well.

7 THE COURT: All right.

8 MR. BRILLIANT: But Your Honor, I don't
9 think they're entitled to, you know, to a stay. In
10 order to show irreparable harm it has to be more than
11 mootness, they would have to show a different plan. If,
12 you know, the confirmation were reversed that somehow
13 they would do better. I think that given all the
14 marketing that's occurred to this property, the
15 termination of exclusivity, the fact that other people
16 came into this court, looked at this asset and there
17 were no higher bids reflects the fact that they would
18 not do any better.

19 And I think they would have to show as
20 part of irreparable harm that somehow they would be
21 worse off if they don't have the right to appeal. And
22 it has to be waived as to whether they would do better,
23 not just that they might not get an appeal because if
24 the idea of the appellate rights which says that you
25 always had to have them, there would be no ability to

1 close under the law. And that's not what the law is.

2 And as Your Honor has pointed out, you
3 know, the public interest here very strongly weighs, you
4 know, for an early closing of this transaction that
5 protects jobs, protects the environment, protects, you
6 know, the pension obligations. The PBCG is not
7 protected under this Lehman, you know, plan. And it
8 resolves everything, you know, potentially very quickly.
9 You know, keep in mind, Your Honor, in determining
10 whether or not, you know, there's a substantial
11 likelihood, substantial likelihood of it being reversed,
12 most of the issues they complain about, almost all the
13 issues they complain about really are fact issues.

14 And to the extent that they are legal
15 issues, they're not close issues. It's not as if Your
16 Honor is going against established precedent. They may
17 want to say that this but Your Honor knows in ruling on
18 this that that's not right. This was not close from a
19 legal perspective. And from a factual perspective it
20 would have to be reviewed on a clearly erroneous basis
21 and Your Honor's findings are supported in the record
22 and you're not going to be reversed.

23 So in balancing all of this, you have to
24 look at the harm to the potential buyers in not being
25 able to get in, close immediately at the benefit of

1 their bargain and all of the value that they would get
2 immediately by transitioning the business to their own
3 way of business, and building the company on a go
4 forward basis, the risk of higher interest rate, the
5 risk of defections of key customers, key employees
6 versus, you know, the harm that they would have, which
7 is to prosecute an appeal, which is highly unlikely to
8 be successful.

9 And if it -- even if they -- I think as
10 Mr. McDowell said, even if they were to lose on the
11 appeal, they will harm everybody else who's involved in
12 the case. They say that they don't have to protect the
13 Palco creditors and other people on the Palco side that
14 are parties of interest. But Your Honor, we disagree
15 with them as a matter of law in applying the test. But
16 even if they're right, those issues have to be
17 considered by Your Honor as part of the issue of the
18 effect on the public interest.

19 THE COURT: All right. Thank you.

20 MR. NEIER: Mr. Fiero wanted to go before
21 me.

22 MR. FIERO: Your Honor, it's John Fiero
23 for the committee. I think that if this Court rules
24 that free logs and a loan from Lehman is enough to
25 prevent the change in Humboldt County that people have

1 been waiting for for all of these months, it will be a
2 very hard thing to explain to a whole lot of people who
3 have been waiting a very long time for the events that
4 have transpired over the last couple of weeks.

5 We're back again, Your Honor, to how do
6 you explain to a regular person that in a bankruptcy
7 court a few logs can make a difference and solve a
8 problem when the problem is as systemic and complicated
9 as the situation that Palco and Scopac find themselves
10 in today with their lack of money, with the complete
11 public understanding of the frailty of the operations at
12 the mill, the security of the town.

13 And so I think we need to look even at
14 the words of the noteholders in their own brief when
15 they over and over again talk about the indubitable
16 equivalents question and they use the phrase "completely
17 compensatory." They, for some reason, believe that
18 after the senior lien on the forest is paid off and they
19 receive the full value of the forest in connection with
20 the Court's ruling on confirmation, that they have still
21 not been completely compensated.

22 Well, if we're going to go through an
23 exercise here in this court today of determining what
24 complete compensation is, it should be their burden,
25 Your Honor, to show that logs and a loan from Lehman

1 will take care of every single possible harm. It
2 shouldn't be our job. It should be their job. And I'll
3 tell you that I was very surprised in the 507(b) motion
4 that not once did we see a chart go up where they
5 outlined for you exactly what each line item of harm
6 was. And the reason they didn't do it, Your Honor, was
7 that they wanted to say things like, well, the forest
8 must have been worth \$754 million at some point. Of
9 course no one ever said that.

10 There was no evidence for that. So you
11 didn't see a line item that said that. But in this
12 instance where it is their burden to show that a stay
13 can be achieved, they're going to have to show you line
14 by line how logs and a \$20 million loan from Lehman, \$5
15 million of which is going to go straight to Gibson Dunn
16 in a matter of weeks is going to solve all the problems
17 through the end of the year.

18 They're also going to have to explain how
19 it is that if they can walk away at any time, which is
20 what this is, they want to try this out and if they
21 don't like it, they want to walk away. Where does that
22 leave anyone who lives in Scotia, who works at the mill,
23 who contracts with Palco or Scopac? That's a truly
24 untenable position for everybody. I mean, they're
25 either in this or they're not. And the fact that they

1 want to back away --

2 THE COURT: If they file an appeal, they
3 can walk away any time they want anyway.

4 MR. FIERO: I'm sorry, Your Honor.

5 THE COURT: If they file an appeal, they
6 can walk away any time.

7 MR. FIERO: Yes, Your Honor, but if there
8 is a big fat bond there to solve the problems of the
9 harm, that would be one thing. If they just stop
10 supplying logs for free and say, you know, here's your
11 forest back, that's a whole another thing.

12 THE COURT: What do you think the bond
13 should be then?

14 MR. FIERO: Your Honor, the committee is
15 interested in the parts of the plan that were essential
16 to the committee. So that would be the payment of the
17 \$10.6 million to general unsecured creditors. That
18 would be all of the pension liability, which is
19 estimated at \$29 million. That would be the payment of
20 all the professional fees, whether at Scopac or at
21 Palco. Because we can't have a situation here, Your
22 Honor, where all of the professionals in this case
23 continue to work, right, because the noteholders want to
24 have an appeal and nobody gets paid. That's not how
25 bankruptcy works.

1 And Your Honor, just focusing on the
2 question of admin expense -- so those would be the big
3 ones, Your Honor. The admin expense is the pension, the
4 dividend to unsecured creditors. Marathon has a DIP
5 which is in default. Under this proposal Marathon will
6 be asked just to continue to sit on its hands, to have
7 no rights to foreclose, no rights to even collect
8 interest because there's no money in the budget to pay
9 it. That can't be an allowable result. Certainly
10 you've got to bond for those kinds of harm.

11 Your Honor, one of the questions that
12 Mr. Krumholz asked the Court to consider was whether or
13 not it was foreseeable to the gentleman in New York who
14 bought these bonds when they were issued or thereafter,
15 that Palco and Scopac would be reorganized together.
16 Well, the committee submits that it was certainly
17 foreseeable. Those two companies were one company for
18 100 years. They were only separated, the artifice was
19 only created and it was an awkward artifice. We've
20 heard testimony about it for 18 months, in order to try
21 to affect a financing solution to equities desired to
22 monetize the forest. But that no one in New York
23 understood that some day the companies might be
24 recombined. It just boggles the imagination. It's not
25 possible.

1 Your Honor, you asked about Bank of
2 America. The expense of Bank of America in this case is
3 documented. Today it's roughly \$2 million in legal fees
4 over 18 months and it's \$3.99 million worth of interest.
5 If we go half that time, you're still at another \$3
6 million of expense.

7 Your Honor, I think it's also very
8 important before this hearing ends if a log and Lehman
9 DIP solution is going to be the answer here, the ability
10 and the certainty -- the ability of the noteholders and
11 the certainty that they have that they can actually do
12 this, I don't believe, Your Honor, that the indenture
13 allows the indenture trustee to give away logs for free.
14 Certainly not \$20 million worth of logs for free.

15 So there are some things that would have
16 to happen before that offer could be firmed up for this
17 Court. And this Court should not rule that that is an
18 appropriate solution until it is convinced that the
19 Scopac board is willing to do it and that the
20 noteholders have complied with their indenture
21 obligations.

22 THE COURT: Unless it's a condition of
23 the appeal on that. If they don't do it, then there's
24 no stay pending appeal. I mean, assuming that that's
25 the right answer. I mean, I'm not going to say, okay,

1 I'm granting a stay pending appeal now please take care
2 of this. I mean, I'm sorry, but I don't mean to be --
3 I'm just saying that all stay pending appeals are
4 conditioned upon providing the security that's ordered.
5 So they have got to do it. I mean, whether they can or
6 not, I don't know. But if they're offering something
7 they can't do, then I think it's time for them to come
8 up with another offer.

9 MR. FIERO: I just think it's important
10 for the Court and the community and the creditors to
11 know whether or not --

12 THE COURT: It is true that we have heard
13 throughout this case that there has been a lack of
14 flexibility that's held them from doing various things
15 because of the terms of the note. Now, whether now it
16 is flexible enough to do this, I don't know.

17 MR. FIERO: Yes, Your Honor. I'll just
18 take the Court back to the comment about sleight of
19 hand. This is the greatest sleight of hand ever
20 proposed.

21 THE COURT: I think you need to be very
22 careful about characterizing things like that because
23 they almost always backfire.

24 MR. FIERO: Okay. Well, in any event, no
25 one can name a moment in this case where the noteholders

1 did not jealously guard their rights to those logs. I'm
2 sure that if we were to scrutinize any of the legal
3 bills associated with the various log motions that we
4 would be quickly over \$1 million and so the notion now
5 that we're just going to give logs away is one that
6 really needs to be examined, especially when the harm to
7 unsecured creditors --

8 THE COURT: No question that it's easier
9 for the noteholders to give logs away than to come up
10 with new money perhaps.

11 MR. FIERO: I think that's right, Your
12 Honor.

13 THE COURT: So I don't know how they do
14 that. I mean, they are a loosely organized committee.
15 They're not a corporation. They're not a partnership.
16 They can't make cash calls on their people. They don't
17 have some memorandum of understanding where they can
18 just say, okay, we're going to need \$20 million so
19 everybody chip in. You know, I don't know how many
20 bondholders there are, everybody chip in their \$200,000,
21 they can't do -- this is not like an oil deal where
22 everybody just chips in their part and goes on with the
23 deal.

24 MR. FIERO: Yes, Your Honor. The
25 committee is just concerned that whatever remedy is

1 fashioned in the event that a stay is to be ordered that
2 it be completely compensatory and consistent with the
3 evidence and consistent with the burden of the indenture
4 trustee.

5 THE COURT: Okay. Now Mr. Neier.

6 MR. NEIER: Good afternoon. David Neier
7 on behalf of Marathon. I thought I would just address
8 briefly the perspective of Marathon which is a little
9 bit different from Mendocino and some of the other folks
10 here.

11 First of all, the DIP, the \$75 million
12 DIP at Palco matures in less than 30 days. It matures
13 on August 6, 2008. Nobody is offering to repay the DIP.
14 And there's been overwhelming testimony in this court
15 and everybody knows and the noteholders admit that Palco
16 declines in value every day. Forget about Scopac.
17 Palco is going down and nobody denies it. Palco doesn't
18 deny it.

19 THE COURT: Okay. And you don't have --
20 you don't have an agreement with Mendocino that
21 contemplates your foreclosing on your DIP?

22 MR. NEIER: That's correct, Your Honor, I
23 do not. And I have one worse fact for you which is very
24 troubling. Probably the hardest fought provision in the
25 deal between Mendocino and Marathon was when does

1 Mendocino get to walk, okay? Because we're a creditor
2 in this case and our collateral is being eviscerated and
3 the only way we've been -- we understand we can save it
4 is to have an integrated company again and to allow for
5 this company to reorganize. And we need Mendocino's
6 capital to do that. They're putting in \$200 million in
7 cash. They're putting up their forest as collateral for
8 a \$325 million bridge loan for this company.

9 So that they've said, hey, we've got
10 other opportunities, the cost of capital will go up, we
11 can't have that kind of cash standing by so they have
12 agreed to 60 days from the date of the confirmation
13 order. The confirmation order was entered two days ago.
14 So on September 6, 2008, Mendocino can walk. And that
15 was a tough provision for us but it was a fair
16 provision. It wasn't like Mr. Beal's, I can walk in one
17 day --

18 THE COURT: That's happened between you
19 and Mendocino.

20 MR. NEIER: That's correct, Your Honor,
21 but it effects us.

22 THE COURT: You and Mendocino could walk
23 tomorrow.

24 MR. NEIER: Jointly, that's correct, Your
25 Honor.

1 THE COURT: Okay.

2 MR. NEIER: But we wouldn't commit
3 economic suicide, Your Honor. We want this deal to go
4 forward. Otherwise, we would have exercised our rights
5 and remedies under the DIP default that currently
6 exists.

7 THE COURT: And you have an agreement not
8 to exercise them until September 6? Your agreement with
9 Mendocino did not account for the possibility that you
10 ultimately foreclose your DIP.

11 MR. NEIER: That's correct, Your Honor.

12 THE COURT: That might change the whole
13 deal. I don't know.

14 MR. NEIER: Interesting aspect.

15 Mr. Pachulski says we're going to -- our motive is to
16 close immediately to move the appeal. Our desire is to
17 close immediately so that we don't commit further
18 economic suicide that we're committing in this case.
19 And you know, obviously there are other problems that
20 everybody else has addressed, the employees, the
21 residents, the community, the regulators, the creditors
22 committee, you know, it goes on and on. I disagree with
23 much of what Mr. Brilliant said in his opening remarks
24 perhaps because he's not in the same position as
25 Marathon which is a creditor in this case.

1 And the only way we can go forward is to
2 have this reorganization plan go forward and close.
3 That's the only way that we are going to make any kind
4 of recovery. And it will be far less than a full
5 recovery, you know, with respect to what we're owed.

6 But Your Honor estimated the appeal
7 period would take six months to a year. We've heard
8 estimates up to two years if there's a stay granted.
9 Obviously a six-month DIP doesn't cut it. And the
10 terms -- and I appreciate the fact that Mr. Krumholz and
11 Mr. Fromme and Mr. Pachulski were trying to address Your
12 Honor's concerns as you spoke. But we don't think
13 Lehman has agreed to some of the things that were said,
14 we don't think the indenture trustee has agreed to
15 everything that has been said here. We don't think that
16 Scopac has agreed to anything -- or to many of the
17 things that were said here. I don't even think,
18 frankly, that Lehman's board of managers have signed off
19 on giving Gibson Dunn \$5 million of the \$20 million DIP.
20 That's news to me.

21 And I think the indenture does not allow
22 these things to go forward in any event. So I would be
23 interested to see whether there's been unanimous consent
24 and unanimous instruction to the indenture trustee to go
25 ahead.

