Case No. 09–40307

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: SCOPAC; SCOTIA DEVELOPMENT LLC; SALMON CREEK LLC; SCOTIA INN INC; BRITT LUMBER COMPANY, INC; THE PACIFIC LUMBER COMPANY; STEVE WILLS TRUCKING AND LOGGING LLC,

Debtors

BANK OF NEW YORK TRUST COMPANY NA, as Indenture Trustee for the Timber Notes ("Indenture Trustee"); CSG INVESTMENTS INC; ANGELO, GORDON & COMPANY L.P.; AURELIUS CAPITAL MANAGEMENT, L.P.; DAVIDSON KEMPNER CAPITAL MANAGEMENT LLC; SCOTIA REDWOOD FOUNDATION INC,

Appellants,

v.

PACIFIC LUMBER COMPANY; SCOTIA PACIFIC LLC; MARATHON STRUCTURED FINANCE FUND LP; MENDOCINO REDWOOD COMPANY LLC; COMMITTEE OF UNSECURED CREDITORS; BANK OF AMERICA,

Appellees.

ANGELO, GORDON & CO LP; AURELIUS CAPITAL MANAGEMENT LP; DAVIDSON KEMPNER CAPITAL MANAGEMENT LLC,

Appellants,

v.

MARATHON STRUCTURED FINANCE FUND LP; MENDOCINO REDWOOD COMPANY LLC; COMMITTEE OF UNSECURED CREDITORS; BANK OF AMERICA; SCOTIA PACIFIC LLC; PACIFIC LUMBER COMPANY,

Appellees.

CSG INVESTMENTS, INC,

Appellant,

v.

SCOTIA PACIFIC LLC; PACIFIC LUMBER COMPANY,

Appellees.

SCOTIA REDWOOD FOUNDATION, INC.,

Appellant,

v.

SCOTIA PACIFIC LLC; PACIFIC LUMBER COMPANY,

Appellees.

Appeal from the United States District Court
for the Southern District of Texas, Corpus Christi Division
No. 08-259

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CERTIFICATE OF INTERESTED PERSONS
PER FIFTH CIRCUIT LOCAL RULES 26.1.1, 27.4, AND 28.2.1

(1) 09-40307: *In the Matter of: Scopac; Scotia Development LLC; Salmon Creek LLC; Scotia Inn Inc.; Britt Lumber Company, Inc.; The Pacific Lumber Company; Steve Wills Trucking and Logging LLC, Debtors. The Bank of New York Trust Company, N.A., as Indenture Trustee for the Timber Notes ("Indenture Trustee"); CSG Investments Inc.; Angelo Gordon & Co. L.P., Aurelius Capital Management, L.P.; Davidson Kempner Capital Management LLC; Scotia Redwood Foundation, Inc., Appellants,* v. *Pacific Lumber Company; Scotia Pacific LLC; Marathon Structured Finance Fund LP; Mendocino Redwood Company LLC; Committee of Unsecured Creditors; Bank of America, Appellees. Angelo Gordon & Co. LP; Aurelius Capital Management LP; Davidson Kempner Capital Management LLC, Appellants* v. *Marathon Structured Finance Fund LP; Mendocino Redwood Company LLC; Committee of Unsecured Creditors; Bank of America; Scotia Pacific LLC; Pacific Lumber Company, Appellees. CSG Investments, Inc., Appellant* v. *Scotia Pacific LLC; Pacific Lumber Company, Appellees. Scotia Redwood Foundation, Inc., Appellant* v. *Scotia Pacific LLC; Pacific Lumber Company, Appellees*.

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

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STATEMENT REGARDING ORAL ARGUMENT

Oral argument has not yet been scheduled in this case. Oral argument would significantly aid this Court's decisional process. See Fed. R. App. P. 34(a)(2)(C).

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STATEMENT OF JURISDICTION

On July 8, 2008, the United States Bankruptcy Court for the Southern District of Texas entered an Order Denying the Indenture Trustee's Motion for a Superpriority Administrative Expense Claim Pursuant to Section 507(b) (the "507(b) Order"). On July 9, 2008, Appellants filed notices of appeal of that Order to the United States District Court for the Southern District of Texas, which had jurisdiction under 28 U.S.C. § 158(a)(1).

On February 6, 2009, the district court dismissed that appeal. On February 17, 2009, Appellants sought rehearing under Bankruptcy Rule 8015. On March 9, 2009, Appellants timely filed a protective notice of appeal to this Court. On April 27, 2009, this court stayed briefing pending the district court's disposition of the rehearing motion. The district court denied that motion on November 12, 2009. On November 30, 2009, Appellants filed an amended notice of appeal also seeking review of the denial of the rehearing motion. See Fed. R. App. P. 6(b)(2)(a)(ii). This Court has jurisdiction under 28 U.S.C. §§ 158(d)(1), 1291.

ISSUES PRESENTED

1. Whether the district court had jurisdiction to hear an appeal from the bankruptcy court's 507(b) Order, while the appeal of a separate order confirming a reorganization plan was pending before this Court.

2. Whether, if the district court did not have jurisdiction, it erred by failing to transfer the appeal to this Court pursuant to 28 U.S.C. § 1631.

3. Whether the bankruptcy court reversibly erred in calculating the Indenture Trustee's superpriority administrative claim by refusing to credit the Indenture Trustee for $29.7 million in proceeds from Scopac's post-petition sale of timber encumbered by the Indenture Trustee's liens, while improperly deducting $8.9 million in professional fees paid to the Indenture Trustee to cover part of its expenses during the bankruptcy proceedings.

4. Whether the bankruptcy court reversibly erred in comparing the *foreclosure* value of Scopac's timberlands on the petition date to the *fair market* value of that asset when the court confirmed a reorganization plan 18 months later in determining whether the value of the Indenture Trustee's collateral had diminished during that time.

5. Whether the bankruptcy court reversibly erred by determining the timberlands' value on the petition date using information that was available to an appraiser or buyer only in hindsight.

STANDARDS OF REVIEW

When acting as a second level of appellate review in a bankruptcy case, this Court reviews both the bankruptcy court's and district court's conclusions of law

de novo. *Mendoza* v. *Temple-Island Mortgage Corp.* (*In re Mendoza)*, 111 F.3d 1264, 1266 (5th Cir. 1997). Mixed questions of law and fact, and the application of law to facts, are also reviewed *de novo*. *Westcap Enters.* v. *City Colleges of Chicago* (*In re Westcap Enters.)*, 230 F.3d 717, 725 (5th Cir. 2000) (citing *Bass* v. *Denney* (*In re Bass)*, 171 F.3d 1016, 1021 (5th Cir. 1999)). Pure findings of fact are reviewed for clear error. *Ibid*.

STATEMENT OF THE CASE

This is an appeal from a bankruptcy court's order denying the Indenture Trustee's superpriority administrative expense claim under 11 U.S.C. § 507(b), and from a district court order dismissing the appeal of that order.

The Bankruptcy Code requires that secured creditors be compensated for any diminution in the value of their collateral that occurs while they are prevented from foreclosing or exercising other remedies by the automatic stay that arises upon the filing of a bankruptcy case (see 11 U.S.C. § 362(a)(4)), or while the debtor continues to use the secured creditor's "cash collateral" under 11 U.S.C. § 363(c). As a first line of defense against such a decrease in value, the Bankruptcy Code requires that a secured creditor receive "adequate protection" for the value of its collateral. *Id.* §§ 362(d)(1), 363(e), 364(d)(1)(B). That adequate

protection can take several forms, including periodic cash payments or the grant of replacement liens. *Id.* § 361.

But adequate protection can turn out to be *inadequate*, leaving a secured creditor short-changed. Section 507(b) is designed to compensate for such shortfalls by providing superpriority status to a secured creditor's administrative claim for the amount of the decrease. This case involves just such a shortfall.

When Scotia Pacific Company LLC ("Scopac") filed for Chapter 11 relief on January 19, 2007 (the "Petition Date"), the Indenture Trustee held a lien on substantially all of Scopac's assets, consisting primarily of (1) 209,000 acres of forest in Northern California (the "Timberlands"); and (2) certain cash and cash equivalents, plus the proceeds from any future sales of timber harvested from the Timberlands (the "Cash Collateral"). That lien secured an approximately $740 million debt owed to noteholders ("Noteholders")—certain of whom (along with the Indenture Trustee) are the Appellants here—under notes (the "Notes") issued pursuant to a July 20, 1998, indenture (the "Indenture").

After its Chapter 11 filing, Scopac obtained the right to use the Indenture Trustee's Cash Collateral, and in return provided the Indenture Trustee with purportedly "adequate protection" against any decline in the value of its collateral in the form of replacement liens granted under multiple cash collateral orders

entered during the 18-month stay. See Dkt-25, Dkt-74, Dkt-308, Dkt-454, Dkt-864, Dkt-2485 (the "Cash Collateral Orders").[1] Scopac never suggested that the Indenture Trustee was undersecured (*i.e.*, that the Indenture Trustee's collateral was worth less than the $740 million claim). Quite the contrary: In a September 30, 2007, joint disclosure statement, the Debtors represented that the secured creditors were significantly *over*secured, Dkt-1498 at 1, and the bankruptcy court noted "indications" as late as December 2007 that the Timberlands' value was "way more than" the Indenture Trustee's claim, Appellant 172 at 86:10-12.