1 You know, with respect to what kind of
2 bond would protect, we did some of the math. And if you
3 could put this up on the screen. Your Honor, we haven't
4 counted for the forest fires. We were told redwoods
5 aren't likely to burn because it's foggy and it's damp
6 and it's cold but unfortunately the redwood forest is on
7 fire in Mendocino County which is right next to Humboldt
8 County so we are a little bit concerned about that. But
9 we're putting that aside and we're just looking at
10 what's reasonable and foreseeable.

11 Obviously it could be higher than this,
12 it could be lower than this. But we figured the -- you
13 take the going concern values, you take out the
14 liquidation values and you then add in all the things
15 that we are going to pay. As Your Honor may recall,
16 we're putting in \$580 million to the reorganization
17 efforts of this company. That would pay off the PBCG
18 claim which would otherwise be \$28.5 million. We would
19 cover the admin expenses of both Scopac and Palco. And
20 I recognize that today these things are higher. These
21 things are higher. But this is the best information we
22 have.

23 We would cover the priority claims. The
24 unsecured creditors committee has the \$10.6 million
25 that's been agreed to be paid to the trade creditors of

1 Scopac and the Palco unsecured creditors. And then
2 there are the professional fees that are outstanding.
3 And actually, the professional fees are much higher than
4 that but that's what the true professionals are owed in
5 this court. That is, other than the lenders'
6 professionals.

7 So we think the minimum amount of bond
8 has to be over \$400 million because that's the only way.
9 We can't assess all the damages that could arise. It
10 could be increased interest expenses, could it be the
11 fact that Mendocino decides it wants to walk. Could it
12 be the fact that the forest fire burns, could it be the
13 fact that the mill shuts down and everybody is impacted.

14 We're not saying who these damages go to,
15 we're not saying this is the maximum damage or these are
16 the minimum damages, we think this is the reasonable and
17 foreseeable likelihood that the difference between going
18 concern and liquidation because we think that if our
19 plan does not go forward, does not close, what we are
20 going to have is liquidation. And as a result, we
21 should look at the difference between going concern
22 value and liquidation value and then the payments that
23 we're making under our plan to those people who would
24 not be paid in a Chapter 7 liquidation, which are the
25 admin creditors, the unsecured creditors pot and the

1 other payments that are owed under our plan. Thank you,
2 Your Honor.

3 MR. PASCUZZI: Good afternoon, Your
4 Honor. Paul Pascuzzi for the California State Agencies.
5 We filed a brief opposing any stay. And I'll save more
6 substantial comments for closing. I do appreciate the
7 Court's comments during the opening argument about my
8 client's interest. From the evidence we've seen and the
9 proffers and depositions, we do have serious concerns
10 about the effects of the stay of this matter. Your
11 Honor is correct about that. If a stay is imposed, we
12 believe there would be substantial harm to
13 third-parties, including the people of the town of
14 Scotia, the people of Humboldt County, the environment,
15 including Palco and Scopac. And we think the evidence
16 will show the possible and likely health and safety
17 consequences if the Marathon/MRC plan is not implemented
18 immediately.

19 Those are the things that are likely to
20 happen. They may not even be the worst things that can
21 happen. Also, Your Honor, we're very concerned about
22 losing the best solution for these cases through delay.
23 As the Court heard during confirmation, the MRC/Marathon
24 plan, we argued, meets the Governor's principals which
25 the Court acknowledged were consistent with the goals of

1 any Chapter 11 as Congress intended. Mr. Krumholz
2 argued that MRC/Marathon going away would be a
3 self-inflicted wound so it's not an issue. But it is an
4 issue for us, Your Honor. It would be the loss of an
5 opportunity to benefit Humboldt County and the State of
6 California to -- and preserve and protect one of the
7 state's most precious natural resources. We believe the
8 evidence will show that the Court should deny the
9 motion. We join in the arguments of the other parties
10 with regard to a bond and the amount of a bond for any
11 stay.

12 And then also for the record, with
13 respect to the petition for certification of a direct
14 appeal, we also filed a joinder in the opposition to
15 that. Thank you, Your Honor.

16 THE COURT: Okay. All right. First
17 witness.

18 MR. KRUMHOLZ: I normally wouldn't do
19 this, but given some of the Court's questions, there's
20 been a request made that we have a very short recess.
21 And I know that --

22 THE COURT: Okay. That's fine.

23 (A recess was taken.)

24 THE CLERK: All rise

25 THE COURT: Be seated.

1 MR. KRUMHOLZ: We call Dr. Jeff Barrett.

2 THE COURT: All right. How many
3 witnesses are you going to call?

4 MR. KRUMHOLZ: We're going to call
5 Dr. Barrett. We're going to call Mr. Young. We're
6 going to call -- we may call Mr. Long. And then --

7 THE COURT: Hughey Long, right.

8 MR. KRUMHOLZ: Yes, Hughey Long.

9 THE COURT: The people's candidate.
10 Okay. Who else? Anybody else?

11 MR. KRUMHOLZ: And we're going to call
12 Mr. Breckenridge by trial testimony.

13 THE COURT: Okay.

14 MR. KRUMHOLZ: And we may call
15 Mr. O'Brien, although we haven't made that decision yet.

16 THE COURT: Okay. So that's fine. Is
17 that what you just said? What about you-all; do you-all
18 have witnesses? Anybody else have witnesses?

19 MR. NEIER: Your Honor, depending on if
20 Mr. O'Brien -- we're going to call Mr. O'Brien. And
21 we're going to call Mr. Johnston. Those are our two
22 witnesses.

23 THE COURT: So now we're up to six.

24 MR. KRUMHOLZ: There is one thing I
25 forgot to mention. We are going to move for admission

1 of the various declarations that were at issue last week
2 with respect to Red Emerson and the other witnesses.

3 MR. NEIER: We'll object.

4 MR. BRILLIANT: We'll object to that,
5 Your Honor. As Your Honor had directed us, we had
6 called Mr. Emerson's counsel to arrange for a
7 deposition. In advance, he told us he was not going to
8 be testifying.

9 THE COURT: Okay.

10 MR. BRILLIANT: And, therefore, we did
11 not depose him.

12 THE COURT: All right. And anybody over
13 here going to call any other witnesses?

14 MR. McDOWELL: No other witnesses, Your
15 Honor.

16 THE COURT: All right. Let's go.

17 MR. NEIER: With respect to the trial
18 testimony witness, Mr. Breckenridge, that was one of the
19 six -- it's really five that we're talking about -- we
20 would counter designate him if we need to.

21 THE COURT: Mr. Holzer, Asarco hearing
22 tomorrow, how long is that supposed to take?

23 MR. HOLZER: Your Honor, it's the -- it's
24 the oral arguments on the jurisdictional issue.

25 THE COURT: Don't tell me what it is.

1 Just tell me how long you think it's going to be.

2 MR. HOLZER: My guess would be two to
3 three hours, Your Honor.

4 THE COURT: So it's in question right
5 now, serious question. All right. Go ahead. It's
6 after this.

7 JEFFREY CHARLES BARRETT,
8 having been duly sworn, testified as follows:

9 DIRECT EXAMINATION

10 BY MR. KRUMHOLZ:

11 Q. Dr. Barrett, can you go ahead and state your
12 full name for the record.

13 A. Jeffrey Charles Barrett.

14 Q. And can you --

15 MR. HAIL: Your Honor, can we object to
16 this. The understanding is there's no ten-minute
17 introductions or anything like that.

18 THE COURT: This is not their witness,
19 but they have a proffer now. Is there something more
20 than the proffer that you need him to say?

21 MR. KRUMHOLZ: The proffer covers a whole
22 host of issues. I think every one of them need to be
23 flushed out in greater detail, given the Court's
24 concerns, and I want to cover it. It's not my witness.
25 I did not --

1 THE COURT: I understand that. What I
2 don't want you to do is pretend like we have a jury over
3 there and go through this in the way a litigator would
4 normally do it. I would prefer you to, with a sword, go
5 straight to the issues you want and get them out there
6 in mechanical fashion. Okay?

7 MR. KRUMHOLZ: I will try to conduct a
8 surgical strike.

9 THE COURT: And we'll all argue about
10 what that record means. Okay?

11 MR. LITVAK: Your Honor, Max Litvak for
12 the creditors committee. I've got a couple of
13 objections to the proffer itself. I don't know when the
14 appropriate time would be to present those to the Court.

15 THE COURT: Well, where is that? What
16 page?

17 MR. LITVAK: Your Honor, paragraph 17,
18 page 6.

19 THE COURT: What's your objection?

20 MR. LITVAK: Hearsay. As to the last
21 three sentences and the first phrase or half sentence in
22 paragraph 18, he's referring to conversations that --

23 THE COURT: Okay. That's overruled. It
24 will go to the weight to be given. Next.

25 MR. LITVAK: Next, Your Honor, is earlier

1 on in the proffer, paragraph 13 and paragraph 16, the
2 objection is that the witness has no personal knowledge.
3 He's not an officer of Palco. He is speculating as to
4 what may happen at Palco or what may not happen at
5 Palco. We have Mr. O'Brien, who's the CEO of Palco
6 here. If Scopac or the noteholders, the indenture
7 trustee, wishes to cross-examine Mr. O'Brien, then they
8 can do so --

9 THE COURT: Okay. That's overruled.

10 MR. LITVAK: -- but there is no basis.

11 Thank you, Your Honor.

12 MR. KRUMHOLZ: Your Honor, Exhibit 190 is
13 Dr. Barrett's declaration. I have an extra copy for
14 you.

15 THE COURT: I have it right here.

16 MR. KRUMHOLZ: And we'd move for its
17 admission at this time.

18 THE COURT: Any other objections? It's
19 admitted.

20 Q. (By Mr. Krumholz) All right. Dr. Barrett,
21 your declaration goes through your background, your work
22 experience. But just quickly, you've been -- given the
23 objections, you were an officer of Scopac and Palco for
24 how long?

25 A. Approximately three years.

1 Q. Are you familiar with the Scopac operations?

2 A. Yes, sir.

3 Q. Are you familiar with the Palco operations?

4 A. Yes, sir.

5 Q. Are you familiar with the financial challenges
6 that have been posed over the last few years in
7 connection with both entities?

8 A. I have some understanding, yes, sir.

9 Q. Do you have a lot of -- I mean, describe your
10 understanding.

11 A. I would say it's comprehensive. I just don't
12 want to pass myself off as an accountant or financial
13 expert.

14 Q. Are you familiar with the regulatory
15 environment in which both companies operate?

16 A. Yes, sir.

17 Q. In fact, you had a fiduciary duty in
18 connection with both of those institutes for a period of
19 time ending at least with respect to Palco just, I
20 think, in September of this last year, is that right?

21 A. Yes, sir.

22 Q. And you still hold those same fiduciary duties
23 with respect to Scopac?

24 A. Yes, sir.

25 Q. And in that regard do you have meetings,

1 routine and frequent meetings with the senior management
2 and officers of Palco as CEO of Scopac?

3 A. Yes, sir.

4 Q. You're currently the CEO of Scopac; is that
5 right?

6 A. Yes, sir.

7 Q. Okay. You are -- you have served as the
8 director of science programs, the director of fish and
9 wildlife programs, and as you have put it in the past,
10 the man in charge of Scopac operations?

11 THE COURT: You see, this is the thing.
12 I've heard all of this. I know what he does, and I
13 think that --

14 MR. KRUMHOLZ: It's a new record.

15 THE COURT: -- that the record that we
16 have created in this whole case can go to his
17 qualifications and understanding.

18 MR. KRUMHOLZ: If that's agreed, I'll
19 move along.

20 THE COURT: I understand that litigators
21 really like to make a record that's fresh for each
22 little thing, but I think I can -- it's fair for me in
23 something like this to look at the entire record of this
24 case in making my decision. And his credentials -- he's
25 testified so many times. But if there's anything new

1 about it, then do that; but let's don't go over the
2 old -- the same old stuff.

3 MR. KRUMHOLZ: Okay. I would rather not,
4 Your Honor. I just want to make sure the record is
5 clear that there's no objection.

6 THE COURT: I understand.

7 MR. KRUMHOLZ: Is there any objection to
8 that?

9 MR. NEIER: No, Your Honor.

10 MR. KRUMHOLZ: Okay. By the silence,
11 I'll assume that's the case.

12 MR. NEIER: No, Your Honor.

13 THE COURT: I assume there's no
14 objection. They have to stand up and object. Move on.

15 Q. (By Mr. Krumholz) I want to move directly to
16 some of the concerns raised by the Court in connection
17 with some of the opening statements, if that's okay,
18 Mr. Barrett. Is Scopac complying with all environmental
19 regulations?

20 A. Yes.

21 Q. Is Scopac complying with the HCP?

22 A. Yes, sir.

23 Q. Do you agree with the notion that there's some
24 sort of risk attendant to continuing operations under
25 the current management team with respect to

1 **environmental issues?**

2 A. No, sir.

3 **Q. Could you explain why that is?**

4 A. Well, we have been -- I personally have been
5 responsible for those environmental compliance issues
6 for most of the past ten years. We have a very good
7 compliance record during that time. Like any company
8 occasionally we'll have, you know, what's called a
9 violation on a THP or something like that. But the most
10 important thing is to ask the question: Is any state or
11 federal regulatory agency now or in the past several
12 years accusing this company of perpetrating significant
13 environmental harm? The answer is no.

14 And, in fact, the opposite is the case. I
15 think there's a broad recognition that we've been very
16 proactive in trying to protect the environment and to
17 ameliorate past legacy impacts on management on the
18 property.

19 **Q. Now, it's also been suggested that there's**
20 **going to be some sort of loss -- you understand, first**
21 **of all, the proposal that's been put into place in terms**
22 **of the DIP facility of \$20 million and log deliveries of**
23 **5 million board feet per month?**

24 A. Yes, sir.

25 **Q. Under that paradigm, under that construct, do**

1 **you know of any reason to believe that you will somehow**
2 **be understaffed and that you will lose critical folks at**
3 **Scopac in connection with moving forward with operations**
4 **through the end of the year?**

5 A. I don't believe that we would have any
6 circumstance that would keep us from being able to
7 operate through the end of the year. In my proffer I
8 acknowledge that we'll probably continue to have some
9 additional staff leave the company. But I do believe
10 that we can either hire new staff or contractors, if
11 necessary. But in any case, I don't see anything that
12 would impede us from doing what we're trying to do and
13 have been doing through the end of the year.

14 **Q. Do you have competent people running Scopac**
15 **right now?**

16 A. I have an extremely competent team that I'm
17 very proud of.

18 **Q. Can you describe those folks in a general way,**
19 **and if you'd like, more specifically for the Court.**

20 A. Well, the structure of Scopac involves a
21 senior management team that reports directly to me.
22 They're called the Mag 7. Almost everyone on the team
23 has been working with the company for five or more
24 years. One of them has been here for more than 30
25 years. They have multiple years of experience in

1 managing their areas. They have a lot of pride in what
2 they do. They have staff that report to them that
3 they're very effective in managing. Below that level of
4 the Mag 7, we have another set of middle managers in
5 science, wildlife, and forestry. They're very effective
6 and in roads as well. They're very effective in what
7 they're doing, so I guess I would just say we've got a
8 very committed team with a lot of experience that know
9 what they're doing.

10 Q. And would there be, in your opinion, any
11 significant impact in terms of staffing and ability to
12 operate Scopac during the appeal if there was a stay
13 granted in this case and presuming that the free log
14 program, as it's been described, and the DIP facility
15 were put into place?

16 A. No, sir.

17 Q. Are you willing to stay on as CEO during the
18 pendency of the appeal?

19 A. Yes, sir.

20 Q. Now, if Palco were given 5 million board feet
21 of logs from Scopac without any requirement that Palco
22 pay for those logs, would you continue to operate Scopac
23 profitably?

24 A. If there was a source of financing for Scopac;
25 yes, sir.

1 **Q. And assume with me that there's a \$20 million**
2 **DIP facility in place as well?**

3 A. Yes, I reviewed the budgets that the CEO, John
4 Young, put together. And according to those budgets
5 with that Lehman DIP or a \$20 million DIP facility in
6 place, we could provide logs to Palco without
7 compensation back from Palco and yet still survive
8 financially through the end of the year.

9 **Q. And would you be able to keep all of Scopac's**
10 **employees on board who are necessary to remain the**
11 **current level of operations?**

12 A. Yes, sir. That budget envisions full -- the
13 full staffing that we have now in terms of both salaries
14 and benefits.

15 **Q. Is it important to keep apprised of what's**
16 **going on over at Palco in light of how the companies**
17 **operate?**

18 A. Yes, sir.

19 **Q. And you've done so; is that right?**

20 A. Yes, sir.

21 **Q. Given your experience as vice president of**
22 **Palco, can Palco continue to operate if it is provided**
23 **logs for the next six months with any -- without any**
24 **requirement to pay for them?**

25 A. Just to be clear, I'm no longer a vice

1 president of Palco.

2 **Q. Given your experience as vice president of**
3 **Palco and given the meetings and the routine**
4 **conversations that you have had and that you've**
5 **testified about?**

6 A. My understanding is that if the Palco mill is
7 supplied with approximately 5 million board foot per
8 month of redwood logs, that mill can continue to
9 operate; that there are customers for the boards that
10 are being produced; and that it can keep full staffing
11 in the mill. Relative to the financial liquidity of
12 Palco, my understanding is that the negative run rate of
13 that liquidity, if you will, on a monthly basis, is less
14 than the amount of money that it owes Scopac for those
15 log sales.

16 So by extension, if you provide the logs, the
17 mill runs. If you don't ask for payment of the logs,
18 then the negative liquidity on a monthly basis at Palco
19 is covered. So the combination of those two should
20 allow Palco to operate through the end of the year.

21 **Q. Now, do you know the Palco management team?**

22 A. Yes, sir.

23 **Q. Who -- we heard from Mr. Litvak a moment ago**
24 **about Mr. O'Brien running Palco. Who from your**
25 **perspective runs Palco?**

1 A. Well, Palco has different groups within it,
2 and each of them has a senior manager. So the sawmill
3 and power plant operations are run by Hughey Long. Our
4 sales operations are run by Kevin Paldino. And our, if
5 you will, administration and finance group until
6 recently was run by Gary Clark, who's just recently
7 resigned as our CFO. And all of those individuals, in
8 turn, report to George O'Brien.

9 **Q. Are Mr. Long and Mr. Paldino competent in what**
10 **they do?**

11 A. In my opinion they're extremely competent;
12 yes, sir.

13 **Q. Are they knowledgeable in what they do?**

14 A. Yes, sir.

15 **Q. Are they diligent in connection with their**
16 **efforts with Palco?**

17 A. Yes, sir.

18 **Q. Now, to your knowledge, does Mr. O'Brien have**
19 **any significant role in the day-to-day operations of**
20 **Palco?**

21 A. I would need you to define sort of day-to-day
22 operations, if you would, please.

23 **Q. Yeah. Of the mill or on the -- of operation**
24 **of the mill that's in the cogen facility, let's start**
25 **with?**

1 A. The management style that exists at Palco
2 right now is one that in which it's fair to say that
3 Hughey Long is responsible for the day-to-day running of
4 both the mill and the power plant.

5 **Q. The other aspects that you mentioned, who is**
6 **responsible for those day-to-day operations?**

7 A. Kevin Paldino is responsible for all
8 day-to-day operations of the sales group, and we're in
9 transition right now to try and figure out how to
10 replace Gary Clark in terms of the administrative and
11 accounting groups. And frankly, I've been here in Texas
12 for most of the past three weeks, so I'm not yet sure if
13 that's been resolved, and if so, how.

14 **Q. If only Mr. Long and you were asked to be the**
15 **CEOs of Scopac and Palco respectively, could you run the**
16 **companies effectively -- together with Mr. Paldino?**

17 A. I believe so; yes, sir.

18 **Q. Okay. Could you maintain the status quo with**
19 **the \$20 million DIP in place and the delivery of the**
20 **logs, if that were the case?**

21 A. Yes, sir.

22 **Q. Now, there were a number of comments about**
23 **what supposedly will occur if there's a stay pending**
24 **appeal. And I want to go through each of those with**
25 **you.**

1 **If there were a stay pinning appeal, do you**
2 **believe that the sawmill would have to shut down, that**
3 **is, the Palco mill?**

4 A. As I testified a couple of minutes ago, if the
5 Palco mill is supplied with 5 million board foot per
6 month of redwood logs and has some means to address its
7 negative liquidity on a monthly basis, there's no reason
8 the sawmill should shut down.

9 **Q. Are those conditions satisfied with what has**
10 **been proposed by the indenture trustee's counsel?**

11 A. I believe that they have; yes, sir.

12 **Q. Okay. The next comment that Mr. O'Brien and**
13 **others in this courtroom have suggested is the workforce**
14 **will not have to be -- will have to be terminated**
15 **somehow, if there's a stay pending appeal. Do you agree**
16 **with that?**

17 A. No, sir. If you don't shut the mill down,
18 then there's no reason that you have to terminate the
19 workforce.

20 **Q. Mr. O'Brien and others have gone on to suggest**
21 **that the cogeneration plant will to be shut down. Is**
22 **that the case?**

23 MR. LITVAK: Your Honor, objection. Do
24 we really need to go through each of these 10 or 15
25 items that are already --

1 THE COURT: If they're already in there,
2 I don't really want to go through them again, so let's
3 move on.

4 **Q. (By Mr. Krumholz) Bottom line, Mr. O'Brien,**
5 **can the status quo be preserved by the delivery of these**
6 **logs without the requirement that the logs be paid for**
7 **over the next six months or at all and the DIP**
8 **facility -- with the DIP facility in place, can the**
9 **status quo be preserved in the Scopac and Palco?**

10 A. Forgive me for correcting you, but you
11 addressed me as Mr. O'Brien.

12 **Q. I'm sorry.**

13 A. Assuming the question was to Barrett --

14 **Q. I apologize.**

15 A. -- it is certainly my opinion based on my
16 experience at both Scopac and Palco for the better part
17 of ten years now, actually more than ten years, that
18 under the terms of the proposed agreement whereby both
19 financing and logs are provided to Palco, that the
20 status quo can be maintained at both companies between
21 now and the end of the year.

22 **Q. Now, Dr. Barrett, there was also some**
23 **suggestion about what the board has and has not**
24 **approved. That is, the Scopac board. Has the DIP**
25 **facility, the \$20 million DIP been approved by the**

1 **Scopac board?**

2 A. Yes, sir.

3 **Q. Has the appeal that's been filed by Scopac**
4 **been approved by the board of directors of Scopac?**

5 A. Yes, sir.

6 **Q. There was a suggestion of somehow a need for a**
7 **board approval of giving the logs up to Palco at the**
8 **rate of 5 million board feet per month. And I just want**
9 **to ask you a couple of questions in that regard. How do**
10 **you -- does that negatively impact Scopac in any way in**
11 **your mind, that delivery of free logs in that amount?**

12 A. No. This might be simplifying it too much,
13 but the way I look at it is Scopac has arranged to do a
14 \$20 million sale of logs to a new buyer. That new buyer
15 is the indenture trustee.

16 **Q. And is the indenture trustee taking on --**
17 **bearing that entire burden?**

18 A. My understanding is that for each dollar that
19 is put forward in what's been called free logs, the
20 recovery that the noteholders would receive would be
21 reduced a dollar. So, in essence, what -- so that does
22 not, in my opinion incur new liabilities for Scopac; no,
23 sir.

24 **Q. A mention of fires has been made in the course**
25 **of opening statements. Do you believe that is a**

1 **significant concern with respect to the Scopac**
2 **timberlands?**

3 A. No, sir. And recognizing that that might not
4 seem credible given the current press about California,
5 while we were in here I e-mailed my logging manager, the
6 manager that's been here for more than 30 years. In 30
7 years, only approximately 3,000 acres or perhaps as much
8 as 3500 acres at the most have burned on the Scopac
9 timberlands. About a third of that was grass land. Of
10 the areas that burned, the timber was recovered for more
11 than half of those burned areas. So the 30 year
12 operational history of Scopac is that we do not have
13 fires. They're relatively rare, and they're usually
14 contained. And in 30 years we've only had one that
15 escaped more than approximately 40 or 50 acres in size.
16 So I view that as an extraordinarily rare outcome for
17 the ownership.

18 **Q. Dr. Barrett, I wanted to address a**
19 **particular -- a very specific question that the Court**
20 **had. You've reviewed the MRC/Marathon plan and the**
21 **confirmation order; is that right?**

22 A. Yes, sir.

23 **Q. What of the Marathon and MRC plan,**
24 **confirmation plan, can the company adopt during the**
25 **pendency of the appeal?**

1 A. Well, I mean, in theory, we could adopt all of
2 it. There's really no hindrance to that. The
3 difference between current forestry under our habitat
4 conservation plan and what has been proposed by
5 Mendocino Redwood really comes down to three or four
6 areas. The first thing that they have said is that they
7 don't do traditional clearcuts. Well, we don't do
8 traditional clearcuts either. So I would argue that
9 we're already in compliance with that.

10 They said that they would pursue what's called
11 Forrest stewardship counsel or FSC certification. We've
12 already had a prescreening audit by FSC auditors, and we
13 know what we would have to do to get FSC certification.
14 So there's no reason that we couldn't pursue that during
15 the pendency of an appeal.

16 They have said that they have an old growth
17 policy. We certainly could adopt that old growth
18 policy. We only have 2.6 million of old growth
19 scheduled for harvest in the next six months, so that
20 would not substantially affect the harvest schedule. So
21 really the only component of the MRC forest management
22 program that could be difficult to implement is that
23 they are committing to do selection harvest only on
24 older stands.

25 There's no way to conduct that selection

1 harvest without significantly reducing the harvest that
2 would occur in the next six months for two reasons:
3 First, you would have to amend all of the existing
4 timber harvesting plans to this new method of
5 silviculture, and the bureaucracy would take a while to
6 do that, and we would lose a big chunk of our summer
7 harvesting season. And secondly, you only take perhaps
8 40 to 60 percent of the volume on selective ground, so
9 the effect of implementing that particular element of
10 the MRC plan is that there's no way to maintain harvest
11 at the currently planned 74 to 75 million board foot
12 this year.

13 So it's feasible to do, I mean, we certainly
14 could implement that element. But it would result in a
15 drop in harvest. My estimate would probably be at least
16 15 and maybe as much as 20 or 25 million board foot.

17 **Q. So that's the only item that you could not**
18 **limit during the pendency of the appeal?**

19 A. Yes, I believe so.

20 **Q. Now, what is your harvest rate that's planned**
21 **during the pendency of appeal, let's say, over the next**
22 **six months to 18 months?**

23 A. Over the next six months through the end of
24 the year, we've harvested approximately 29 million on
25 our way to a target of 75. So we have approximately 46

1 million left to harvest. We're really in the thick of
2 the season right now, so we're bringing in a million and
3 a half board feet a week. That will probably grow to 2
4 million board foot a week as soon as we get some tier 2
5 permits that we apparently are going to get this week,
6 which is good news. So I think we're well -- I think we
7 will be able to meet our harvest goal of approximately
8 75 million for the year. 29 are already in, and we've
9 got approximately another 46 to go.

10 Q. And are you projecting a 75 million board
11 rate, harvest rate, for the pendency of the appeal on an
12 annualized basis?

13 A. Yes, sir.

14 Q. Okay. And just to be clear, Mr. LaMont ran
15 some -- did some runs, as you will recall, in connection
16 with the confirmation hearing?

17 A. Yes, sir.

18 Q. And he also prepared harvest rates or
19 contributed to a business plan that was prepared in
20 November of 2007. Do you remember that testimony?

21 A. Yes, sir.

22 Q. And run 3 for Mr. LaMont in connection with
23 his own analysis was 74 million board feet, which he
24 said was sustainable; is that right?

25 A. As I recall his testimony; yes, sir.

1 Q. And back in November of 2007, what was the
2 harvest rate of the business plan which he contributed
3 to in connection with this bankruptcy? Do you remember
4 78 million board feet?

5 A. Again, I believe that was his testimony; yes,
6 sir.

7 Q. Do you believe that the harvest rates that you
8 have proposed, that Scopac has proposed, would have any
9 negative impact at all in connection with the value of
10 Scopac or Palco?

11 A. No, not at all.

12 Q. How would it impact Palco if you reduce the
13 number of logs you were going to harvest?

14 A. Well, that actually could be fairly
15 significant. The mill needs approximately 5 million
16 board foot per month of redwood. Harvesting 75 million
17 board foot per year, Scopac is not going to be able to
18 provide the full 60 million board feet. We'll get
19 close, but we won't get all the way there. So at 75
20 million board foot of harvest, we can barely meet
21 Palco's log needs.

22 If we were to significantly reduce that
23 harvest by extension, Palco would get far fewer logs,
24 which means it would have greater and greater difficulty
25 maintaining staffing and operations on a one-shift

1 configuration, which is where there are now.

2 Too many words to say, it would negatively
3 affect both Palco and its employees.

4 Q. Do you know of any reason at all if the
5 proposal by the IT, the indenture trustee, is adopted by
6 this Court for purposes of the bond, if you're able to
7 operate with the logs and with the DIP loan in place
8 over the next six months or even longer, if necessary,
9 during the pendency of the appeal, that somehow the
10 value of Scopac and Palco would go down in any way? I
11 know you're not a valuation expert.

12 My question is, do you know of any reason to
13 believe that that value would be impacted by those
14 operations continuing?

15 A. Well, again, I am not a valuation expert, so
16 let's see if I can answer it in this way. I believe the
17 status quo can be maintained of both Scopac and Palco
18 for the next six months. If that's consistent with not
19 leading to a decrease in value, then, yes, I don't think
20 there would be a decrease in value, sir.

21 MR. KRUMHOLZ: Pass the witness.

22 CROSS-EXAMINATION

23 BY MR. McDOWELL:

24 Q. Dr. Barrett, for the record, Luckey McDowell
25 for the Palco debtors. I believe you testified just a

1 **minute ago that you had provided approximately 30**
2 **million board feet of timber so far this year in 2008;**
3 **is that correct?**

4 A. Just to be clear, we've harvested
5 approximately 29 million board foot, but I recall that
6 Palco is not taking deliveries of either Douglas Fir or
7 whitewood, so that's not the same as the amount that's
8 been delivered to Palco.