But when Mendocino Redwood Company ("MRC")—a competing lumber company—and Marathon Structured Finance Fund, L.P. ("Marathon," and collectively "MRC/Marathon") proposed a reorganization plan for Scopac in January 2008, they contended that the Indenture Trustee's collateral was worth significantly *less* than the debt it secured, and so they could essentially purchase that collateral (free of the Indenture Trustee's lien and over its objection) by paying the Indenture Trustee far less than the amount outstanding on the Notes. In June 2008 (17 months after the Petition Date), the bankruptcy court agreed, concluding that by then (1) the Timberlands were worth "not more than $510 million" and

[1] Citations to the Record, Third Supplemental Record, and Fourth Supplemental Record are indicated as R:[page], R3d:[page], and R4th:[page], respectively. Citations to the Second Supplemental Record are either to the bankruptcy court docket number ("Dkt-[number]") or to the Appellants' or Appellees' designation (listed at R3d:32-68 and R3d:82-128).

(2) Scopac's Cash Collateral had been almost entirely depleted. Dkt-3088 at 61, 63-64. Over the Indenture Trustee's objection, the bankruptcy court entered an order confirming the MRC/Marathon Plan ("Confirmation Order") and its $513.6 million payment on the now-undersecured $740 million Notes claim, leaving $226 million unpaid. The Indenture Trustee appealed the Confirmation Order directly to this Court (the "Confirmation Appeal"), which affirmed in part and reversed in part. *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009).

The bankruptcy court premised that June 2008 valuation of the Timberlands on a "significant[]," 10-15% drop in log prices in the six months preceding confirmation, attributing that decline to "the economic slowdown, particularly in the housing market, which ha[d] resulted in a decline in building and remodeling activity." Dkt-3088 at 36 ¶ 111; see also *id.* at 45 ¶ 156. In a different 507(b) Order, however, the bankruptcy court denied the Indenture Trustee's Section 507(b) claim for compensation for the diminution in the value of its collateral during the pendency of the bankruptcy proceedings. Excerpt-G. First, it considered whether there had been a diminution in the value of the Cash Collateral without accounting for timber-sale profits generated during the 18-month stay and subject to the Indenture Trustee's liens, which represented *additional* Cash Collateral; and it *deducted* payments Scopac made after the Petition Date to

reimburse some of the Indenture Trustee's fees for bankruptcy professionals. Second, the court compared the Timberlands' *foreclosure* value on the Petition Date to their *fair market* value at confirmation, and held that there was no diminution in value.

When it appealed the Confirmation Order directly to this Court, the Indenture Trustee simultaneously appealed that separate 507(b) Order to the district court (the "507(b) Appeal"). The 507(b) Appeal asserted that—even if the MRC/Marathon Plan had been properly confirmed—the bankruptcy court erred in holding that the Indenture Trustee's collateral did not decline in value between the Petition Date and confirmation. In a two-page order, the district court dismissed the 507(b) Appeal for lack of jurisdiction, reasoning that the Confirmation Order "expressly incorporate[d]" the 507(b) Order and that the latter was "an integral part" of the former. Excerpt-D. The Indenture Trustee sought rehearing under Bankruptcy Rule 8015, explaining that the remedy for such a perceived jurisdictional defect was to transfer the case to this Court pursuant to 28 U.S.C. § 1631. The district court denied rehearing. Excerpt-E; Excerpt-F.

STATEMENT OF FACTS

1. *Background*. In 1998, the Pacific Lumber Company ("Palco") created Scopac for the sole purpose of transferring to the new entity its most valuable

assets to serve as bankruptcy-remote, high-quality collateral for a substantial round of secured financing. Pursuant to the Indenture, Scopac issued and sold $867.2 million in Notes secured by liens encumbering virtually all of its assets, principally the Timberlands and Cash Collateral. Thereafter, Scopac's operations consisted almost entirely of selling timber harvested from the Timberlands and using the proceeds to make payments on the Notes.

On the Petition Date, January 18, 2007, Scopac filed a Chapter 11 bankruptcy petition. At that time, it owed approximately $740 million on the Notes. (Palco and four of its affiliates filed separate petitions.)

2. *Cash Collateral Orders and Adequate Protection*. The next day, Scopac asked the bankruptcy court for interim and final orders authorizing it to use the Cash Collateral to pay its expenses during the proceedings. Dkt-17. In return for such authorization, Scopac agreed to provide its secured creditors with "adequate protection . . . to the extent of any diminution in the value of their respective interests" in the collateral. *Id.* at 11.

The bankruptcy court entered an interim Cash Collateral Order the same day. Dkt-25. That order approved Scopac's use of Cash Collateral on the condition that Scopac provide "adequate protection" for the Indenture Trustee's security interests in the collateral by the grant of a first-priority, perfected

replacement lien on Scopac's assets to the extent of any diminution of the Indenture Trustee's interest in its collateral—specifically including the "product and *proceeds* of the Prepetition Collateral" (principally the Timberlands and the timber grown thereon). *Id.* at 5, 7 (emphasis added). The bankruptcy court also granted the Indenture Trustee a 507(b) Claim to the extent of any such diminution. *Id.* at 5. Subsequent Cash Collateral Orders—entered over the Indenture Trustee's objection (see, *e.g.*, Dkt-189 at 4)—provided purportedly "adequate protection" nearly identical to that outlined in the first interim order (see Dkt-74, Dkt-308, Dkt-454, Dkt-863, Dkt-2485), in some instances adding that Scopac could pay the Indenture Trustee's reasonable professional fees as "additional adequate protection" (see, *e.g.*, Dkt-863 at 10).

3. *Confirmation Hearings*. From April 8, 2008, through May 2, 2008, the bankruptcy court held hearings to consider five proposed reorganization plans, see Appellant 188-193, 197-202, three of which were ultimately withdrawn, leaving (1) a plan proposed by the Indenture Trustee, and (2) a plan jointly proposed by MRC (a competitor of Palco) and Marathon (an unsecured creditor of Palco). The MRC/Marathon Plan, as amended, proposed to pay the Indenture Trustee $530 million minus certain deductions. See Dkt-3171 ex. A-2 at 6; see also *id.* ex. A-1 at 4 (defining the "Class 6 Distribution Adjustment").

4. *507(b) Claim.* On May 1, 2008, the Indenture Trustee filed a Motion to Grant Indenture Trustee a Superpriority Administrative Expense Claim Pursuant to Section 507(b). Dkt-2814 (the "507(b) Claim"). The 507(b) Claim asserted that the proposed payment to the Indenture Trustee under the MRC/Marathon Plan reflected a substantial decline in the value of that collateral during the pendency of the automatic stay.

5. *Confirmation Ruling.* On June 6, 2008, the court entered findings of fact and conclusions of law regarding confirmation of the MRC/Marathon Plan. Dkt-3088. The bankruptcy court determined that the Timberlands' current value was "not more than $510 million," *id.* at 61, and therefore required that the Indenture Trustee receive at least $510 million as the "indubitable equivalent" of the secured portion of its $740 million claim, *id.* at 113-14; see also 11 U.S.C. § 1129(b)(2)(A)(iii). At MRC/Marathon's request, the court delayed entry of the Confirmation Order and expedited a trial of the Indenture Trustee's 507(b) claim so that MRC/Marathon would know the full amount owed to the Indenture Trustee before the plan was finally confirmed. See Appellant 207 at 13:14-15:24.

6. *507(b) Hearings and Order*. From June 30 through July 2, 2008, the bankruptcy court held hearings on the Indenture Trustee's 507(b) Claim ("507(b) Hearings"). Appellant 210-212. The court did not reopen its finding that the

Timberlands were worth not more than $510 million at confirmation. See, *e.g.*, Appellant 210 at 32:15-33:7. Instead, the hearings focused on whether the Indenture Trustee's collateral had declined in value *before* confirmation, thereby giving rise to a 507(b) Claim.

Regarding the Cash Collateral, Scopac's Interim Chief Financial Officer testified that Scopac held at least $44.1 million in cash and cash equivalents on the Petition Date. Appellant 211 at 230:21-232:25. Scopac's operating reports also showed that, during the 18 months between the Petition Date and confirmation, Scopac received another $29.7 million in profits from the harvesting and sale of logs (proceeds that were subject to the Indenture Trustee's lien). Appellant 449 at MOR-1, MOR-6. By the time the 507(b) Hearings commenced, however, Scopac had less than *$5 million* in remaining cash and cash equivalents. See Appellant 211 at 231:2-5.

With respect to the Timberlands, the bankruptcy judge inquired whether he was "supposed to decide the value at the beginning of this case based on how someone who didn't know what the future held would have determined the value to be" or whether he could "take into consideration what I know happened in the period following." Appellant 210 at 57:17-22. The Indenture Trustee explained that the court had to "go back in time and figure out what the values were on the

petition date" without regard to subsequent information available only in hindsight. *Id.* at 59:2-4.

The Indenture Trustee's expert, James Fleming, testified that the Petition Date value of the Timberlands was $646 million—well above the $510 million value set by the bankruptcy court at confirmation 18 months later. Fleming explained that (1) there had been a precipitous decline in timber prices between January 2007 and June 2008—including the 10-15% price drop that the court had found to have occurred between October 2007 and June 2008—and (2) an appraiser or buyer, evaluating then-available information, would have projected a higher harvest rate on the Petition Date than at confirmation. See Appellant 211 at 116:6-11; see also Appellant 384 (Fleming proffer). Another expert, Joseph Radecki, testified that the decrease in value correlated with a "significant[] deteriorat[ion]" of "economic conditions in the United States, and specifically in California," during the bankruptcy proceedings that caused a "significant reduction in . . . residential construction" and "reduction in the value for companies related to forest products, building products and homebuilding." Appellant 389 at ¶ 6 (Radecki declaration).