9 **Q. That's where I was getting. How much of that**
10 **is redwood?**

11 A. Sorry, I don't know off the top of my head,
12 but if you have a calculator you can get really close.
13 Deliveries year-to-date have been right around 80
14 percent redwood. This's beginning to shift now that
15 we're in the summer season and we get into our Douglas
16 Fir hardwood areas, but approximately 80 percent.

17 **Q. 80 percent of 30 million; would that be about**
18 **24 million?**

19 A. Yes, approximately. Yes, sir.

20 **Q. Approximately 24 million has been harvested so**
21 **far of the redwood?**

22 A. Yes, sir.

23 **Q. And you said your target is 75 million.**
24 **Again, that's redwood and everything else that you're**
25 **harvesting, correct?**

1 A. Yes, sir.

2 **Q. What percentage of that 75 million would be**
3 **redwood? Is that the same 80 percent ratio?**

4 A. No, sir. About this time of year we'll drop
5 down to approximately 67 percent ratio, 65, 70. It
6 depends on the specific THPs. If you'd let me say 65 to
7 70, I would be close. I do know that we're planning on
8 harvesting approximately 32 million redwood through the
9 remainder of the year. So if you add that to your 24
10 million, you would have a good estimate of what we
11 believe the total redwood harvest and delivery to Palco
12 will be this year.

13 **Q. Okay. And you agree that the sawmill probably**
14 **needs about 60 million board feet of redwood a year?**

15 A. That's my understanding; yes, sir.

16 **Q. And you've delivered approximately 24 million**
17 **of that so far?**

18 A. Yes, sir.

19 **Q. And you're estimating you're probably only**
20 **going to cut total this year about 45 million board feet**
21 **of redwood, correct?**

22 A. Yes, sir.

23 **Q. So of the --**

24 A. No. Excuse me. No. You would have to add
25 the 32 that we've harvested -- the 32 million that we

1 expect to harvest and the --

2 **Q. Let me stop you right there, actually.**

3 MR. KRUMHOLZ: Actually, Your Honor, I
4 would like the witness to be able to continue because it
5 was very responsive to the question asked.

6 THE COURT: Reask the question.

7 MR. McDOWELL: I'll reask the question.

8 **Q. (By Mr. McDowell) Do you believe that Scopac**
9 **is only going to cut 45 million board feet of redwood or**
10 **so this year?**

11 A. No, sir.

12 MR. McDOWELL: Your Honor, may I approach
13 the witness?

14 THE COURT: Yes.

15 MR. McDOWELL: Your Honor, may I also
16 hand you a copy of this?

17 **Q. (By Mr. McDowell) Mr. Barrett, do you**
18 **recognize what I've handed you?**

19 A. Yes, sir.

20 **Q. It's an e-mail that you sent yesterday morning**
21 **to Palco, correct?**

22 A. Yes, sir.

23 MR. KRUMHOLZ: Your Honor, I haven't seen
24 it.

25 MR. McDOWELL: They're making their

1 rounds.

2 THE COURT: Well, you have it now, don't
3 you?

4 MR. KRUMHOLZ: Yes, I would like to
5 review it before questions are asked.

6 Q. (By Mr. McDowell) I call your attention to
7 paragraph 2, the first two sentences. I'll ask you the
8 question again, Dr. Barrett. You only believe you're
9 only going to be able to cut 45 million or so board feet
10 of redwood this year, right?

11 A. That's what I say in this e-mail.

12 Q. That was yesterday morning?

13 A. Yes, sir.

14 Q. And today you say something different?

15 A. Yes, sir.

16 Q. What happened?

17 A. You catch me in a mode that they call the
18 terminator mode, which is there's an argument that's
19 going on or was going on about whether or not Palco was
20 going to take delivery of short redwood logs. I thought
21 that was a phenomenally dumb thing to be debating. And
22 so in my terminator mode, instead of just saying I don't
23 think that's a good idea, I list reason after reason
24 after reason why I'm right and somebody else is wrong.
25 I did this relatively quickly. And so I was trying to

1 make a point that total harvest off the lands will not
2 be sufficient to meet the mill's needs.

3 **Q. Is that still true today?**

4 A. Yes, I do believe that the total harvest for
5 the year will be less than the amount of redwood that we
6 will harvest. However, for the next six months, we will
7 harvest enough redwood to meet the mill's needs.

8 **Q. That's what I'm really try to get, because you**
9 **said earlier that you've done about 30 million so far,**
10 **and you need 5 million a month. We have six months for**
11 **the rest of the year. So that would be another 30**
12 **million. But on the e-mail you sent yesterday morning**
13 **you only have 15 million. So now the estimate is**
14 **doubled. So was -- I mean, I'm trying to have a hard**
15 **time here because yesterday you said you had 15 million**
16 **more and now today you have 30 million more. Do you**
17 **follow the question?**

18 A. I do. And I guess what I'm trying to
19 encourage you to understand is this e-mail was a fight
20 between myself and other decision makers in the
21 companies. I was less worried about the total accuracy
22 of the numbers than I was about winning the argument,
23 frankly, sir. And so the numbers that I gave you today
24 on the total amount of redwood that's been harvested
25 year-to-date and that I expect to harvest through the

1 remainder of the year are the accurate numbers because I
2 checked them.

3 Q. Not the numbers you told Palco yesterday?

4 A. Yes, sir.

5 Q. Okay. Let me move on to another topic. When
6 I refer to the free log program, that phrase has been
7 tossed around a little bit this morning. Do you know
8 generally what I'm referring to?

9 A. Yes, sir.

10 Q. Did you ever talk with anyone at Palco about
11 the free log program before you filed your proffer last
12 night?

13 A. Well, one part of the answer is easy. With
14 respect to using the Lehman DIP to fund this kind of a
15 program, the answer is no. I have worked with Hughey
16 Long and with other members of the Palco team in the
17 past to try and figure out ways to make both businesses
18 work well. It won't surprise me at all if in the past
19 he and I have talked about how to use Scopac's better
20 financial position to benefit Palco. In fact, I know
21 we've had those discussions. If those discussions could
22 be characterized as a free log program, then I would
23 admit to having had them.

24 Q. You know, it was probably my mistake when I
25 asked earlier if you understood I was talking about a

1 free log program. I thought we had an understanding,
2 but it seems like we don't. So I'll work here. The
3 free log program I'm talking about is where you've
4 proposed in your proffer to give Palco logs at no cost
5 to Palco. That's what I mean by the free log program.

6 So my question to you is: Prior to
7 circulating your proffer last night, you didn't discuss
8 with anyone at Palco Scopac's offer to provide them logs
9 at no cost?

10 A. No, sir.

11 Q. And you're also on the Board of Directors for
12 Scopac? Yes?

13 A. Yes, sir.

14 Q. And if I heard correctly a minute ago during
15 your direct, there were -- there's no resolution from
16 the board of Scopac where they've authorized Scopac to
17 give logs free of charge to Palco?

18 A. No, sir.

19 Q. In fact, have you had any discussions with any
20 of the other board members regarding this free log
21 proposal?

22 A. There have been discussions about using the
23 Lehman DIP. And I'm not sure that we would have -- I
24 would characterize it as free logs. But there have been
25 discussions about the Lehman DIP and its use to fund

1 Palco's operations. We certainly did not use the term
2 "free logs."

3 **Q. But the logs are free to Palco, as I**
4 **understand the proposal, is that correct?**

5 A. That's my understanding as well, sir.

6 **Q. Well, it's your proposal, right, as CEO of**
7 **Scopac?**

8 A. Well, the CFO and I worked up a proposal to
9 try and use funding to provide both logs and liquidity
10 to Palco. I have never used the term "free logs." So
11 if that's the characterization, I just don't want to be
12 stuck with a guy who came up with the name. If that's
13 the effect of it, then, yes, sir, I was very much
14 involved in developing it.

15 **Q. Let me ask you the effect because this is an**
16 **important question that my client have been wrestling**
17 **with: Is Scopac under any circumstance, under any**
18 **circumstance ever going to ask Palco to pay for the logs**
19 **that it's going to be proposing to deliver to Palco?**

20 A. I think you should ask that question of John
21 Young since he's the ultimate authority and CFO. But to
22 my understanding, the answer is no.

23 **Q. The CFO is the ultimate authority, not the**
24 **CEO?**

25 A. He prepared the budget, so with respect to

1 what is anticipated in the budget, he's the ultimate
2 authority, sir.

3 **Q. And absent board approval, you're not willing**
4 **to take on that authority and make that decision as CEO**
5 **of Scopac?**

6 MR. FROMME: Objection, Your Honor. That
7 calls for a legal conclusion.

8 MR. McDOWELL: I'm asking whether he's
9 willing to take on --

10 THE COURT: I think he can answer the
11 question. Do you think you can give away those logs
12 without board approval?

13 THE WITNESS: Well, I would certainly
14 want to talk to my board, Your Honor, before we went
15 through with actually doing it; but since we have been
16 given authority for the Lehman DIP, I would argue and am
17 comfortable as CEO that I already have authority to
18 pursue getting a \$20 million DIP facility. The actual
19 implementation of the use of those funds is something
20 that would need to be discussed with the board. But I
21 feel like we're already two-thirds of the way there by
22 virtue of getting board approval for the funding.

23 **Q. (By Mr. McDowell) But you admit it would need**
24 **to be approved by the board before you could**
25 **affirmatively --**

1 MR. FROMME: Objection.

2 MR. McDOWELL: Let me finish the
3 question, please.

4 MR. FROMME: Sorry.

5 Q. (By Mr. McDowell) I believe you said you
6 believe you would need to get board approval before you
7 could offer this to Palco. And correct me if I
8 misstated your testimony. I'm just trying to get a
9 straight answer.

10 MR. FROMME: Well, Your Honor, just let
11 me say my objection here. I object to the extent it
12 calls for a leading conclusion.

13 THE COURT: Okay. Well, you tell me,
14 does he need board approval?

15 MR. FROMME: No, I don't think he needs
16 board approval, Your Honor.

17 THE COURT: They can give away logs to
18 Palco without board approval?

19 MR. FROMME: Yes, Your Honor, he can
20 because it's covered by the authority the board granted
21 Scopac --

22 THE COURT: To go out and get them.

23 MR. FROMME: -- to go out and get the DIP
24 financing, and it's a cash neutral situation for -- and
25 a debt neutral -- and neutral to -- on the balance sheet

1 for Scopac.

2 MR. McDOWELL: I appreciate the testimony
3 of counsel. I think my point's been made. I'm not
4 going to belabor it.

5 THE COURT: Okay.

6 Q. (By Mr. McDowell) Let me move on to another
7 issue. You say in your proffer that the indenture
8 trustee has agreed to this proposal to provide logs to
9 Palco free of charge; is that correct?

10 A. Yes, sir. That's my understanding.

11 Q. Do you have a written consent from the
12 indenture trustee authorizing that?

13 A. I don't know of a written consent; no, sir.

14 Q. You don't know if there's one?

15 A. I don't know if there's one. I'm sorry.

16 Q. Who would know at Scopac?

17 A. At this point since this is such a
18 fast-breaking development, if you will, probably counsel
19 is the ultimate authority. John Young as CFO may have
20 seen written documentation, if it exists, sir.

21 Q. I know you testified that you didn't believe
22 that Palco is going to have to close its mill. But let
23 me ask you a series of questions. Presuppose for me
24 that the mill is closed. You don't dispute that if the
25 mill -- that the mill is closed that Palco will have to

1 **lay off employees, do you?**

2 A. No, sir.

3 **Q. And if the mill is closed, you're not**
4 **disputing that the town of Scotia may be irreparably**
5 **harmed, do you?**

6 A. I don't know what irreparably harmed is.

7 **Q. Fair enough. Let's take it in steps. You're**
8 **not disputing that if the mill is closed, the town of**
9 **Scotia will be harmed, are you?**

10 A. No, sir.

11 **Q. How do you think the town of Scotia would be**
12 **harmed in that circumstance?**

13 A. In several ways. Probably the most visible is
14 that many of the people that live in the town work in
15 the mill. To the extent that some of those people were
16 the people that are laid off, they would probably leave
17 town, and that would have a real effect.

18 In addition, the people that are there buy
19 goods, services, etcetera, use some of the services from
20 the power plant itself. So there would be spinoff
21 effects in that regard as well, sir.

22 **Q. Now, is the town of Scotia completely -- is it**
23 **at full capacity right now, that is, are all the houses**
24 **leased at this moment?**

25 A. I'm sorry, sir, I wouldn't know that.

1 **Q. Notwithstanding your experience, long-term**
2 **experience with Palco and Scopac?**

3 A. No, sir. I can tell you that in general for
4 the last year or two, we have not been at full capacity;
5 but I can't confirm right now at this time that we are
6 not at full capacity.

7 **Q. Would you expect that the people, employees**
8 **move, as you testified a minute ago, would you expect**
9 **that those houses would be immediately filled again with**
10 **new people for the -- from the town of Scotia?**

11 A. No, I would not think so, sir.

12 MR. McDOWELL: I have no further
13 questions, Your Honor.

14 THE COURT: All right.

15 CROSS-EXAMINATION

16 BY MR. NEIER:

17 **Q. David Neier on behalf of Marathon. Good**
18 **afternoon, Dr. Barrett.**

19 A. Good afternoon, Mr. Neier.

20 **Q. You recall in March of 2008 Mr. Krumholz took**
21 **a lengthy deposition of you and quite a lengthy**
22 **deposition concerning this case?**

23 A. Yes, sir.

24 **Q. And he asked you -- I understand you're not a**
25 **financial person, but he asked you whether you**

1 **understood the basics of special purpose entity and why**
2 **it was important. Do you recall that testimony?**

3 A. Yes, sir.

4 **Q. And nevertheless, you believe that Scopac and**
5 **Palco have to operate as an integrated company in order**
6 **to be successful, correct?**

7 A. I think my testimony has been that the two
8 companies benefit tremendously from working together
9 and, therefore, that's the ideal situation. Essential,
10 I think, is a bit of a loaded term, so I would like to
11 avoid it if I could.

12 **Q. Okay. Would Scopac be impacted if Palco were**
13 **to shut down?**

14 A. Yes, sir.

15 **Q. Would that impact be positive or negative with**
16 **respect to Scopac?**

17 A. It would be negative, sir.

18 **Q. In what way?**

19 A. Well, the most dramatic effect, of course,
20 would be that a mill consuming approximately 60 million
21 board foot would go off-line. That would immediately
22 cause an imbalance between the total amount of wood
23 fiber available for sale on the north coast and the
24 milling capacity that was still operating. And I would
25 expect in accordance with basic sort of market

1 principles, that the price of logs would then fall to
2 Scopac's detriment, sir.