MRC/Marathon's expert, Richard LaMont, testified that, despite that economic collapse, the Timberlands were worth $65 million *more* at confirmation

than on the Petition Date. See Appellee 276 at ¶ 5 (LaMont declaration). To reach that result, LaMont first concluded that, between the January 2007 Petition Date and the April 2008 date of his confirmation valuation, log prices had changed very little. *Id.* ¶ 21. Significantly, in determining January 2007 log prices, LaMont used a publication that he had never relied on before—and that reported generally lower prices—because he believed it reflected *current* market conditions (at the time of the June 2008 hearing on the 507(b) Claim). Appellant 211 at 403:15-18; Appellant 212 at 27:9-25. LaMont further lowered those prices by basing his estimation of *January* 2007 prices on "2007 *average* and *actual* price movements." Appellee 276 at ¶ 21 (emphasis added). LaMont also based his Petition Date valuation on a relatively low assumed harvest rate (60 million board feet per year) derived from Scopac's *subsequent* harvest experience in 2007 and 2008, rather than relying on estimates made during the period leading up to the January 2007 Petition Date (which ranged from 78 to 100 million board feet per year). Appellant 211 at 376:16-377:8, 382:4-386:16.

Then, relying on a March 2008 affidavit by Scopac's CEO that described *actual* forest growth during 2007 (*after* the Petition Date), LaMont employed an admittedly "backwards-looking" analysis of forest growth during the pendency of the bankruptcy case to lower his Petition Date valuation by between $5 and $7

million. Appellee 276 at ¶¶ 25-26; Appellant 212 at 85:11-15. Finally, he took the 7% discount rate he used for the purpose of his analysis in support of confirmation, and increased it to 8% for his Petition Date analysis. Appellee 276 at ¶¶ 14-20.[2]

The bankruptcy court denied the 507(b) Claim on July 7, 2008. Excerpt-H at 7:21-28:23. The court acknowledged the "undisputed testimony" that there was $48.7 million in non-Timberlands collateral on the Petition Date (*Id.* at 27:3, 8-11)—primarily $44.1 million of Cash Collateral. The court failed, however, to increase that amount to reflect the approximately $29.7 million in timber-sale profits from Scopac's post-petition operation of the Timberlands, even though the court's prior orders had included such proceeds in the definition of the "Cash Collateral" entitled to adequate protection. The court deducted $36.2 million that Scopac owed to Bank of America on a higher-priority secured claim, leaving the Indenture Trustee with an interest in the Cash Collateral in existence on the Petition Date worth $12.5 million. *Id.* at 27:12-14.

With respect to the Timberlands, the court held that "the appropriate value to protect [from diminution] is the foreclosure value of the property and not the fair market value of the property," reasoning that the Bankruptcy Code recognizes only a secured creditor's "right to foreclose" on its collateral through a forced

[2] The discount rate is the annual percentage by which a potential investor would reduce projected future payments to their present value; the higher the discount rate, the lower the present value of future payments.

liquidation sale. *Id.* at 23:19-23. The court accordingly held that there was insufficient evidence "that the *liquidation or foreclosure value* at filing [of Scopac's bankruptcy petition] was higher than the *fair market value* at confirmation." *Id.* at 24:16-19 (emphasis added).

The bankruptcy court concluded that the Indenture Trustee's interest in its collateral "on the date of filing" was $522.5 million (consisting of $510 million for the Timberlands plus $12.5 million in Cash Collateral). *Id.* at 27:13-16, 28:3-5. The Court then deducted $8.9 million that Scopac had paid the Indenture Trustee's professionals for services during the bankruptcy litigation, leaving a $3.6 million interest in cash collateral ($12.5 million minus $8.9 million) to protect. *Id.* at 28:6-15. The court therefore held that, so long as the MRC/Marathon Plan paid the Indenture Trustee at least $513.6 million on its $740 million claim (the $510 million Plan confirmation date value of the Timberlands plus $3.6 million for the Cash Collateral), the Indenture Trustee was entitled to nothing more under Section 507(b). *Id.* at 28:16-18.

MRC/Marathon agreed to that slight modification of their plan and, the next day, asked the court to enter a confirmation order that incorporated the denial of the 507(b) Claim. The court refused. Instead, it issued two separate orders to permit the Indenture Trustee to decide whether "to appeal both of them, or . . . to

appeal just one order." Appellant 214 at 18:23-25. Accordingly, on July 8, 2008, the bankruptcy court entered the 507(b) Order, which was specifically labeled a "Final Order" and explicitly relied on the conclusions and findings entered orally at hearings on July 7 and 8, 2008. Excerpt-G. The same day, the court entered the separate Confirmation Order confirming the MRC/Marathon Plan. Dkt-3302.

7. *Separate Appeals*. On July 9, 2008, Appellants filed separate notices of appeal from each order. See Dkt-3306; Dkt-3307; Dkt-3313; Dkt-3316 (507(b) Order). With respect to the Confirmation Order, Appellants sought a stay pending appeal, Dkt-3309, and petitioned for direct review in this Court under 28 U.S.C. § 158(d)(2). Dkt-3308. This Court permitted the direct appeal on July 24, 2008, see R3d:165, and expedited the case.

The Confirmation Appeal was argued on October 6, 2008. Meanwhile, the 507(b) Appeal proceeded before the district court. On October 16, 2008, the Indenture Trustee and Noteholders filed their corrected opening brief. See R:216-279. On November 14, 2008, MRC/Marathon filed a responsive brief, R:286-335, and a motion to dismiss the appeal, R:343-479. In that motion to dismiss—filed more than a month after the Confirmation Appeal had been briefed, argued, and submitted—MRC/Marathon suggested for the first time that the 507(b) Appeal should be dismissed for lack of subject-matter jurisdiction. They claimed the

507(b) issues should have been argued as part of the Confirmation Appeal. See R:453-455. MRC/Marathon also argued that the 507(b) Appeal was equitably moot. The Indenture Trustee and Noteholders opposed the motion. See R:552-586.

On February 9, 2009, the district court entered a two-page order dismissing the 507(b) Appeal for lack of subject-matter jurisdiction. The district court believed the 507(b) Order to be "expressly incorporate[d]" into the Confirmation Order and "an integral part" of it. R:690. Because this Court had already "accepted appellant [sic] jurisdiction to review the Confirmation Order," the district court held it lacked jurisdiction over the 507(b) Appeal. *Ibid.*

The Indenture Trustee and Noteholders timely moved for rehearing of the district court's dismissal pursuant to Bankruptcy Rule 8015. See R:695-711. They argued that—if the district court had correctly concluded that the 507(b) Appeal should have been pursued in this Court along with the Confirmation Appeal—the proper remedy was to transfer the 507(b) Appeal to this Court pursuant to 28 U.S.C. § 1631. That statute provides that a court lacking jurisdiction "*shall*, if it is in the interest of justice, transfer such . . . appeal to any other such court in which the . . . appeal could have been brought at the time it was . . . noticed." *Ibid.* (emphasis added).

While the rehearing motion remained pending in the district court, this Court decided the Confirmation Appeal, affirming in substantial part, reversing on one issue, and remanding another issue for further proceedings. *In re Pacific Lumber Co.*, 584 F.3d 229. On all but two issues (the MRC/Marathon Plan's gerrymandering of classes and unfair discrimination against the Indenture Trustee's unsecured deficiency claim, *id.* at 250-51), this Court rejected MRC/Marathon's contention that appellate review of the Confirmation Order was equitably moot. *Id.* at 236. This court explained that there could be no equitable mootness given the Court's ability to fashion *some* effective relief. *Id.* at 243-44. The Court was untroubled "[t]hat there might be adverse consequences to MRC/Marathon" if they lost on appeal, because "adverse appellate consequences were foreseeable to them as sophisticated investors who opted to press the limits of bankruptcy confirmation and valuation rules." *Id.* at 244.

On the merits, this Court held that the bankruptcy court's determination that, at confirmation, the Timberlands and the Cash Collateral were worth $513.6 million was not clear error (*id.* at 248-49), and that the cash payment of that amount to the Indenture Trustee satisfied 11 U.S.C. § 1129(b)(2)(A) because the Indenture Trustee received the "indubitable equivalent" of its secured claim at confirmation (584 F.3d at 245-48). The Court had no occasion to address the value

of the collateral *before* confirmation, but mentioned in passing that the Indenture Trustee's superpriority administrative expense claim had been rejected following hearings. *Id.* at 239. The Court reversed with respect to the MRC/Marathon Plan's non-debtor exculpation and release clause (*id.* at 251-53), remanded with respect to its treatment of an $11.1 million account receivable between Palco and Scopac (*id.* at 250), and affirmed with respect to whether the Plan effected a *de facto* substantive consolidation of two estates (*id.* at 249-50).