3 Q. In other words, if you have a lot of logs to
4 sell and not a mill right next door to mill them, other
5 mills are going to be able to take advantage of that
6 situation and drive the price down, correct?

7 A. Yes, sir.

8 Q. And these forest fires in Mendocino that are
9 going on, that's going to result in a lot of salvage of
10 redwood, correct?

11 A. It may, sir. Yes, sir.

12 Q. And by salvage, I mean that logs are going to
13 be felled as a result of the fire, and then they're
14 going to be brought -- and then they're going to be sold
15 as salvage, correct?

16 A. Yes, sir.

17 Q. And that's going to drive the price down, too?

18 A. Well, it will certainly drive up the supply.
19 And if there's no change in the demand, then, yes, sir,
20 it would drop the price.

21 Q. And prices for redwood have been falling in
22 any event?

23 A. Yes, sir.

24 Q. And Palco buys prices -- buys logs at the SBE
25 price, correct?

1 A. Yes, sir.

2 **Q. And other mills are not going to buy the logs**
3 **at the SBE price?**

4 A. No, sir.

5 **Q. And there's a difference between the SBE price**
6 **and the market price, correct?**

7 A. Yes. Understanding that the market price is
8 kind of variable, I think it's fair to say they're never
9 exactly the same. But more importantly, I'm quite happy
10 to acknowledge that the SBE is not the same thing as
11 current market prices.

12 **Q. Now, the indenture trustee's plan did not**
13 **provide for an integrated company with commercial**
14 **timberland and mill operations, correct?**

15 A. I'm sorry, sir. You mean the plan that was in
16 the disclosure statement?

17 **Q. The indenture trustee's plan described in the**
18 **joint disclosure statement?**

19 A. You're correct, sir; it did not propose an
20 integrated company.

21 **Q. And Scopac has on file a 363 motion to sell**
22 **all its assets, correct?**

23 A. Yes, sir; that's my understanding.

24 **Q. And if that happen -- I'm sorry, go ahead.**

25 A. That's my understanding. Yes, sir.

1 **Q. And if that happened, then the mill and the**
2 **forest would be owned by different people, correct?**

3 MR. KRUMHOLZ: I'll object, Your Honor,
4 as calling for speculation.

5 THE COURT: What?

6 MR. KRUMHOLZ: I'll object as calling for
7 speculation.

8 MR. NEIER: Your Honor, he's the CEO of
9 the company. He has on file a motion to sell all of
10 Scopac's assets. I don't understand why that's
11 speculation.

12 THE COURT: I mean, under that -- you
13 remember that deal. What do you think? Is that going
14 to be something different?

15 THE WITNESS: Well, it certainly could
16 end up in different hands. There's no requirement that
17 under the 363 sale, that they would go to different
18 owners, however, sir.

19 **Q. (By Mr. Neier) You mentioned that there was a**
20 **loss of personnel at Scopac. Is there also a loss of**
21 **personnel at Palco?**

22 A. Yes, sir.

23 **Q. And is that loss of personnel detrimental to**
24 **Palco?**

25 A. Yes, sir.

1 Q. And is that continuing?

2 A. Yes, sir.

3 Q. And do you believe that if there's a stay of
4 six months to a year or even longer, that that's
5 going -- that that uncertainty, if you will, will create
6 further losses or cause further losses of personnel at
7 Palco?

8 A. Yes, sir.

9 Q. The same would be true at Scopac, correct?

10 A. Yes, sir.

11 Q. And I take it you have some issue with
12 Mr. O'Brien when he says that if there's a stay, it
13 could force Palco to shut down, correct?

14 A. My reading of his proffer is that he offered
15 that it would shut down. My issue is with the certainty
16 that it would rather than, you know, necessarily some of
17 the possible effects that could happen that he paused it
18 on if it did shut down.

19 Q. But you would agree, would you not, if there's
20 a lengthy stay, it is certainly foreseeable that the
21 mill could shut down?

22 A. Well, I mean, certainly it's possible. My
23 testimony earlier, however, was that I believe that
24 under the scheme that's been put forward, Scopac can
25 provide the essentials for the mill not having to shut

1 down, sir.

2 Q. What you're offering, isn't it fair to say, is
3 basically a six-month window to keep -- to keep things
4 as they are in an effort to keep the mill open, correct?

5 A. Yes, sir.

6 Q. But it's not longer than six months?

7 A. No, sir.

8 Q. And if there's a stay, the appeal does not
9 necessarily have to be expedited; it could take a longer
10 than six months? Is that your understanding?

11 A. I'm not an expert on appeals, sir, but I've
12 certainly heard several counsel, yourself included, say
13 that it could take longer than six months.

14 Q. And are you aware of the fact that the 75
15 million dollar DIP is due to be paid on August 6, 2008?

16 A. No, sir, I was not.

17 Q. Okay. And I take it that there's no provision
18 for the payment of Marathon on August 6, 2008 from
19 the -- of \$75 million from the \$20 million Lehman DIP,
20 correct?

21 A. That IS correct, sir.

22 Q. Has the board -- do you have a legal opinion
23 from Mr. Fromme or other lawyers that you don't need
24 board approval for this gifting of logs to Palco?

25 MR. FROMME: Objection, Your Honor, to

1 the extent the substance of the -- of any opinion is
2 attorney/client communication. The fact that an opinion
3 has been received can be --

4 MR. NEIER: That's all I'm asking, a yes
5 or no question.

6 MR. KRUMHOLZ: He already has it.

7 Q. (By Mr. Neier) Do you have an opinion from
8 Gibson, Dunn that you don't need board approval to give
9 away logs?

10 MR. KRUMHOLZ: Your Honor, I know this
11 is --

12 MR. NEIER: It's a yes or no question.

13 MR. KRUMHOLZ: It's an awkward question.
14 But, first of all, Mr. Fromme in open court gave him
15 that opinion. And so we all know what has been provided
16 in that regard. And so -- and this witness is not a
17 lawyer, so I think it's an inappropriate question of
18 this witness.

19 MR. NEIER: I'm asking --

20 THE COURT: He did state in his opinion
21 that they didn't need -- they didn't need board
22 approval. However, you asked him another question. Do
23 you have a written opinion from counsel about that?

24 THE WITNESS: No, sir.

25 THE COURT: Or other than what you heard

1 today in court, do you have any other opinions from
2 counsel?

3 THE WITNESS: Yes. Prior to open court
4 today, Your Honor, I was given a verbal opinion by
5 counsel from Gibson, Dunn.

6 Q. (By Mr. Neier) And you're familiar in general
7 terms with the indenture, correct?

8 A. In general terms, yes, sir.

9 Q. In fact, you've testified on several occasions
10 that you view yourself as having a fiduciary obligation
11 under the indenture because -- a fiduciary obligation to
12 the creditors, the noteholders, correct?

13 A. Yes, sir.

14 Q. And are you familiar also with the new master
15 purchase agreement?

16 A. Yes, sir.

17 Q. Are you aware of whether the indenture allows
18 logs to be transferred to anybody except under the new
19 master purchase agreement?

20 A. My understanding is -- let me back up. The
21 indenture is a long, legal document.

22 Q. It certainly is.

23 A. I don't profess to know all of its provisions,
24 so I can't competently offer an opinion on that. I'm
25 sorry, sir.

1 **Q. But you have been in court, and you have heard**
2 **testimony. And you yourself have in the past indicated**
3 **that what logs Scopac has have to be sold to Palco,**
4 **correct, under the new master purchase agreement?**

5 A. Under -- yes, sir, with the caveat. Under the
6 new master purchase agreement, Palco has what you might
7 call a first right of refusal to all Scopac logs. So I
8 see the new master purchase agreement as being binding
9 upon offering the logs to Scopac -- or to Palco for
10 sale, but not necessarily being binding on Palco to pay
11 for those logs or to buy them, sir.

12 **Q. But Scopac is bound in that regard?**

13 A. Yes, sir.

14 **Q. And are you aware that the indenture trustee**
15 **has to enforce the new master purchase agreement as part**
16 **of the indenture?**

17 A. It might have generally said so, but I can't
18 say with specificity; no, sir.

19 **Q. Well, let me ask you this: Have you received**
20 **any formal or informal opinion from counsel for the**
21 **indenture trustee, that it's just fine to give away the**
22 **logs?**

23 A. No, sir, I have not received any such opinion.

24 **Q. Now, is it your understanding of the current**
25 **Lehman DIP that's on file with this court, that it will**

1 **come out of the noteholders recovery, that is, out of**
2 **the \$513.6 million that they're going to receive or the**
3 **530 subject to adjustments downward to 513.6? Is it**
4 **your understanding the Lehman DIP is going to come out**
5 **of that amount?**

6 A. Yes.

7 Q. But is it your understanding that the written
8 **documents say that?**

9 A. I don't know what written documents you're
10 specifying, sir.

11 Q. Okay. You recall you testified, I think it
12 **was on May 1st, 2008 in this court at the confirmation**
13 **hearing?**

14 A. Yes, sir.

15 Q. And you may not recall the date, but you
16 **recall testifying at the confirmation hearing, correct?**

17 A. You got me. Exactly right, Mr. Neier.

18 Q. In your testimony I asked you as to whether
19 **there was a backlog for road maintenance. Do you**
20 **remember that?**

21 A. Yes, sir.

22 Q. And you said there is a backlog for road
23 **maintenance. Do you remember that?**

24 A. I do, sir.

25 Q. And is there still a backlog for road

1 maintenance?

2 A. Yes, sir.

3 Q. Under this proposal where you give the logs to
4 Palco, who is going to pay for the road maintenance?

5 A. That will be paid for by Palco, sir.

6 Q. And how much do you estimate the road
7 maintenance would be over the next six months?

8 A. Again, I think John Young can give you exact
9 numbers. But my understanding is it's approximately 6.4
10 million through the remainder of the year for roads and
11 reforestation. I don't know that I've seen the two
12 broken out, sir.

13 Q. Does that take care of the backlog?

14 A. No, sir.

15 Q. And does -- do you recall that your -- that
16 you testified that Scopac was really on borrowed time
17 with respect to some of this maintenance, that you only
18 have a certain amount of time under the THPs to do this
19 road maintenance, and that if you don't do it, you're
20 then in violation, correct?

21 A. Yes, sir.

22 Q. And then you won't be able to harvest,
23 correct?

24 A. Well, we might not be able to harvest, but
25 more importantly what would happen is we would come

1 under CDS purview for being in violation of our THPs,
2 and we would be subject to citations and corrective
3 actions. And it would all get very unpleasant very
4 quickly, sir.

5 **Q. And none of what your proposal is going to**
6 **deal with this backlog that really has to be dealt with**
7 **in the near term, correct?**

8 A. The Lehman DIP proposal certainly does not
9 specifically address the elements of the backlog.
10 However, the funding levels that are being provided for
11 roads under the Lehman DIP, I believe, are sufficient to
12 meet our critical road sites for summer of 2008, sir.

13 **Q. But not dealing with the backlog that has a**
14 **definite time limit on it, that has to be dealt with the**
15 **next year, correct? You're just talking about through**
16 **December 31st, 2008?**

17 A. Yes, sir; that is correct.

18 MR. NEIER: I have no further questions.

19 MR. HOLZER: Your Honor, I had an inquiry
20 from folks traveling tonight for the Asarco hearings
21 tomorrow whether they're continued. There's a Tuesday 9
22 o'clock next week Asarco setting.

23 THE COURT: Go ahead.

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CROSS-EXAMINATION

BY MR. LITVAK:

Q. Good afternoon, Mr. Barrett. Max Litvak for the creditors committee.

A. Good afternoon, sir.

Q. Mr. Barrett, do you know how long an appeal will take in this case?

A. I said a little bit earlier I'm not an expert on appeals. I have heard estimates ranging anywhere from four months to I believe Mr. Neier told me as long as two years. I think if you were to look at the majority of opinions that I've been exposed to, it sounded like it's somewhere in the neighborhood of six to eight months, sir.

Q. But you don't really know, do you?

A. No, sir, I don't. I'm not an expert on such things.

Q. And I think you were very careful to say in your earlier testimony today that under the budgets that Scopac is proposing, that Scopac would have sufficient funds, assuming that the Lehman DIP is in place, to continue to operate even under this what's been called free log program through the end of this year; is that correct?

A. Yes, sir.

1 Q. Okay. But your own budget indicates that at
2 the end of this year, Scopac will only have
3 approximately .3 million -- \$300,000 in availability
4 under that Lehman DIP; isn't that right?

5 A. Yes, sir.

6 Q. And there would be no other available cash in
7 the Scopac estate to draw on, is that right, by the end
8 of this year?

9 A. I'm not a financial expert, so somebody like
10 John Young might be able to know about some closet where
11 there's some extra money, but according to our budget
12 anyway, sir, I think you're right; that would be the
13 extent of our liquidity at the end of the year.

14 Q. Are you comfortable with only having \$300,000
15 in cash at Scopac?

16 A. I would view that as being a very, very
17 limited amount of liquidity. So if -- so the general
18 answer is no, I would not be comfortable having only
19 \$300,000 liquidity, if I thought that was going to
20 extend for any period of time or we had to survive off
21 of that, sir.

22 Q. That's extremely tight, isn't it?

23 A. Yes, sir.

24 Q. Do you have any commitment from Lehman to
25 extend their financing beyond the \$20 million that's

1 **currently contemplated?**

2 A. I have not been part of any conversations
3 where a commitment beyond \$20 million has been made. I
4 can't say that there haven't been such conversations. I
5 just haven't been part of them, sir.

6 **Q. You're not aware of any commitment in excess**
7 **of \$20 million; is that right?**

8 A. I am not; no, sir.

9 **Q. So if the appeal were to take eight months or**
10 **nine months or 12 months, Scopac would not have --**
11 **Scopac does not have any funding commitment in place**
12 **today to get it to that point; is that right?**

13 A. That is my understanding; yes, sir.

14 **Q. Now, we talked about -- and you testified to**
15 **your opinion that if Palco is essentially given free**
16 **logs or not required to compensate Scopac for log**
17 **deliveries through the end of this year, that Palco**
18 **would have sufficient funding, in your opinion, to make**
19 **it to the end of the year; is that right?**

20 A. Yes, sir.

21 **Q. Okay. But in that calculus, you're not taking**
22 **into account payment of accrued professional fees at the**
23 **Palco estate; is that right?**

24 MR. KRUMHOLZ: Objection, Your Honor, to
25 the foundation.

1 THE COURT: He's asking him a question.

2 Are you taking any account of professional fees?

3 THE WITNESS: Not as I understand, sir.

4 Q. (By Mr. Litvak) Do you know what the accrued
5 professional fees at Palco are?

6 A. No, sir, I do not.

7 Q. I think we heard counsel for Palco mention
8 that the number is in excess of 10 million. Is that
9 correct? Do you know whether there's the correct
10 number?

11 A. I'm sorry, sir, I do not.

12 Q. Okay. I want to clarify something, just move
13 on to a different topic, and that is that in your mind
14 this free log program, you view this as not a gift of
15 logs from Scopac to Palco, but rather as a sale of logs
16 from Scopac to the indenture trustee, and then a
17 reduction in the indenture trustee's claim against
18 Scopac; is that correct?

19 A. Generally, yes, sir. I want to -- I want to
20 avoid having those two outcomes be mutually exclusive.
21 I think they're both true to a degree. I don't like the
22 word "gift." I view this as a way to keep my sister
23 company and my best customer alive in status quo mode
24 through the end of the year. I think it works for them,
25 I think it's good for the employees, and I think it's

1 good for both companies. But it is certainly true that
2 I view this as, in my mind -- and I said maybe a
3 simplified way to look at it -- we've done a \$20 million
4 log sale to a new customer. And we've asked the new
5 customer, where do you want those logs to go, just like
6 we would do with any third-party sale.

7 And instead of delivering it to a mill here, a
8 mill there, they're saying, we want you to deliver it to
9 Palco. And again, I'm sorry if that's a simplified way
10 of looking at it, but that's kind of how I've been doing
11 it.

12 Q. I want to clarify that a little bit, and that
13 is, is that how you justify it from Scopac's
14 perspective, that you can deliver logs to Palco for six
15 months free of charge? Is that -- is that the way you
16 justify that the indenture trustee's claim will be
17 reduced?

18 A. Yes, sir, intellectually that is how I'm
19 looking at it.

20 Q. Okay. So just so I understand, and I think
21 Mr. Neier mentioned it, but the claim that's actually
22 being reduced is the 513.6 million that the Court
23 required MRC and Marathon to pay under their plan to the
24 indenture trustee; is that right?

25 A. Yes, sir, that's my understanding.

1 **Q. So what happens if the Mendocino/Marathon plan**
2 **falls apart during the course of this stay pending**
3 **appeal?**

4 A. I'm sure there's a lot of possible outcomes,
5 but very generically what I would say is that there's
6 now an additional \$20 million of debt on the Scopac
7 timberlands. And whether it be a Chapter 7 liquidation
8 or a 363 sale, it's going to reduce the recoveries that
9 the noteholders get, sir.

10 **Q. Okay. But what about the -- I'm talking about**
11 **the logs delivered to Palco during that time. So let's**
12 **assume hypothetically that a stay pending appeal is**
13 **issued and for six months Scopac delivers logs to Palco**
14 **without compensation. Then something happens and**
15 **Mendocino and Marathon walk from the plan. How does**
16 **that work? Those deliveries of logs, what impact is**
17 **that going to have on the indenture trustee's claim?**

18 A. I don't know. Let me try, and if I don't get
19 it right, we'll go at it again.

20 MR. KRUMHOLZ: I'll object as calling for
21 a legal conclusion.

22 THE COURT: I think he's asking him for
23 his understanding. I'd like to know, too. What is your
24 understanding of what happens?

25 THE WITNESS: My understanding --

1 THE COURT: Let's just make it real
2 simple. So they cut down a tree, and it goes from
3 Scopac to Palco without any payment?

4 THE WITNESS: Yes, sir.

5 THE COURT: And then Palco mills it, and
6 they sell that lumber?

7 THE WITNESS: Yes, sir.

8 THE COURT: And they get to keep the
9 money?

10 THE WITNESS: Yes, sir.

11 THE COURT: Okay.

12 Q. (By Mr. Litvak) So my question is --

13 THE COURT: And the only thing that
14 happened is that for that log that's worth something,
15 there's a diminution in the total amount owed to the --
16 under the plan, there would be a diminution of the total
17 amount owed to the noteholders; is that what your
18 understanding is?

19 THE WITNESS: Yes, sir, it is.

20 THE COURT: And if the plan falls apart,
21 it just doesn't impact the noteholders because they're
22 still owed whatever they're owed?

23 THE WITNESS: Yes, sir.

24 Q. (By Mr. Litvak) Well, wouldn't it impact the
25 principal amount of their claim at least, the \$714

1 million in principal roughly that they're owed?
2 Shouldn't that be a reduction of that claim? Are you
3 saying that --

4 THE COURT: Whether it should or should
5 not be, who cares? What happens?

6 Q. (By Mr. Litvak) Yeah, what happens?

7 THE COURT: In your understanding.

8 THE WITNESS: Again, in some ways it's
9 unfortunate I'm the first witness because I'm not a CFO,
10 so I keep going back to simplified ways of looking
11 things, which is what you do when you're a forestry guy
12 instead of a CFO. I look at it like this: The
13 noteholders are willing to spend \$20 million of their
14 own money to pursue an appeal. They're going to spend
15 it. It's gone. They never get it back. If the MRC
16 plan prevails on appeal, then they'll take \$20 million
17 out of the 513, and they'll get less. If the MRC plan
18 is not successful on appeal, then you don't know what
19 happens next. Maybe it's a Chapter 7. Maybe it's a 363
20 sale. Maybe the judge tries to confirm some other plan.
21 You don't know what the outcome is.

22 But my understanding is that \$20 million
23 is gone. It's going to reduce the amount that the
24 noteholders walk away with, whether it's Chapter 7,
25 whether it's 363, whether it's a reorganized plan by \$20

1 million. That's my understanding. John may tell you
2 that I don't have a very good understanding on that; but
3 that's the way I look at it sitting up here today, sir.

4 Q. (By Mr. Litvak) Okay. And I think you
5 mentioned this before, but I just want to make sure.
6 You don't actually have anything in writing in your
7 possession that reflects the noteholders' agreement to
8 reduce their claim in the amount of the log purchases or
9 log deliveries to Palco during this six-month period; is
10 that right?

11 A. I have not seen any written documentation; no,
12 sir.

13 MR. LITVAK: Thank you, Your Honor.

14 THE COURT: Anyone else?

15 MR. BRILLIANT: I just have a few
16 questions.

17 THE COURT: All right.

18 MR. PASCUZZI: I'll have some questions
19 when he's done.

20 THE COURT: Okay.

21 CROSS-EXAMINATION

22 BY MR. BRILLIANT:

23 Q. Dr. Barrett, whose idea was the free log plan?

24 A. There wasn't a person --

25 MR. FROMME: Your Honor, objection to the

1 extent it calls for attorney/client communication. You
2 know, I direct that he can't answer that question.

3 THE COURT: I don't want you to tell us
4 what your lawyer told you.

5 A. Fair enough. There was not a person. There
6 were a series of discussions, some of which involved
7 counsel, some of which were between John Young and I.
8 And some of which were involving all of us. But
9 fundamentally what happened is the noteholders asked us
10 to provide input on possible ways to address Palco's
11 needs during the next six months. Those discussions
12 collectively led to this idea of using the Lehman DIP to
13 be able to provide logs to Palco at no cost, thereby
14 addressing log supply and liquidity.

15 **Q. Was the idea of Scopac or the noteholders and**
16 **the indenture trustee's idea?**

17 A. It was -- well, I can't speak for whether or
18 not the noteholders had that idea as well, but certainly
19 I can testify that the idea came in my experience from
20 within the Scopac group, sir.

21 **Q. Now, did you negotiate this directly with**
22 **somebody from Bank of New York?**

23 A. I wasn't involved in those discussions, going
24 back to being more a forest guy than a CFO guy.
25 Unfortunately, John and counsel got stuck with those

1 negotiations. I was kept apprised. I was asked some
2 questions, but didn't do the direct negotiating, sir.

3 **Q. Were you involved in any negotiations with**
4 **anybody about the free log plan?**

5 A. Negotiations implies trying to reach a
6 consensual agreement. I was not involved in discussions
7 in trying to reach a consensual agreement; no, sir.

8 **Q. Did anybody from the indenture trustee or**
9 **their counselor or Houlihan or anyone talk to you and**
10 **tell you what the terms were of the deal?**

11 A. I was -- I was part of discussions about what
12 the developing terms were. Those discussions were with
13 counsel. So I assume that I shouldn't go into the
14 details of them. I was also asked questions about how
15 it will work operationally, which gets back into my area
16 of knowledge and expertise. And I provided that input
17 to counsel for the noteholders, sir.

18 **Q. Have you ever been on a call with anybody from**
19 **Bank of New York in connection with this?**

20 A. Excuse me, let me back up. I want to make
21 sure I don't miss something. Those discussions where I
22 talked about the operational impacts were not just with
23 counsel for the noteholders. I was also involved in
24 explaining some of that to Lehman, sir.

25 **Q. But were you on any calls with Bank of New**

1 **York?**

2 A. No, I was not, sir.

3 **Q. So you testified you haven't seen any**
4 **documentation with respect to this deal, but have you**
5 **heard anyone from Bank of New York specifically tell you**
6 **that this business person at Bank of New York -- that**
7 **this their understanding of the deal?**

8 MR. KRUMHOLZ: Your Honor, if I could
9 object because of time. We really are short on time,
10 and Your Honor is going to have a condition on any bond,
11 that we can either do it or not. And that will be
12 fulfilled or not in connection with the funding, and so
13 whether they've seen a document or not or whether it's
14 been approved or not, we can discuss all day with this
15 witness. But the reality of it is, is that the way that
16 the funding or bonds work in our world is that you set
17 it. And either we meet it or not to effectuate the
18 stay. So it seems to be irrelevant.

19 MR. FIERO: Your Honor, I think this is
20 totally relevant. There was a time when the noteholders
21 came to this Court and told everyone -- it was printed
22 in the paper that everyone was going to have a job for a
23 year. Well, that wasn't in the ultimate plan. And it's
24 pretty clear that somewhere along the line that got run
25 up some flagpole and shot down. And if that's what's

1 going to happen here, we need to know it.

2 MR. KRUMHOLZ: Your Honor, that is
3 irrelevant.

4 THE COURT: Okay. Well, all right, so
5 let's move on. I think we do need to -- there's a
6 certain amount of time I have for this hearing, and I
7 want to give everybody a fair chance to do it. But I
8 don't -- I mean, this is not like a confirmation
9 hearing. I feel like I've got to give you almost all
10 the time you need in a confirmation hearing on all
11 sides.

12 I think that you-all need to target this
13 stuff and get it to me because we're going to hear this
14 today until about 6:00, and then we're going to hear it
15 tomorrow until about 6:00, and that's about it. So get
16 it out that way. Use your time wisely. So if you want
17 to -- you got -- you-all got time and you've got time.

18 MR. BRILLIANT: Thank you.

19 THE COURT: You're spending time on these
20 questions when I'm going to tell you it ain't going to
21 be approved unless they can do it. I mean, whatever
22 bond that I require, they've got to post it. It's not
23 going to be, well, if you will post this, I'm going to
24 go ahead and stay it and now let's see if you can post
25 the bond. It's not going to be that. You know, nobody

1 expects that. Okay?

2 MR. BRILLIANT: Thank you, Your Honor.

3 Q. (By Mr. Brilliant) Mr. Barrett, you're not
4 aware --

5 THE COURT: On the other hand, let me
6 just say that there have been plenty of statements about
7 the inflexibility of the bondholders committee or the
8 indenture trustee doing things without either 66 percent
9 or 100 percent or all that sort of stuff. So it
10 certainly is -- I mean, I'm not going to issue an order
11 that I know you can't do if you're not going to be able
12 to do it. That doesn't make any sense either. So if
13 you guys got problems getting this stuff solved, don't
14 be telling me things to put it in an order that aren't
15 going to get solved. That'd be stupid, too.

16 MR. KRUMHOLZ: We completely agree to
17 what you said, Your Honor.

18 THE COURT: All right. So move on.
19 Let's go.

20 MR. BRILLIANT: Thank you, Your Honor.

21 Q. (By Mr. Brilliant) Dr. Barrett, you're not
22 aware of which specific trees that Mendocino would be
23 logging currently if the Mendocino/Marathon plan were to
24 close imminently, are you?

25 A. I'd be silly if I told you the specific trees.

1 I assume, sir, that during the first year because it
2 takes so long to get THPs approved, minimum of 90 days
3 after they're submitted, and they take probably three to
4 six months to prepare, that Mendocino will have no
5 choice but to operate on the existing batch of THPs.
6 Again, they'll have to amend them to selection only
7 harvest. So I certainly don't know the individual
8 trees. I can't say which of those THPs they may
9 ultimately reject, but I think relative to the next six
10 months, I have a pretty good idea where they're going to
11 go, which is the areas where we currently have THPs
12 planned for operations.

13 Q. So that's just an assumption you're making; is
14 that right?

15 A. Yes, sir.

16 Q. So it's possible that they would be logging
17 different trees than you?

18 A. Yes, sir.

19 Q. And you're aware that Mendocino would be
20 logging fewer trees than the company is currently
21 logging, isn't that right?

22 A. Yes, sir.

23 Q. And by leaving the trees in the field,
24 Mendocino would have them for future seasons to have a
25 more sustainable logging program over the long-term, is

1 **that right?**

2 A. The term "sustainable" is a term of art in
3 California, so I'm going to object to that or at least
4 ask you to clarify. But let me help you on the part
5 that's easy. To the extent that Mendocino leaves trees
6 in the forest, they will certainly be there in the
7 future, and they will have the growth that they will
8 have experienced during the time between when they were
9 left and when they were ultimately harvested; yes, sir.

10 **Q. So it's possible that you would be cutting**
11 **down trees that Mendocino has plans to cut down in the**
12 **future; isn't that right?**

13 A. Yes, sir.

14 **Q. And that could affect Mendocino's long-term**
15 **plans for the forest; is that right?**

16 A. Yes, sir, it could.

17 **Q. Now, Dr. Barrett do you have any expectation**
18 **to go to work for, you know, Mendocino after the plan**
19 **were to be consummated?**

20 A. No, sir.

21 **Q. And what is your expectation if the -- if no**
22 **stay is granted and the transaction closes as to your**
23 **employment?**

24 A. Probably be an at-large person looking for
25 employment within 30 days.

1 **Q. And if the six months free logs plan is done,**
2 **what is your expectation on your employment?**

3 A. I made a commitment in my proffer to stay as
4 the CEO during that period, if the Scopac board desires
5 my services.

6 **Q. Now, you're a forester and not a financial**
7 **person; isn't that right?**

8 A. Generally, yes, sir.

9 **Q. And as part of your job at Palco and**
10 **previously at Scopac, you were not responsible for**
11 **putting together the company's financial cash flows;**
12 **isn't that right?**

13 A. No, sir, I did not put together the financial
14 cash flows.

15 **Q. Now, I think you testified earlier that there**
16 **haven't been any major fires for a number of years on**
17 **the Scopac lands; is that right?**

18 A. Yes. Again, we burned approximately 3,000 to
19 3500 in 1990. Since that time we've had small fires
20 during the latest set of storms. We actually had four
21 fires ignited by lightning. I'm told that the combined
22 acreage before they were brought under control was
23 approximately 200 acres, sir.

24 **Q. And are you aware of when the last major fire**
25 **in Mendocino County was?**

1 A. No, sir, I'm not.

2 **Q. If I told you it was 1934, would that surprise**
3 **you?**

4 A. Yes, sir, it would.

5 **Q. The fire season is just getting underway;**
6 **isn't that right?**

7 A. Yes, sir.

8 **Q. And it's just getting started, and it**
9 **continues for a number of months in the future; isn't**
10 **that right?**

11 A. Yes, sir, until we've had approximately, say,
12 an inch and a half to two and a half inches of rain in
13 the fall, I think most people would argue you're still
14 in fire season, somewhere around that neighborhood.
15 That typically happens at least on the Scopac
16 timberlands by somewhere between the first and third
17 weeks of November, sir.