On November 12, 2009, the district court denied rehearing on the 507(b) Appeal, refusing to transfer the 507(b) Appeal to this Court under 28 U.S.C. § 1631. The court held that the 507(b) Appeal did not meet Section 1631's requirement that, "on the date the notice of appeal was filed, the transferee court could have heard the appeal." Excerpt-E at 2. Although the Indenture Trustee and Noteholders filed their separate notices of appeal with respect to the Confirmation Order and the 507(b) Order on the same day, the district court explained, "the Fifth Circuit had not yet *accepted* jurisdiction to hear a direct appeal of the Confirmation Order" pursuant to 28 U.S.C. § 158(d)(2). *Ibid.* (emphasis added). The district court further held that the interests of justice would not be served by transferring the 507(b) Appeal because, in its view, this Court's decision on the Confirmation Appeal "addresses the valuation concerns raised by Appellants in their appeal of

the 507(b) Order" by "address[ing] the Indenture Trustee's challenges to what the Noteholders received for their collateral." *Id.* at 3. In a supplemental order, the district court further suggested that the "interests of justice" prong of Section 1631 required the Indenture Trustee affirmatively to seek a transfer to the Fifth Circuit in response to MRC/Marathon's motion to dismiss the 507(b) Appeal. Excerpt-F.

Appellants filed an amended notice of appeal on November 30, 2009, pursuant to Fed. R. App. P. 6(b)(2)(A)(ii). See R4th:20-50.

SUMMARY OF ARGUMENT

The district court was wrong to dismiss this appeal on jurisdictional grounds. The bankruptcy court deliberately issued the Confirmation Order and the 507(b) Order as *separate* final orders. Each was based on distinct records and hearings; addressed different legal and factual aspects of the underlying bankruptcy proceeding; and reflected separate conclusions of law and findings of fact. The Confirmation Order (and the MRC/Marathon Plan that it confirmed) addressed the *treatment* of any administrative claim that the Indenture Trustee might have *if* such an administrative expense claim were allowed. The 507(b) Order, however, addressed whether diminution in the value of the collateral since the Petition Date provided the Indenture Trustee with an allowed administrative expense claim.

Even if jurisdiction over the separate 507(b) Appeal at all times resided in this Court, rather than in the district court, then 28 U.S.C. § 1631 required the district court to transfer the appeal to this Court. Appellants had a good-faith belief that the 507(b) Order was independent of the Confirmation Order for purposes of appeal. That belief was grounded in the form of the two orders and in the stated intent of the bankruptcy court. Appellees did nothing to suggest otherwise until a month *after* the Confirmation Appeal was argued.

This Court can and should reach the merits of this appeal. This Court and the district court apply the same standards of review to the bankruptcy court's determination. Moreover, considerations of judicial economy strongly favor a prompt, final disposition.

The bankruptcy court's ruling rests on three legal errors, each of which independently requires reversal: First, when calculating the diminution in value of the Indenture Trustee's Cash Collateral, the bankruptcy court excluded Scopac's $29.7 million in profits from timber sales during the 18-month stay. The Indenture Trustee, however, indisputably held liens on the timber that was sold *and* the cash proceeds from those post-petition sales. The bankruptcy court's Cash Collateral Orders defined the protected Cash Collateral to include such proceeds, and provided that the Indenture Trustee's entire interest in that Cash Collateral was entitled to "adequate protection." See, *e.g.*, Dkt-25 at 5. In clear violation of the terms of the Bankruptcy Code and its own prior orders, however, the bankruptcy court allowed Scopac to spend those funds for purposes other than operating the Timberlands (primarily to pay bankruptcy professionals), *without* compensating the secured creditors. And, even as it refused to *credit* the Indenture Trustee for cash collateral generated after the Petition Date, the bankruptcy court improperly

deducted $8.9 million from the Indenture Trustee's interest in the Cash Collateral to account for professional fees paid by Scopac after the Petition Date.

Second, the bankruptcy court relied on a legally flawed method for assessing whether the Timberlands had declined in value since the Petition Date. The court erroneously compared the Timberlands' *foreclosure* value on the Petition Date with the Timberlands' *fair market* value at confirmation. Such an "apples to oranges" comparison was an improper basis for determining that the Timberlands had not diminished in value.

Third, the bankruptcy court arrived at the Timberlands' Petition Date value by relying, in large part, on information available only in hindsight, many months *after* the Petition Date. MRC/Marathon's sole expert witness on valuation expressly premised his Petition Date valuation on such retrospective data. Hindsight evidence, however, is legally irrelevant to establishing an asset's value at an earlier time.

ARGUMENT AND AUTHORITIES

I. The District Court Had Jurisdiction To Address The 507(b) Order

The district court dismissed the 507(b) Appeal because it believed the pending Confirmation Appeal deprived it of subject-matter jurisdiction. Excerpt-D. That decision rested on the demonstrably false premise that "the 507(b) Order is an integral part of the Confirmation Order," which "expressly incorporates" it. *Ibid.* The Confirmation Order did not "incorporate" the 507(b) Order; indeed, the bankruptcy court deliberately issued two separate final orders. And the orders were based on distinct records and hearings; reflected separate conclusions of law and findings of fact; and addressed different legal and factual aspects of the bankruptcy proceeding. Whereas the Confirmation Appeal challenged whether the MRC/Marathon Plan was confirmable under 11 U.S.C. § 1129, the 507(b) Appeal asserted that—even if the plan was properly confirmed—the Indenture Trustee has a superpriority administrative expense claim under Section 507(b) for the difference between the value at which Scopac afforded the Indenture Trustee's collateral adequate protection and the amount MRC/Marathon paid to release the Indenture Trustee's liens on that collateral at confirmation. Those are precisely the circumstances justifying separate appeals.

A. The 507(b) Order Is A Separate Final Order, And Was Neither Part Of Nor Incorporated Into The Confirmation Order

The view that the 507(b) Order is "part of" and "expressly incorporate[ed]" into the Confirmation Order, Excerpt-D at 2, simply does not correspond to the record. The 507(b) Order was a separate "Final Order" that "determined . . . that the 507(b) Motion, as amended, should be denied." Excerpt-G. Thus, by its terms, the 507(b) Order was distinct from the Confirmation Order the bankruptcy court entered.

The entry of a separate 507(b) Order was not inadvertent. MRC/Marathon proposed that the bankruptcy court enter a single order confirming the MRC/Marathon Plan *and* denying the 507(b) Claim. As certain Noteholders' counsel explained to the bankruptcy court at the time, however, separate orders were necessary because

> there were two *separate* contested matters here; one dealing with the administrative claim and one dealing with the contested confirmation hearing. They were teed up by *separate* motions, *separate* objections; they're *separate* contested matters. *They are really entitled to separate orders so that they can be separately appealed*.

Appellant 214 at 20:24-21:4 (emphasis added); see also *id.* at 190:5-6 (explaining that "[t]here's no question the 507(b) motion and a confirmation hearing are separate").

The bankruptcy court rejected MRC/Marathon's proposal and entered a separate 507(b) Order. The court recognized that entering two orders would permit the Indenture Trustee to decide whether it "prefer[red] to appeal both of them, or . . . to appeal just one order." *Id.* at 18:23-25; see also *id.* at 19:1-4 ("MR. GREENDYKE: I think we prefer to have the right to decide whether or not to appeal both of them, and therefore you have to enter a separate order. THE COURT: Okay."). The court further acknowledged that certain substantive arguments—for example, "on mootness"—might differ with respect to each order. Accordingly, the court concluded, "we need to have the Order on the administrative claim final and give [the Indenture Trustee] the right to appeal that." *Id.* at 192:25-193:2; see also *id.* at 190:11-12.

Indeed, the bankruptcy court made three changes to MRC/Marathon's proposed Confirmation Order to reflect the separation of the 507(b) Order. First, MRC/Marathon had included in the caption of the first proposed confirmation order the words "Denying Indenture Trustee's 507(b) Administrative Claim." See *id.* at 190:13-18. The court removed that reference to the 507(b) Claim from the final Confirmation Order in response to a specific request by Appellants' counsel. *Id.* at 196:3-16 ("MR. GREENDYKE: [We requested that the court] change the title of the confirmation order *so that it's not a combined* order . . . ."); see also *id.*

at 205:10-17. Second, the Court changed the proposed confirmation order to reflect that the 507(b) Claim had been denied in a "separate order." *Id.* at 157:16-160:1; 205:10-17. Finally, MRC/Marathon agreed, at the Indenture Trustee's request, to remove a paragraph in the reorganization plan stating that there would not be a final order on the 507(b) Claim. *Id.* at 69:8-70:21. Thus, the 507(b) Order was neither "part of" nor "incorporate[d]" into the Confirmation Order.

Moreover, the district court was wrong, when denying the rehearing motion, to criticize the Indenture Trustee for bringing the 507(b) Appeal in that court "under the guise of the 507(b) Order being a separate and distinct order." Excerpt-F at 1. As is evident from the bankruptcy court proceedings, *the 507(b) Order was precisely that*. Indeed, until MRC/Marathon filed their Motion to Dismiss in the district court more than four months after the orders were separately entered—and more than a month after the Confirmation Appeal had been argued and submitted—MRC/Marathon never indicated that they believed otherwise.

B. This 507(b) Appeal Involves Different Legal And Factual Questions From Those Addressed In The Confirmation Appeal

The district court's belief that the 507(b) and Confirmation Appeals could not proceed separately reflected its misunderstanding of the difference between plan confirmation proceedings and administrative claim allowance proceedings. Where, as here, a proceeding addresses legal and factual questions distinct from

those at issue in a separate appeal to another court, the court in the former proceeding may exercise jurisdiction over the proceeding before it. That is, where the issues are discrete, the pursuit of one appeal does not threaten the integrity of the other, and there is no bar to simultaneous appeals.

In bankruptcy practice, separate substantive aspects of a proceeding often proceed simultaneously in different courts. This Court has long "decline[d]" to adopt "the broad rule that a bankruptcy court may not consider any request which either directly or indirectly touches upon the issues involved in a pending appeal and may not do anything which has any impact on the order on appeal." *Sullivan Central Plaza I, Ltd.* v. *BancBoston Real Estate Capital Corp. (In re Sullivan Central Plaza I, Ltd.)*, 935 F.2d 723, 727 (5th Cir. 1991). Rather, this Court has "repeatedly recognized that, when a notice of appeal has been filed in a bankruptcy case, the bankruptcy court retains jurisdiction to address elements of the bankruptcy proceeding that are not the subject of that appeal." *Texas Comptroller of Pub. Accounts* v. *Transtexas Gas Corp. (In re Transtexas Gas Corp.)*, 303 F.3d 571, 580 n.2 (5th Cir. 2002). That corresponds with the long-settled rule that the "jurisdictional significance" of a notice of appeal is limited to "those aspects of the case involved in the appeal." *Griggs* v. *Provident Consumer Discount Co.*, 459 U.S. 56, 58 (1982); see also *Marrese* v. *Am. Acad. of Orthopaedic Surgeons*, 470

U.S. 373, 378-79 (1985); *Resolution Trust Corp.* v. *Smith (In re Fuqua)*, 53 F.3d 72, 76 (5th Cir. 1995). Just as a bankruptcy court can *decide* a matter while another aspect of the case is on appeal, a district court likewise can *review* a bankruptcy court's decision while the Court of Appeals hears a different appeal.

The 507(b) and Confirmation Appeals concern fundamentally different issues. Most importantly, the 507(b) Appeal does not contest the confirmation of the MRC/Marathon Plan or the $513.6 million paid to the Indenture Trustee under that Plan as the "confirmation value" of the collateral. See Appellant 210 at 32:21-33:7; Appellant 213 at 19:23-25. Those issues were the exclusive purview of the Confirmation Appeal.

This appeal—like the 507(b) proceedings before the bankruptcy court—involves the different assertion that, because the collateral *used to be* worth more than $513.6 million, the Indenture Trustee is entitled to a superpriority administrative expense claim to compensate for the decline. This appeal focuses on issues unrelated to whether the plan was properly confirmed: whether Scopac's encumbered net proceeds from operating the Timberlands during the stay—which it spent almost entirely on bankruptcy professionals—should be accounted for in measuring the 507(b) Claim; whether the bankruptcy court improperly deducted from the 507(b) Claim the $8.9 million Scopac paid to reimburse part of the legal

fees that the Indenture Trustee incurred to protect its collateral during the bankruptcy proceedings; and whether the value of the Timberlands on the Petition Date was higher than the $510 million value placed on them at confirmation.

The Confirmation Appeal, by contrast, hinged on whether confirmation of the MRC/Marathon Plan met the requirements of 11 U.S.C. § 1129. It presented eight challenges to the MRC/Marathon Plan, none of which is implicated by this 507(b) Appeal. See *In re Pacific Lumber Co.*, 584 F.3d at 239 (listing issues on Confirmation Appeal). That is because Section 1129's confirmation requirements are distinct from concerns about adequate protection and the merits of any particular administrative expense claim. Nor does the 507(b) Appeal call into question any aspect of this Court's decision on the Confirmation Appeal. The holding that the bankruptcy court made no clear error in determining that the collateral was worth $513.6 million *at confirmation* is in no way undermined by the Indenture Trustee's contention, in this 507(b) Appeal, that the bankruptcy court erred when it failed to conclude that the collateral *had been worth* more than $513.6 million *before confirmation*, and that it therefore declined in value during the course of the automatic stay.

In re Strawberry Square Assocs., 152 B.R. 699 (Bankr. E.D.N.Y. 1993), is instructive. In that case, the debtor appealed the bankruptcy court's decision to lift

an automatic stay—an appeal that turned on, among other things, whether the debtor had provided adequate protection to its creditors to justify maintaining the stay. While that appeal was pending, the bankruptcy court adjudicated plan confirmation over the debtor's jurisdictional objection. The court explained that the first appeal did not deprive it of jurisdiction to confirm a plan: The two proceedings involved distinct questions of law and fact because "[t]he issues to be considered as prerequisite to confirmation . . . are the requirements listed in 11 U.S.C. § 1129, *none of which coincide* with any of the § 362 stay issues which the debtor may have asserted as a basis for its appeal . . . [including a] lack of adequate protection." *Id*. at 702 (emphasis added). Likewise here, dealing with confirmation in one proceeding and a lack of adequate protection in another did not "put the same matter before two courts at the same time," and therefore did not represent a "threat to the integrity of the appeal process" or "serve as a substitute for the appeal of the order vacating the stay, nor would it circumvent the authority of the appellate court." *Ibid.*

Here, the district court did not base its conclusion that the two proceedings were one and the same on anything found in the Appellants' briefs in the Confirmation Appeal. Rather, the court looked only to a preliminary statement of issues that two of the Noteholders provided to the bankruptcy court pursuant to

Bankruptcy Rule 8006. See Excerpt-D at 2 ("[O]ne of the issues raised by certain Appellants in their statement of issues on appeal of the Confirmation Order is 'whether the bankruptcy court erred as a matter of law in concluding that the MRC/Marathon Plan satisfies 11 U.S.C. § 1129(a)(9) because it does not adequately provide for payment in full of the Indenture Trustee's superpriority claim under 11 U.S.C. § 507(b).'" (quoting R3d:135)).

A statement of issues under Bankruptcy Rule 8006 is merely a procedural mechanism in the bankruptcy court; its "purpose . . . is principally to identify the portions of the testimony below that should be included in the record on appeal." *Zer-Ilan* v. *Frankford* (*In re CPDC, Inc.)*, 221 F.3d 693, 698 (5th Cir. 2000) (internal quotation marks omitted). Making such a statement the fodder for later jurisdictional objections in other proceedings does not advance that purpose.

Even if a preliminary statement of issues by certain Appellants did have jurisdictional significance, the stated Confirmation Appeal "issue" to which the district court pointed is *not* the same as any matter raised in this 507(b) Appeal. Section 1129(a)(9)(A) requires that, to be confirmed, a Chapter 11 reorganization plan must "provide[]" that any allowed administrative expense claims will be paid in full with cash on the plan's effective date. Challenging a reorganization plan on the ground that it does not sufficiently *provide for* those required payments is

different from challenging the disallowance of a particular administrative expense claim.

Appellants expressly noted that distinction when they requested a stay of the Confirmation Order pending appeal. In that request, they explained that "[t]he MRC/Marathon Plan fails to comply with section 1129(a)(9), because it does not *provide for* the payment of the Indenture Trustee's superpriority administrative claim (*the denial of which is being separately appealed*)." Dkt-3309 ¶ 111 (double emphasis added). The Indenture Trustee made a similar distinction when it petitioned the bankruptcy court to certify a direct appeal of the Confirmation Order. See Dkt-3308 at ¶¶ 80 ("[T]he MRC/Marathon Plan fails to comply with Section 1129(a)(9) because it does not *make provision for the payment* of the Indenture Trustee's superpriority administrative claim." (emphasis added)), 81 (arguing that "there is a substantial question whether [the reorganized Scopac] will have sufficient capital to operate and avoid either liquidation or the need for further financial reorganization" if the claim is allowed).

The distinction between *allowing* a claim (*i.e.*, fixing its amount), and providing for the *payment* of an allowed claim, is a well-recognized distinction in bankruptcy. Parties to a bankruptcy proceeding routinely challenge, for example, whether a reorganization plan must *provide for* administrative and tax claims that

are still under dispute by setting aside sufficient reserves for any claims that may subsequently be allowed. See, *e.g.*, *In re Revco D.S., Inc.*, 131 B.R. 615, 619-21 (Bankr. N.D. Ohio 1990) (challenging whether a $4 million reserve fund for disputed claims was sufficient under § 1129(a)(9)). Similarly, it is not unusual for a plan to be confirmed despite ongoing disputes regarding the allowance of particular claims. See, *e.g.*, *Oakwood Homes Corp.* v. *Jefferson-Pilot Life Ins. Co. (In re Oakwood Homes Corp.)*, 449 F.3d 588, 591 (3d Cir. 2006) (confirmation of plan specifying percentage-based payments of certain approved claims was "immaterial to [an] appeal" regarding the total amount of a particular claim); *AMC Mortgage Co.* v. *Tenn. Dep't of Revenue*, 213 F.3d 917, 919 (6th Cir. 2000) (discussing a confirmed plan providing for treatment of state tax claims that were subject of a separate dispute); *Pettibone Corp.* v. *United States*, 34 F.3d 536, 538 (7th Cir. 1994) ("[Debtor] agreed to a Chapter 11 reorganization plan that calls for full payment of its tax obligations. See 11 U.S.C. § 1129(a)(9). The plan does not, however, provide the rules to use in determining what these tax obligations are.").