18 **Q. Now, if Scopac gives away its logs, it's going**
19 **to be unprofitable on a go-forward basis, isn't that**
20 **right?**

21 A. We have -- under the budget that we're
22 prepared, we have negative cash flow consistently for
23 the next six months, if that's what you mean, sir.

24 **Q. And are you aware of whether the mill can run**
25 **profitably on just the five million board feet per**

1 **month?**

2 A. I don't mean to be sort of a wag, but Palco
3 has never made money in the ten years since we signed
4 the HCP. It certainly has not been cash flow positive
5 under a one-shift configuration. So absent either free
6 logs or subsidized logs from Scopac, I don't believe
7 that a one-shift operation would be profitable, sir.

8 **Q. So by not having to pay for the logs, they may**
9 **have liquidity, but they won't necessarily be**
10 **profitable; isn't that right?**

11 A. I'm sorry, I may have misunderstood your
12 question. The whole issue of what constitutes --

13 THE COURT: We've got somebody on the
14 phone that's making some noise. I hope the court call
15 is still there. They can either get that mooted or the
16 party can keep quiet. Go ahead.

17 MR. KRUMHOLZ: I think the witness may
18 have been in the middle of his answer.

19 A. Yes, I'm sorry, I'm having to fess up to, you
20 know, my more basic financial understanding. I know
21 that the word "profitability" is a term of art to an
22 accounting or financial person. If you were to ask me
23 what that means, I would say that essentially the value
24 that you get for the products that you produce is
25 greater than the costs that go into it. That may be

1 right, that may be wrong, but that's what I'll offer
2 here at the stand off the top of my head. And on that
3 basis, I do not believe that Palco will be profitable
4 for the next six months. However, under the proposal to
5 use the Lehman DIP, they will be cash flow positive
6 because the -- they're not paying for the logs. If
7 they -- if you want to assume that the logs really have
8 a value of zero dollars, then you can argue that Palco
9 will be profitable. But, again, struggling to
10 understand what that term means, I assume that if you
11 wanted to analyze profitability, you'd have to look at
12 really what the fair market value of the log is. And if
13 you did that and you ran the numbers, you would find
14 that Palco is not going to be profitable for the next
15 six months, sir.

16 **Q. Thank you. Have you reviewed the indenture to**
17 **determine whether or not Scopac can engage in log sales**
18 **outside of the new master purchase agreement?**

19 A. I have not; no, sir.

20 **Q. Have you directed your counsel to do that?**
21 **Just yes or no. I don't want to know the advice they**
22 **have given you. I just want to know whether he's**
23 **recommended to do that?**

24 A. I have not recently directed them to do that.
25 At the time that the Scopac log deck motion was being

1 considered, I guess that was approximately 11 -- 10
2 months ago. I know that at that time counsel looked at
3 whether or not we could do log sales under the
4 indenture. But I have not asked that that be done
5 recently; no, sir.

6 **Q. I'd like you to review what's been put on the**
7 **screen, which is Exhibit IT 112.**

8 MR. NEIER: 112-A.

9 **Q. (By Mr. Brilliant) 112-A, which is the**
10 **indenture. And look at paragraph 14.17. Can you please**
11 **read it?**

12 A. Yes, sir. It says: Company timber sales.
13 All sales of company timber which are made by the issuer
14 to a specific lumberer shall be made pursuant to the new
15 master purchase agreement and related log purchase
16 agreements. All sales of company timber which are made
17 by the issuer to any other person (other than lump sum
18 sales pursuant to section 6.1 and 6.5) shall be made
19 pursuant to written purchase agreements satisfying the
20 criteria specified in Section 7-1(h)(1) of the deed of
21 trust.

22 **Q. Do you have an understanding as to whether or**
23 **not this provision of the indenture would -- is**
24 **currently operative, and whether it would prevent the**
25 **free log program from going into effect?**

1 A. Two questions there. The first is: No, this
2 isn't completely operative because the Court approved a
3 different way of dealing with log sales as part of the
4 Scopac log deck motion. As to whether or not this
5 language would govern in the proposal for what's --
6 we've been calling free logs, I'm sorry, sir, I don't
7 know if it's operative or not.

8 MR. BRILLIANT: I have no further
9 questions, Your Honor.

10 THE COURT: All right. California.

11 MR. PASCUZZI: Thank you, Your Honor.
12 Paul Pascuzzi for the California State Agencies.

13 CROSS-EXAMINATION

14 BY MR. PASCUZZI:

15 **Q. Good afternoon, Dr. Barrett.**

16 A. Good afternoon.

17 **Q. I believe Mr. Krumholz asked you if Scopac is**
18 **in compliance with all governmental regulations and**
19 **compliance with the HCP. Do you recall that?**

20 A. Yes, sir.

21 **Q. And your answer was yes; is that correct?**

22 A. He specifically -- yes, but I mentioned that
23 we do have THP violations and things like that, but that
24 there are no, to the best of my knowledge, any
25 accusations that are operations that are significantly

1 harming the environment, something close to that, sir.

2 **Q. Okay. And Mr. Neier asked you about road**
3 **maintenance and the backlog of road maintenance; is that**
4 **correct?**

5 A. Yes, sir.

6 **Q. Do you remember that? And you talked about**
7 **the certain period of time to clear out that road**
8 **maintenance. Otherwise, I think either he or you said**
9 **they'd be subject to citations and unpleasant actions?**

10 A. That was my testimony; yes, sir.

11 MR. PASCUZZI: Okay. Your Honor, if I
12 may approach?

13 THE COURT: Sure.

14 **Q. (By Mr. Pascuzzi) Dr. Barrett, do you**
15 **recognize what I've just handed you?**

16 A. Yes, sir.

17 **Q. And is it a letter dated May 1, 2008 from the**
18 **Department of Forestry and Fire Protection?**

19 A. Yes, sir.

20 **Q. Addressed to you?**

21 A. Yes, sir.

22 **Q. And it is a notice of violation of forest**
23 **practice laws; is that correct?**

24 A. Yes, sir.

25 **Q. And it alleges a violation of a THP involving**

1 **South Scotia flats; is that correct?**

2 A. Yes, sir.

3 **Q. And the main violation, I guess, or a**
4 **violation in there is failing to install culverts under**
5 **railroad tracks; is that correct?**

6 A. I don't know if it was a railroad track. It
7 looked more like a dirt road to me; but if that's what
8 it says, I'll go with that, sir.

9 **Q. Okay. And it's on page 2 in the comments**
10 **section. It also alleges the failure to install the**
11 **culverts has caused water to overtop the railroad tracks**
12 **and the road in the comments section on page 2; is that**
13 **correct?**

14 A. I see that; yes, sir.

15 **Q. It alleges the failure to perform maintenance**
16 **on the culverts as well?**

17 A. Yes, sir.

18 **Q. And this could be something that there could**
19 **be fines for these violations, is that correct?**

20 A. Yes, sir.

21 **Q. And Palco is also on the hook for these**
22 **violations in addition to Scopac; is that correct?**

23 A. All correspondence comes to Scopac, but I
24 would assume that at least historically we've been a
25 wholly-owned subsidiary that the liability would accrue

1 to Palco as well, sir.

2 Q. Well, isn't it direct that Palco and Scopac
3 are both parties to the HCP and that violations of the
4 THPs cause violations of the HCP; is that correct?

5 A. No. Actually -- first of all, they are both
6 parties to the HCP. But it is certainly possible to
7 have a violation on a THP that is not a violation of the
8 HCP. Sometimes a violation will accrue to both the THP
9 and HCP and sometimes not, sir.

10 Q. And the work that's required for this
11 particular violation, it cannot be done without amending
12 THP or otherwise getting approval in a new THP; is that
13 correct?

14 A. Yes, sir. Under California law, any kind of
15 substantial roadwork has to go through what's called
16 California Environmental Quality Act, CEQA or CEQA
17 equivalent environmental review. In practice, no one
18 does EIS's and -- excuse me, EIR's and EA's, so they use
19 the THP, which is deemed a CEQA equivalent document to
20 do that compliance, sir.

21 Q. Dr. Barrett, are you also aware of some
22 alleged violations of cleanup and abatement orders by
23 the California State Water Resources Control Board?

24 A. Yes, sir.

25 Q. And are you in discussions with those folks

1 **about resolving those violations?**

2 A. Yes, sir.

3 **Q. And there will likely be fines for those**
4 **violations?**

5 A. Yes, sir.

6 **Q. And do you know how much?**

7 A. There's a proposal that would total
8 approximately \$500,000.

9 **Q. You were asked some questions about the timber**
10 **harvesting, I believe, for the balance of the year for**
11 **Scopac by Palco's counsel. Do you recall that?**

12 A. Yes, sir.

13 **Q. Isn't it fair to say that most of Scopac's**
14 **remaining harvest for the balance of this year relates**
15 **to Tier II THPs?**

16 A. No, sir.

17 **Q. Are they -- does it relate to THPs that have**
18 **already been approved?**

19 A. Yes, sir.

20 **Q. Okay. Then -- just a couple more questions.**
21 **Do I under your testimony correctly that Scopac can**
22 **survive the rest of this year, 2008, with the DIP and**
23 **the free log program, as we're calling it?**

24 A. Yes, sir. That is my testimony.

25 **Q. I mean, you're not testifying and you're not**

1 **saying in your proffer that Scopac can survive without**
2 **the DIP; is that correct?**

3 A. I don't say that in my proffer. But just to
4 be clear, if there's no free log program, Scopac can
5 survive, in my opinion. If there is a free log program,
6 Scopac cannot survive without external funding, be it a
7 DIP or other source.

8 **Q. And I don't believe your proffer says that**
9 **Scopac and Palco will be able to comply with all their**
10 **environmental obligations during an extended stay**
11 **without the DIP, correct?**

12 A. It does not say that in my proffer; no, sir.

13 **Q. And quickly on the fires issue. Do you keep**
14 **track of the fires going on in northern California?**

15 A. Yes, sir.

16 **Q. And do you go to the website, the Department**
17 **of Forestry and Fire Protection official website at**
18 **fire.ca.gov? Is that where you --**

19 A. I don't. I have staff that do. I tend to go
20 to things like cnn.com, sir.

21 **Q. Are you aware that there are fires in Humboldt**
22 **County right now?**

23 A. No, sir, I was not.

24 **Q. And are you aware that there are fires in**
25 **other northern California counties?**

1 MR. KRUMHOLZ: I'll object. Assumes
2 facts not in evidence.

3 MR. PASCUZZI: I'm asking if he's aware.

4 MR. KRUMHOLZ: Well, he's asking if he's
5 aware as a fact, not if there are. If you assume that
6 there are, it assumes facts not in evidence.

7 THE COURT: I think he can ask him if
8 he's aware that there are fires in Humboldt County.

9 MR. KRUMHOLZ: It assumes facts that may
10 not be true.

11 THE COURT: Well, he's asking if he's
12 aware. I mean, if he's not aware -- if he's aware,
13 he'll say, yeah, I'm aware there's a fire in Humboldt
14 County. If he's not aware, he won't. But it still
15 isn't testimony whether there is or isn't a fire; it's
16 just whether he's aware of one.

17 Q. (By Mr. Pascuzzi) Dr. Barrett, are you aware
18 there are in Butte County?

19 A. Yes, sir, I've heard about that county.

20 Q. And Butte County is in northern California?

21 A. Yes, sir.

22 Q. Are you aware there are fires in Shasta
23 County?

24 A. I've heard that as well; yes, sir.

25 Q. Trinity County?

1 A. Yes, sir.

2 Q. Glenn County?

3 A. I didn't know about that one; no, sir.

4 Q. Santa Clara County?

5 A. I also didn't know. Actually, I did know
6 about that one; yes, sir.

7 Q. Napa?

8 A. I heard about the Napa fire, yes.

9 Q. Solano?

10 A. The Napa fire, I think, went into Solano, so,
11 yes, sir.

12 Q. Tehama?

13 A. Didn't know about that one; no, sir.

14 Q. All of the counties I just mentioned are in
15 northern California, correct?

16 A. Yes, sir.

17 MR. PASCUZZI: No further questions, Your
18 Honor.

19 MR. TENEBBAUM: Your Honor?

20 THE COURT: Yes.

21 MR. TENEBBAUM: This is Alan Tenebaum from
22 the Department of Justice. I represent the federal
23 wildlife agencies. I just have a few questions,
24 Dr. Barrett.

25 THE WITNESS: Yes, sir.

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CROSS EXAMINATION

BY MR. TENEBBAUM:

Q. Has Scopac -- does it have a monitoring contract in place in order to comply with various regulatory requirements for monitoring of conditions in the environment?

A. Sir, we actually have several. Some are conducted internally. And we choose sometimes to use contractors to do that monitoring or to assist us with that. For example, roads monitoring. So those would be contracts that we have with external parties. We also have a contract called the HCP monitor contract, which is between us and the HCP agency, specifically the U.S. Fish and Wildlife Service, and that's to fund a third-party monitor of the company's timberlands.

Q. Thank you. Has Scopac recently asked to reduce the amount of monitoring under any of these contracts?

A. Not asked to reduce the amount of monitoring on any of our internal contracts. On the HCP monitor contract, we've requested a reduction in funding, sir.

Q. A reduction in funding?

A. Yes, sir. A reduction in the amount of funds that we provide for the maintenance of that program, sir.

1 **Q. And that would result in a lowering of the**
2 **amount of monitoring from what you've done in the past**
3 **during the bankruptcy case?**

4 A. Well, we don't do that monitoring, sir. It's
5 done by third parties. I don't know how the agencies
6 would adapt the program to lower funding levels,
7 although we have recommendations. But I think it's fair
8 to say fewer dollars would probably result in less
9 monitoring overall. Yes, sir.

10 **Q. So in the event that a stay is granted, if it**
11 **is, will Scopac be agreeing to the same level of funding**
12 **for monitoring that has been provided during the**
13 **bankruptcy case or will it be seeking a reduction in**
14 **that funding during that stay period?**

15 A. Sir, our last proposal to the state and
16 federal HCP agencies is that we would continue the
17 historic level of funding through the end of the year to
18 allow all of us to work collectively to develop an
19 alternate program that would begin funding at a lower
20 level in January 1. So through the end of the year it
21 would be the same funding level. After January 1, we're
22 proposing a lower funding level, sir.

23 **Q. So if they were to extend that, it would be a**
24 **reduction in monitoring?**

25 A. If the stay were to extend past January 1,

1 then we are proposing a reduction in funding. But
2 that's not a unilateral decision that we make. It's a
3 decision we make through negotiations with the agency,
4 so nothing's been finalized, sir.