This case is no different. The MRC/Marathon Plan itself recognizes this distinction by including separate provisions that cover, respectively, the filing of, and resolution of disputes over the allowance of, administrative expense claims (see Dkt. 3302.2 at §§ 2.2, 9.2, 9.3)) and the treatment of "Allowed Administrative

Claims" (see *id.* at § 2.1). Indeed, the Plan did not require the filing of administrative expense claims until thirty days *after* the Plan's effective date. See *id.* at § 2.2, app. A at 2 (definition of "Administrative Expense Claims Bar Date"). *This* administrative expense claim happened to be a large one, and for that reason MRC/Marathon asked the court to address it *before* it entered an order confirming their plan. But that sequence did not somehow fuse the denial of the 507(b) Claim and the separate Confirmation Order for purposes of jurisdiction on appeal; it was simply a matter of coordinating two separate contested matters that were *never* consolidated. The two separate proceedings at most "touch[] upon" one another "indirectly," leaving undisturbed each court's exercise of jurisdiction over the matters properly before it. *Sullivan Central Plaza I*, 935 F.3d at 727.

Moreover, the district court's decision seriously complicates the operation of the direct-review statute, 28 U.S.C. § 158(d)(2). Under Section 158(d)(2), direct review of a bankruptcy court's final order by a Court of Appeals is discretionary, and available only if: (1) the order involves a question of law as to which there is no controlling decision, or involves a matter of public importance; (2) it involves a question of law requiring resolution of conflicting decisions; or (3) an immediate appeal may materially advance the progress of the case or proceeding.

The Indenture Trustee sought and received direct review of the Confirmation Order by this Court because, among other things, the Confirmation Appeal involved "novel issues" and "unusual, perhaps unprecedented decisions" deserving of direct review. *In re Pacific Lumber Co.*, 584 F.3d at 242-43. According to the district court, however, the Indenture Trustee was also *required* to seek *and to receive* certification of the 507(b) Appeal for direct review, with the corresponding anomaly that any failure to do so would leave the 507(b) Appeal in jurisdictional no-man's-land, where *no court* would have jurisdiction to hear the appeal.

If that is the law, then even mildly risk-averse appellants will include every conceivable issue when seeking to certify a bankruptcy court order for direct appeal, for fear of later discovering that a district court believes it lacks jurisdiction over a particular order because another proceeded on direct appeal. That risk is heightened by the district court's incorrect reading of 28 U.S.C. § 1631 in this case, which leaves little room for transferring mislaid issues to the correct court. But Congress did not design 28 U.S.C. § 158(d)(2) to waste the Courts of Appeals' resources on tangential matters, or to be a trap for the unwary. The purpose is to get certain fundamental issues before the Court of Appeals expeditiously—a purpose frustrated if the Court of Appeals must at the same time consider separate matters of lesser precedential significance.

Finally, it bears emphasis that the limitation on concurrent jurisdiction "is a judge-made, rather than a statutory, creation that is founded on prudential considerations" and "should not be applied when to do so would defeat its purpose of achieving judicial economy." *Mary Ann Pensiero, Inc.* v. *Lingle*, 847 F.2d 90, 97 (3d Cir. 1988); see also 20 JAMES WM. MOORE, ET AL., MOORE'S FEDERAL PRACTICE § 303.32[1] at 303-72 to 303-73 (3d ed. 2003). Prudence is particularly crucial in bankruptcy matters, where "the unique nature of [the] proceedings, combined with the public policy interest in promoting successful reorganizations, often favors tolerance of greater procedural flexibility." *In re Transtexas Gas Corp.*, 303 F.3d at 580. Here, the Indenture Trustee proceeded with separate appeals of two separate orders, each of which addressed distinct questions. That manner of proceeding was completely transparent to the parties. In such circumstances, upholding MRC/Marathon's belated objection would defeat the purposes of the jurisdictional rule.

C. In The Alternative, The District Court Should Have Transferred This 507(b) Appeal To This Court Under 28 U.S.C. § 1631

Even if the district court lacked jurisdiction over this 507(b) Appeal, it should not have dismissed the appeal. Instead, it was required to transfer the matter to this Court under 28 U.S.C. § 1631. That statute provides, in pertinent part:

> Whenever a civil action is filed in a court . . . and that court finds that there is a want of jurisdiction, the court *shall*, if it is in the interest of justice, transfer such action or appeal to any other such court in which the action or appeal could have been brought at the time it was filed or noticed, and the action or appeal shall proceed as if it had been filed in or noticed for the court to which it is transferred on the date upon which it was actually filed in or noticed for the court from which it is transferred.

Ibid. (emphasis added). The district court was wrong in refusing to transfer the 507(b) Appeal under that provision. See Excerpt-E; Excerpt-F.

First, it was "in the interest of justice" to transfer the appeal to this Court. Appellants have consistently operated under the good-faith belief that the 507(b) Order was independent of the Confirmation Order for purposes of appeal. Most notably, just the day after the orders were entered, Appellants explicitly informed the bankruptcy court—without objection from MRC/Marathon—that Appellants were pursuing separate appellate tracks. See Dkt-3309 at ¶ 111. Section 1631's purpose is to protect parties when such a belief proves to have been mistaken. "[I]t is abundantly clear that Congress intended that 'a case mistakenly filed in the wrong court [should] be transferred as though it was filed in the transferee court on the date in which it had been filed in the transferor court.'" *Dornbusch* v. *Comm'r of Internal Rev.*, 860 F.2d 611, 613 (5th Cir. 1988) (quoting *Alexander* v. *C.I.R.*, 825 F.2d 499, 501 (D.C. Cir. 1987), in turn quoting 128 Cong. Rec. 3572 (1982)). What is more, "the interests of justice would be served by a transfer" where, as

here, "appellant might [otherwise] lose the right to appeal the bankruptcy judge's decision." *Thistlethwaite* v. *First Nat'l Bank of Lafayette, LA* (*In re Exclusive Indus. Corp.)*, 751 F.2d 806, 809 (5th Cir. 1985).

The district court's rationale for a contrary view is incorrect. The district court first theorized that this Court's decision on the Confirmation Appeal "addresses the valuation concerns raised by Appellants in their appeal of the 507(b) Order." Excerpt-E at 3. As explained above, however, the bankruptcy court's valuation of the Timberlands and Cash Collateral *at confirmation* involved issues distinct from the bankruptcy court's separate determination that the Timberlands and Cash Collateral had not declined in value *during the prior 18 months*. The district court further suggested in a supplemental order that a transfer under 28 U.S.C. § 1631 was not in the interest of justice because the Indenture Trustee did not *ask* for such a transfer in response to MRC/Marathon's motion to dismiss the appeal. Excerpt-F at 2. But a Section 1631 transfer is mandatory if a "court finds that there is a want of jurisdiction" and the action meets the statutory criteria. See, *e.g.*, *Trujillo* v. *Williams*, 465 F.3d 1210, 1222 & n.15 (10th Cir. 2006) (holding that a court may transfer a suit under Section 1631 *sua sponte*, and that, "[b]ased on the mandatory language of [Section 1631], . . . the [party] need not first file a motion to transfer"). In analogous circumstances, this Court

transferred a matter to itself *sua sponte* after holding that the district court properly dismissed an action that should have proceeded before the Court of Appeals on direct review. See *Salazar-Regino* v. *Trominski*, 415 F.3d 436, 445 & n.16 (5th Cir. 2005), vacated on other grounds *sub nom. Salazar-Regino* v. *Moore*, 549 U.S. 1093 (2006).

Second, if the district court was correct that it lacked jurisdiction over the 507(b) Appeal—because such jurisdiction belonged to this Court—then that appeal undoubtedly "could have been brought" in this Court at the time of filing within the meaning of 28 U.S.C. § 1631. Indeed, the crux of the district court's jurisdictional ruling was that the 507(b) Appeal *had to be brought* to this Court along with the Confirmation Appeal. The district court later claimed, however, that this Court "could not have heard" (Excerpt-E at 2) the 507(b) Appeal on the day that it and the Confirmation Appeal were noticed, because this Court still would have had the discretion not to authorize the direct appeal. See 28 U.S.C. § 158(d)(2)(A). That erroneous reading of the Section 1631 would lead to the utterly bizarre result that *no court* had jurisdiction to hear the 507(b) Appeal if this Court did not permit a direct appeal of the 507(b) Order. The only sensible reading of Section 1631 is that, because the Confirmation Appeal was brought directly to this Court, any proceeding that had to be brought alongside it "could have been

brought" here within the meaning of Section 1631 when noticed. The district court's contrary ruling flies in the face of the purpose of Section 1631 to *protect* the unwary from jurisdictional traps.[3]

II. The Bankruptcy Court Committed Multiple Legal Errors In Denying The 507(b) Claim

Whether the district court had jurisdiction to hear the 507(b) Appeal or should have transferred the case to this Court pursuant to 28 U.S.C. § 1631, this Court can and should reach the merits of this appeal. This Court and the district court apply the same standard of review to the bankruptcy court's conclusions, and "[n]o purpose would be served in remanding this matter back to the district court [because] the record is adequate for [this Court] to exercise the identical review of the [bankruptcy court's] order." *Texas Extrusion Corp.* v. *Lockheed Corp.* (*In re Texas Extrusion Corp.)*, 844 F.2d 1142, 1157 (5th Cir. 1988). As of the date of this brief, approximately 18 months have passed since the commencement of this appeal, and so "considerations of judicial economy" militate in favor of a disposition on the merits at this time. *Id.* at 1156; see also *Adams* v. *Sidney Schafer & Assocs., Inc.* (*In re Adams)*, 809 F.2d 1187, 1189 (5th Cir. 1987)

[3] If this Court agrees that transfer was the appropriate remedy for the district court's asserted lack of jurisdiction, it is not necessary to remand this case for entry of such an order. See *Salazar-Regino*, 415 F.3d at 445 & n.16.

(explaining that the "long pendency" of an appeal meant "it is in the interest of justice for [this Court] to rule" rather than to remand to the district court).

Turning to the merits, the Bankruptcy Code "entitles the secured creditor to the present value of its claim at the *institution* of the automatic stay." *Chase Manhattan Bank USA NA* v. *Stembridge* (*In re Stembridge)*, 394 F.3d 383, 387 (5th Cir. 2004). As explained at pages 3-4 above, adequate protection is supposed to protect a secured creditor from any decrease in the value of its collateral while the automatic stay is in effect or its cash collateral is being used. See 11 U.S.C. § 361. Of course, such protection ultimately proved inadequate here, where the economic and housing market collapse—and particularly the sharp decline in homebuilding and corresponding plummet in timber demand and prices—caused the Timberlands' value to drop precipitously from January 2007 to June 2008. Meanwhile, the secured creditors' loss was compounded by Scopac's expenditure of nearly all of the profits generated from post-petition sales of the Indenture Trustee's timber collateral on bankruptcy professionals rather than Note payments.

An inadequately protected secured creditor such as the Indenture Trustee is entitled to a superpriority administrative expense claim to make up the difference. Such a claim has two components. First, Section 507(b) requires that the claimant have an allowable administrative claim under Section 503(b). That element is

satisfied, for example, if the value of collateral falls while it is retained and used by the debtor during the automatic stay, because such diminution in value is considered to be an "actual, necessary cost[] and expense[] of preserving the estate." See 11 U.S.C. § 503(b)(1); *Bonapfel* v. *Nalley Motor Trucks* (*In re Carpet Center Leasing Co.)*, 991 F.2d 682, 685 (11th Cir. 1993) (Section 507(b) "'converts a creditor's claim where there has been a diminution in the value of a creditor's secured collateral . . . into an allowable administrative claim under § 503(b)'" (quoting *Grundy Nat'l Bank* v. *Rife*, 876 F.2d 361, 363-64 (4th Cir. 1989)).

Second, Section 507(b) gives such an administrative claim under Section 503(b) "superpriority" treatment—moving it to the front of the line ahead of nearly all other unsecured claims—if that claim exists despite the provision of ostensibly adequate protection from the estate, and if that claim arises from the automatic stay; the use, sale, or lease of the collateral; or the granting of a lien to secure post-petition financing. See also 4 LAWRENCE P. KING, ET AL., COLLIER ON BANKRUPTCY ¶ 507.12[1] at 507-89 to 507-90 (15th ed. rev. 2008) (outlining Section 507(b)'s elements); Appellant 213 at 20:18-21:2 (same).[4] As the

[4] Section 507(b) provides:

> If the trustee, under section 362, 363, or 364 of this title [11 U.S.C. §§ 362, 363, or 364], provides adequate protection of the interest of a holder of a claim secured by a lien on

bankruptcy court recognized, however, the "superpriority" aspect of Section 507(b) is not at issue here, because "all administrative claims must be paid" pursuant to a Chapter 11 Plan under 11 U.S.C. § 1129(a)(9)(A). Appellant 213 at 11:3-6.

The bankruptcy court held that the Indenture Trustee did not have an underlying administrative expense claim because its collateral did not decline in value. That holding was based on three critical legal errors. First, the bankruptcy court failed to compensate the Indenture Trustee for Scopac's expenditure of encumbered timber-sale proceeds to pay bankruptcy professionals during the Chapter 11 proceedings. Second, the bankruptcy court erroneously compared the Timberlands' *foreclosure* value on the Petition Date to their *fair market* value at confirmation to determine the extent of any diminution in their value during the intervening 18 months. Finally, the court improperly based its Petition Date valuation of the Timberlands on retrospective data—*i.e.*, information about post-petition log prices and harvest rates—that would have been unknown to a potential buyer or anyone who actually appraised the Timberlands on the Petition Date.

> property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(2) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

11 U.S.C. § 507(b).

Those errors led the court to deny compensation for the millions of dollars of collateral value that the Indenture Trustee and Noteholders lost during the automatic stay and Scopac's continued use of the Cash Collateral. *Each* error requires reversal of the 507(b) Order.

A. The 507(b) Order Failed To Account For The Indenture Trustee's Lien On Scopac's Post-Petition Timber Sale Proceeds And Scopac's Expenditure Of Those Proceeds To Pay Bankruptcy Professionals Rather Than The Notes

The bankruptcy court substantially undervalued the Indenture Trustee's interest in the Cash Collateral by excluding nearly $30 million in profits that Scopac generated during the stay by selling timber that was subject to the Indenture Trustee's liens. See Appellant 449 at MOR-1, MOR-6. The bankruptcy court considered only the amount of non-Timberlands collateral that existed on the Petition Date ($48.7 million), ignoring the substantial encumbered net proceeds that Scopac took in *while* the automatic stay was in place ($29.7 million). Those proceeds indisputably were subject to the Indenture Trustee's liens, and the bankruptcy court's prior Cash Collateral Orders expressly provided adequate protection for them and a compensatory 507(b) Claim if they turned out to be inadequately protected from any diminution in value. Their exclusion from the bankruptcy court's evaluation of the 507(b) Claim was legal error.

After accounting for Bank of America's senior lien ($36.2 million), the Indenture Trustee had a $42.2 million interest in Cash Collateral for purposes of its 507(b) Claim—not $12.5 million as the bankruptcy court concluded (Appellant 213 at 27:12-16)—with the difference accounted for by the $29.7 million in net proceeds referred to above. The value of that interest had declined nearly to zero (largely through Scopac's payments to bankruptcy professionals) by the time the bankruptcy court confirmed the MRC/Marathon Plan. Under the MRC/Marathon Plan, the Indenture Trustee received only $3.6 million on account of its interest in the Cash Collateral; it was entitled to a superpriority administrative expense claim for the $38.6 million difference ($42.2 million minus $3.6 million).

There can be no dispute that proceeds from the sale of encumbered timber were expressly subject to the Indenture Trustee's liens. The Deed of Trust granted the Indenture Trustee a security interest in "Mortgaged Property," which included "all of the rights, titles, interests and estates *now owned or hereafter acquired* by [Scopac] in . . . all Company Timber . . . [and] the *Proceeds*" thereof, including "all Assigned Proceeds." Appellant 271 at 64-66 (emphasis added). "Proceeds" included "whatever is receivable or received when any of the Mortgaged Property or Proceeds is sold, collected, exchanged or otherwise disposed of." *Id.* at 70-71. Moreover, "Assigned Proceeds"—which are singled out as "Mortgaged

Property"—included "all Harvested Timber and all Proceeds *now or hereafter* receivable, owing, deliverable, or otherwise attributable to, from or on account of any of the Company Timber." *Id.* at 3 (emphasis added). Consequently, when Scopac sold timber that secured the Notes, the sale proceeds were subject to the Indenture Trustee's liens, as expressly contemplated under the Code. See 11 U.S.C. § 552(b) ("[I]f the security interest created by [a pre-petition] security agreement extends to property of the debtor acquired before the commencement of the case and to the proceeds . . . of such property, then such security interest extends to such proceeds . . . acquired by the estate after the commencement of the case to the extent provided by such security agreement.").

As explained to the bankruptcy court by Scopac's counsel, "when [timber is] cut that doesn't mean it goes away"; rather, "it simply means it's turned into logs, which are inventory, which is turned into cash, which are receivables, *which are ultimately the noteholders' cash collateral as well*." Appellant 172 at 76:18-21 (emphasis added); see also *id.* at 75:2-4 ("[Noteholders are] entitled to protection for our proceeds that we get every month from Palco and any other receipts that Scopac has that are proceeds of the noteholders' collateral."); Appellant 167 at 22:20-23 ("THE COURT: "[The boards that have been cut are] proceeds. So they have a lien post-petition on those proceeds? MS. COLEMAN: They absolutely do,

your Honor. They absolutely do."). Under the bankruptcy court's analysis, however, trees that had been harvested during the pendency of the bankruptcy proceedings—and the cash generated by their sale—inexplicably vanished from the Indenture Trustee's collateral.

The Cash Collateral Orders provided for the adequate protection of the Indenture Trustee's interests in the Timberlands *and* the Cash Collateral: "The proceeds and product of the Prepetition Collateral constitute cash collateral." See, *e.g.*, Dkt-454 at 5. That adequate protection, however, was ultimately *in*adequate with respect to the Cash Collateral, because (it is undisputed) virtually all of Scopac's pre-petition cash ($44.1 million) *and* timber sale net proceeds ($29.7 million) were gone by confirmation.