5 **Q. Okay. Do the regulators require certain**
6 **financial adjusts to comport with the regulatory**
7 **requirements under the law?**

8 A. Yes, sir, the HCP has a bond, a performance
9 bond that has to be reposted each year, sir. I believe
10 it's currently about \$2.2 million, if I recall
11 correctly.

12 **Q. Is that the certificate of deposit issued by**
13 **Bank of America?**

14 A. Yes, sir. That's my understanding.

15 **Q. Is that certificate currently in effect and**
16 **enforceable, or has it not been renewed?**

17 A. No, sir. I saw a notification from Frank
18 Bacik, our in-house counsel, about that long ago, that
19 it had been renewed, sir.

20 **Q. Okay. If they do and it is granted, will**
21 **Scopac continue as any financial assurance, including**
22 **the certificate of deposit issued by Bank of America in**
23 **effect in the same amount?**

24 A. Yes, sir. My testimony earlier is that we
25 would maintain, I think I called it, status quo

1 operations and -- on the properties. So if I wasn't
2 inclusive enough, let me say explicitly that we would
3 continue to meet all of our environmental obligations,
4 including that funding commitment of the HCP is my
5 understanding of the way we would operate during the
6 duration of the stay, sir.

7 MR. TENEBBAUM: Thank you.

8 THE COURT: Anyone else? Anything else?

9 MR. KRUMHOLZ: Yes, Your Honor.

10 MR. FROMME: I just have a clarification,
11 Your Honor.

12 RE-CROSS-EXAMINATION

13 BY MR. FROMME:

14 Q. Dr. Barrett, do you recall some questions
15 about selection harvesting that MRC proposed, proposed
16 to do if it obtains ownership of Scopac's timberlands?

17 A. Yes, sir.

18 Q. And you -- you testified that if Scopac were
19 to adopt that, you would require amendments to THPs; is
20 that right?

21 A. Yes, sir. Not all THPs -- well, for the
22 Court, I've given testimony on prior occasions that
23 Scopac does do selection harvest of its own accord.
24 However, the majority of the harvest we do is
25 nontraditional clearcutting. To go to a selection only

1 harvest method would require an amendment of the THPs.
2 I'm advised by my staff that they believe that would be
3 a major amendment. That would require recirculation for
4 public review and a minimum of anywhere between 30 and
5 45 days. If they could be processed as minor amendments
6 then after they were submitted to CDF, they could be
7 approved in short order. But in any case, it would
8 require rewriting the THPs or, excuse me, preparing what
9 are called amendments to the THPs to change the
10 silvicultural methods, sir.

11 **Q. If MRC were to take control of the Scopac**
12 **timberlands and their plan confirmed, would MRC be**
13 **required to amend those THPs as well?**

14 A. Yes, sir. That applies regardless to who owns
15 the lands, sir.

16 **Q. Would the selection harvesting that MRC**
17 **proposes require any amendments to Scopac's current**
18 **Option A?**

19 A. Yes, sir. Our Option A -- our Option A
20 currently requires that intensive silviculture,
21 intensive silviculture methods be used where feasible.
22 There's lots of element, but relative to the key
23 question that you're asking here, it requires that
24 so-called even aged management methods or clearcutting,
25 even in the nontraditional form that we practice it,

1 have to be exercised on the lands where the tree stands
2 are suitable for such treatment. If MRC wants to go to
3 a selection only regime for such stands, they're going
4 to have to modify their Option A. And I will say the
5 last time we modified our Option A, it took the better
6 part of nine months, sir.

7 Q. And if -- well, just to be clear, if Scopac
8 were to attempt to do the selection harvesting as
9 proposed by MRC during the stay period, it would need
10 to -- it would need to seek modification of the Option
11 A; is that right?

12 A. Likely. I mean, the part you know for sure is
13 that you would have to meet with CDF and see how they
14 would want to address the issue. I assume that they
15 would want to see the Option A modified, but they're the
16 regulatory body. It will be up to them to decide, sir.

17 Q. I forget who actually asked you some questions
18 about Tier II approvals. Do you recall that, sir?

19 A. Yes, sir.

20 Q. Has Scopac obtained approval to harvest in
21 Tier II areas or obtained Tier II approvals in the past
22 years?

23 A. Yes, sir. In each of the past two years we've
24 received Tier II approvals.

25 Q. Has Scopac received any Tier II approvals this

1 **year?**

2 A. No, but the good news is Mike Miles, one of
3 the staff that reports to me, sent an e-mail saying that
4 the water board assured him that we're about to get our
5 first Tier II approvals for 2008. And I think I said
6 earlier that's somewhere in the neighborhood of about
7 five months earlier than we received them last year.

8 **Q. Now, Mr. Pascuzzi asked you some questions**
9 **about -- I think it was a THP violation; is that**
10 **correct?**

11 A. Yes, sir.

12 **Q. Is that a significant -- is that causing a**
13 **significant impact on the environment in Scopac lands,**
14 **in your opinion?**

15 A. No. I don't think so. I think it's worth
16 pointing out we get violations every year. Every
17 landowner gets violations. I'm confident MRC does as
18 well. Many of them have no real significant
19 environmental impact. This particular one, which my
20 staff took me out to see because CDF was considering how
21 best to deal with the issue given that the -- there is
22 not currently a THP that will let us do roadwork, it
23 looks like it moved probably about nine or ten cubic
24 yards of sediment into the Eel River.

25 However, you have to understand the Eel River,

1 which is as I recall correctly -- well, first of all,
2 it's an enormous river. Secondly, this occurred during
3 a flood when the sediment loads in the Eel River were
4 already extraordinarily. Those that live in Humboldt
5 County know what that looks like. So my view is the
6 amount of sediment was modest, but more importantly it
7 went into a receding water body during a flood that was
8 already extremely high in sediment, so I doubt there was
9 much high environmental impact, sir.

10 Q. I'm sorry to make a big point of this, Your
11 Honor, but I just want to make sure you understand there
12 were a lot of questions about fires in northern
13 California. And Mr. Pascuzzi went through whether you
14 were aware of potential fires in some counties in
15 northern California. Do you remember that?

16 A. Yes, sir.

17 Q. And some of those counties were hundreds of
18 miles away from Humboldt County. Do you recall?

19 A. Yes, sir.

20 Q. For example, Santa Clara County is on the
21 other side of San Francisco Bay?

22 A. Yes, sir.

23 MR. FROMME: I have no further questions,
24 Your Honor.

25 THE COURT: All right.

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REDIRECT EXAMINATION

BY MR. KRUMHOLZ:

Q. Dr. Barrett, Mr. Litvak asked you a number of different questions about six months out what may or may not happen under the IT?

MR. McDOWELL: Are we going to -- we're allowing recrosses today?

THE COURT: Well, I'm not sure. These two are sort of aligned, and so he started it, so I'm letting him finish. And he's got about ten minutes. So you sit down. You ask your questions.

Q. (By Mr. Krumholz) Dr. Barrett, Mr. Litvak talked about that this only goes out six months and do you know how long an appeal is. Do you remember that line of questioning?

A. Yes, sir.

Q. And do you understand that the IT is proposing that the Court revisit the issue in November or early December to determine if further funding is needed?

A. Yes, sir, I do understand that.

Q. And if indeed further funding is needed, the IT can then, of course, continue with the bond and the stay pending appeal, if that were to be approved, right?

A. Yes, sir.

THE COURT: I understand all of that,

1 although tomorrow I want you to tell me how we can ever
2 do that because once this is on appeal, I don't think I
3 have any control.

4 MR. KRUMHOLZ: You do. We have
5 researched it.

6 THE COURT: Okay.

7 MR. KRUMHOLZ: They're not making a
8 commitment. They're saying they can do it.

9 THE COURT: I understand. But I just
10 want to know if I have the jurisdiction to do it. And
11 you say I do. Okay.

12 MR. KRUMHOLZ: You do.

13 THE COURT: Go ahead.

14 **Q. (By Mr. Krumholz) And, of course, if there is**
15 **going to be funding after that point, it can close**
16 **immediately because the appeal will -- or the stay will**
17 **terminate; is that your understanding?**

18 A. I'm sorry, you lost me. Please reask the
19 question.

20 THE COURT: That's my understanding, so
21 let's move on.

22 MR. KRUMHOLZ: Okay.

23 **Q. (By Mr. Krumholz) Now, Mr. Neier asked you**
24 **questions about -- something about I think \$6 million**
25 **worth of roads and reforestation work, some of which**

1 goes back log issues; do you recall those questions?

2 A. Yes, sir.

3 Q. And if Palco actually took -- excuse me, if
4 MRC and Marathon took possession in the near future in a
5 month or so, they would need to do that work on their
6 dime, right?

7 A. Yes, sir.

8 Q. But under this proposal actually the DIP
9 covers much of that?

10 A. Yes, sir, for the next six months.

11 Q. And then if and when the stay ends or the
12 appeal is decided, if there's any additional work that
13 needs to be done, only that portion would be paid by
14 Marathon and MRC presumably?

15 A. Yes, sir. I would assume that's true.

16 Q. Okay. Now, Mr. Neier also asked you questions
17 about loss of personnel at Palco and loss of personnel
18 at Scopac. I just want to make sure we're being very
19 clear here. Is there going to be any significant loss
20 of personnel to the extent that you will not be able to
21 operate Scopac through December 31, 2008 with
22 appropriate personnel if you were to adopt the IT
23 proposal?

24 A. No. I testified earlier that I do not believe
25 staff losses will keep us from being able to maintain

1 the status quo for Scopac. I also don't believe that it
2 will affect the status quo at Palco. The key managers,
3 the key staff have been amazingly loyal throughout all
4 of this. If one looks at it from an employee's point of
5 view, in some ways the stay offers a greater level of
6 certainty than we've had for the last month or two. You
7 know, for at least six months and perhaps longer than
8 that that the existing management team has the funds and
9 ability and logs to run the respective organizations,
10 Palco and Scopac. So, of course, I expect other people
11 to leave. I certainly do not expect to lose the ability
12 to run either my business or for Hughey to run Palco,
13 sir.

14 Q. Okay. So I want to go to a little bit
15 different line of question from Mr. McDowell. And
16 specifically with respect to what you are or are not
17 going to be providing to Palco.

18 If this Court puts in the order that you will
19 provide blank number of redwood logs and other logs to
20 Palco up to 5 million board feet, and you can do it
21 pursuant to your THPs, do you fully intend to do so?

22 A. Absolutely, sir.

23 Q. Do you have any doubt in your mind at all that
24 Scopac can provide sufficient types and quantities of
25 logs to keep Palco running under this so-called free log

1 **program through the end of December 2008 with the DIP**
2 **facility in place?**

3 A. Well, I've previously testified that once you
4 get into the rainy season, predictions are difficult.
5 So I'm not going to say to you that there's a 100
6 percent that we will be able to keep Palco at 5 million
7 board foot a month between now and the end of the year.
8 That said, we already have about 4 million on the deck
9 waiting for Palco to use them. We're bringing in, as I
10 said earlier, about a million and a half a week. That's
11 going to go to 2 million soon. We have most of our THP
12 permits in place. We have logging contractors doing the
13 work, and we're about to get our first Tier II permits.
14 Those are all, you might say, good tail winds, so my
15 confidence is we'll be able to keep the mill supplied in
16 logs. It's good. It's higher than frankly it's been
17 during some of my task period of working Scopac and
18 being responsible to keep the mill going.

19 I just in the name of total disclosure want to
20 acknowledge that some of the harvest that we're planning
21 is in late October and November when if rains come
22 early, we might trip up a little bit. That said, if you
23 look at my proffer, we actually have more wood in the
24 next six months coming in than Palco is expected to use,
25 especially if one considers that there's normally a

1 maintenance furlough during the winter months. So there
2 is some cushion built in. And I'm sorry if I'm talking
3 too much. I have good to high confidence. I cannot
4 guarantee it, however, sir.

5 Q. I want to get to one other issue. If -- I
6 guess, let me -- let me put it to you a different way.
7 Well, first of all, you don't foresee any reason under
8 your control anyway that you wouldn't -- that you
9 wouldn't be able to deliver the quantity and types of
10 logs necessary for Palco to operate?

11 A. No, sir, I do not.

12 Q. Under the current plan proposed by the
13 indenture trustee; is that correct?

14 A. No, sir, I do not.

15 Q. Okay. And there was a line of questions about
16 the employment, and what I gathered was they were
17 suggesting that you were testifying the way you are or
18 that you were in favor of this plan because of your own
19 personal interest, employment interest. Do you recall
20 those questions?

21 A. Yes, sir.

22 Q. Is that the reason why you're in favor of this
23 plan?

24 A. No, sir.

25 Q. You have a fiduciary duty to the creditors of

1 **Scopac?**

2 A. Yes. I've been led to understand that that
3 duty requires me to do the most that I can to maximize
4 the return to the noteholders. They are the major
5 creditor, and also the unsecured creditors. And those
6 noteholders believe very strongly that their total
7 recoveries will be greater if they pursue an appeal and
8 win that appeal than if not. Consequently, as the CEO
9 of Scopac and officer of same, I have a duty to try and
10 represent that fiduciary desire, if you will, sir.

11 **Q. Does it have anything to do with your personal**
12 **interest in employment at Scopac over the next six**
13 **months?**

14 A. Well, I'd be lying if I didn't say it will be
15 better to be employed than not employed, but --

16 **Q. Does your testimony impacted by that?**

17 A. No, sir, of course not.

18 MR. KRUMHOLZ: Pass the witness.

19 MR. McDOWELL: Your Honor, just as
20 procedural matter, I would like to move for admittance
21 of Palco Exhibit 1. It was used during the --

22 THE COURT: What is Palco Exhibit 1?

23 MR. McDOWELL: The e-mail that --

24 THE COURT: Any objection?

25 MR. HOLZER: It would be 7 on our list.

1 MR. FROMME: No objection, Your Honor.

2 MR. McDOWELL: Excuse me, Palco Exhibit

3 7.

4 THE COURT: It's admitted.

5 MR. NEIER: We would like to move for
6 admission of --

7 THE COURT: I wish by tomorrow morning
8 everybody have whatever exhibits they want numbered and
9 ready to go, and let me know whether anybody wants to
10 object to them. All right. We'll start at 8:30 in the
11 morning.

12 MR. HOLZER: Your Honor, just one
13 procedural matter. We're filing tonight a motion to
14 make another Palco pension plan payment. I've waited --

15 THE COURT: You say that three times in a
16 row quickly.

17 MR. HOLZER: I hope not. And we'd like
18 to bring that up tomorrow, if we have a break.

19 THE COURT: If we have time for it, we
20 will do that. We're going to get this one done. Thank
21 you.

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1 THE STATE OF TEXAS:

2 COUNTY OF NUECES:

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4 I, SYLVIA KERR, Certified Court Reporter in and for
5 the State of Texas, do hereby certify that the above
6 foregoing contains a true and correct transcription, to
7 the best of my ability, of all portions of evidence and
8 other proceedings requested in writing by counsel for
9 the parties to be included in this volume of the
10 Reporter's Record in the above-styled and numbered
11 cause, all of which occurred in open court and were
12 reported by me.

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Date of Expiration: 12/31/08

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