Scopac spent about $28.5 million to pay various fees to bankruptcy professionals during the proceedings. Appellant 449 at 3-5. Scopac made those payments directly out of the Indenture Trustee's Cash Collateral, causing the Noteholders to foot the bill for the debtor's bankruptcy. See generally *General Elec. Credit Corp.* v. *Levin & Weintraub (In re Flagstaff Foodservice Corp.)*, 739 F.2d 73 (2d Cir. 1984) (holding that a secured creditor's super-priority claim under 11 U.S.C. § 364(c)(1) had priority over claims for bankruptcy-related professional fees). The resulting diminution in the value of the Cash Collateral before

confirmation gives the Indenture Trustee a clear claim under Section 507(b). By not compensating the Indenture Trustee for the expenditure of its Cash Collateral on bankruptcy professionals, MRC/Marathon experienced a substantial a windfall. Had the Debtor not paid those fees out of the Indenture Trustee's Cash Collateral during the stay, there would have been another $28.5 million subject to the Indenture Trustee's liens at confirmation, and those professional fees would have constituted administrative expense claims that MRC/Marathon would have had to pay out of *other* funds on the effective date of their Plan. See 11 U.S.C. § 1129(a)(9)(A).

The bankruptcy court also erred by subtracting $8.9 million in payments that Scopac made to cover certain of the Indenture Trustee's professional fees incurred during (and as a result of) the automatic stay. See Appellant 213 at 28:6-15. Had the Indenture Trustee been allowed to foreclose at the outset of the case—18 months earlier—it would *not have had to spend $8.9 million in collateral proceeds litigating in this bankruptcy case to try to protect and realize the value of its collateral*. Those fees were incurred and payments were made during (and because of) the automatic stay, and diminished the Indenture Trustee's Cash Collateral. In addition, it was incongruous for the bankruptcy court to *deduct* the $8.9 million paid out of the Cash Collateral to cover the Indenture Trustee's professional fees

without first *crediting* the Indenture Trustee's interest in the Cash Collateral for the $29.7 million in post-petition timber sale proceeds *from which those payments were made*.

Free of legal error, the proper calculation of the Indenture Trustee's 507(b) Claim with respect to the Cash Collateral is as follows:

Indenture Trustee's interest in the Cash Collateral =

$48.7 million in pre-petition cash and cash equivalents (including small amount of other non-Timberlands collateral)

+ $29.7 million in timber sale net proceeds

– 36.2 million higher priority Bank of America lien

= **$42.2 million**.

MRC/Marathon Plan Payments to the Indenture Trustee in exchange for release of Indenture Trustee's liens on Cash Collateral = **$3.6 million**.

507(b) Claim with respect to Cash Collateral

$42.2 million (interest in Cash Collateral)

– $3.6 million (payments to Indenture Trustee)

= $**38.6 million**

Accordingly, the Indenture Trustee was entitled to a superpriority administrative expense claim in the amount of $38.6 million, and MRC/Marathon are obligated to pay that amount.

B. The Bankruptcy Court Improperly Compared The Timberlands' *Foreclosure* Value On The Petition Date To Their *Fair Market* Value At Confirmation When It Held They Did Not Decline In Value

The bankruptcy court denied the Indenture Trustee's 507(b) Claim as to the Timberlands because there was "[n]o evidence . . . that the *liquidation or foreclosure value* at filing was higher than the *fair market value* at confirmation." Appellant 213 at 24:16-19 (emphasis added). Thus, the court compared the (typically lower) foreclosure value of the Timberlands in January 2007 to their (typically higher) fair market value in June 2008. Both the Supreme Court and this Court have held, however, that the "foreclosure value" of an asset does not fairly measure a secured creditor's interest in its collateral. *Assocs. Commercial Corp.* v. *Rash*, 520 U.S. 953, 955-56, 960-65 (1997); *In re Stembridge*, 394 F.3d at 386-88.

The bankruptcy court's error was significant. An asset's foreclosure value usually will be *substantially* lower than its fair market value (alternatively referred to as its "going concern" or "replacement" value) at the same moment. See *Rash*, 520 U.S. at 957-58 (foreclosure value "typically lower" than replacement value). The discrepancy between the two valuation standards arises because an asset's fair market value reflects "'a price as would be fixed by negotiation and mutual agreement, after ample time to find a purchaser, as between a vendor who is willing (but not compelled) to sell and a purchaser who desires to buy but is not

compelled to take the particular . . . piece of property.'" *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 538 (1994) (quoting BLACK'S LAW DICTIONARY 971 (6th ed. 1990)). By contrast, foreclosure value—the "very antithesis" of fair market value—involves a forced sale for "'the price which might be obtained on a sale at public auction or a sale forced by the necessities of the owner.'" *Id.* at 537-38 (same). There is a "glaring discrepancy between the factors relevant to an appraisal of a property's market value, on the one hand, and the strictures of the foreclosure process on the other." *Id.* at 538.

Employing contradictory valuation standards at either end of the Section 507(b) analysis is an apples-to-oranges comparison that subverts that provision's intended purpose to compensate secured creditors fully for any inadequately protected drop in the value of their collateral. See David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63, 86 (1991) (explaining that changing valuation methods in the middle of a case is "arbitrary and open to manipulation" because it "belies the objectivity that valuations are supposed to represent"; "[i]t would be better if a single valuation standard was adopted for an entire bankruptcy proceeding").

Here, using the foreclosure value on the Petition Date as the starting point for determining diminution in value masked the precipitous decline in the value of

the Timberlands during the pendency of the automatic stay. The bankruptcy court's stated reason for using inconsistent valuation methodologies to assess "diminution in value" was its belief that, "[w]ith non-cash property" such as the Timberlands, "the interest the secured creditor has a right to is the right to foreclose," and for that reason "the appropriate value to protect is the foreclosure value of the property and not [its] fair market value." Appellant 213 at 23:18-22.

That is wrong. In *Rash*, 520 U.S. at 962, the Court held that "the 'proposed disposition or use' of the collateral is of paramount importance to the valuation question." Where the continued use of collateral is contemplated, a secured creditor's interest in that collateral must be measured by its fair market value and not merely its foreclosure value. *Id.* at 955-56, 960. In so holding (in that case, for the purpose of a Chapter 13 cramdown), the Supreme Court explained that this Court had misconstrued 11 U.S.C. § 506(a), which describes how secured claims are valued. *Id.* at 959-65. This Court had reasoned—much as the bankruptcy court did here, see Appellant 213 at 23:16-24:22—that a "foreclosure value" standard was appropriate because the "creditor's interest" was "the right to repossess and sell the collateral and nothing more." See 520 U.S. at 958-59; see also 90 F.3d 1036 (5th Cir. 1996) (en banc). The Supreme Court, however, held that "the value of the property (and thus the amount of the secured claim under § 506(a)) is the

price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller"—that is, the fair market value of the property. 520 U.S. at 960.

There is no question here that that the "proposed disposition or use" of Scopac's Timberlands was to remain in operation. The Cash Collateral Orders and the MRC/Marathon Plan, for example, contemplated the Timberlands as a going concern. Moreover, had the automatic stay not blocked the Indenture Trustee from foreclosing on the Timberlands and the Cash Collateral, the Indenture would have *required* the Indenture Trustee to accept nothing less than the full amount due on the Notes ($740 million) at any foreclosure sale. Otherwise the Indenture required the Indenture Trustee to credit bid to acquire the collateral (see Appellant 269 at § 7.18), following which the Indenture Trustee could proceed with an orderly, not forced, sale of the Timberlands as a going concern for fair market value.

This Court has held since *Rash* that a secured creditor whose collateral is proposed for continued use is entitled to its fair market value *as of the petition date*. *In re Stembridge*, 394 F.3d at 388. In *Stembridge*, the bankruptcy court had applied *Rash*'s holding to valuation at confirmation, but (as here) concluded that a secured creditor's interest beforehand was merely the "total value realizable from its collateral through foreclosure." *In re Stembridge*, 287 B.R. 658, 662 (Bankr.

N.D. Tex. 2002). For that reason, the bankruptcy court determined that the value of a secured claim is *either* the foreclosure value of its collateral on the petition date *or* its replacement value at confirmation, whichever is greater. See *Stembridge*, 394 F.3d at 385. If the fair market value on the petition date was higher than both, the bankruptcy court concluded, it did not factor into valuation of the claim.

This Court reversed. The Court rejected the argument that the foreclosure value of collateral on the bankruptcy petition date appropriately measures a secured creditor's claim to assets that are proposed for continued use, holding instead that such a creditor must receive the fair market value of its collateral on the petition date. *Id.* at 388. That conclusion, the Court explained, is consistent with the purpose of providing adequate protection: If a court fails to give a secured claim its fair market value on the petition date, then it "eviscerate[s] the value of the secured creditor's claim for a depreciating asset—for each day after filing, the value of the collateral decreases, and the deficiency is neither *captured through adequate protection* nor . . . the confirmation plan itself." *Id.* at 387 (emphasis added).

This case is a mirror image of that principle. If a creditor's secured claim is valued by the fair market value of its collateral on the petition date, 394 F.3d at

388, and "[a]dequate protection, properly defined, is the amount of an asset's decrease in value from the petition date," *id.* at 387, then adequate protection guards against a decrease in that fair market value before confirmation. And, although Section 506(a)—the provision at issue in *Rash* and *Stembridge*—may not strictly apply to Section 507(b) claims, it "is often of critical importance in the adjudication of requests for adequate protection." 4 COLLIER'S ¶ 506.03[4][a][4] at 506-28. Indeed, using fair market value as of the petition date to measure the adequate protection to which a secured creditor is entitled flows naturally from the requirement that, unless reorganization efforts will not succeed, a bankruptcy court must apply a "fair market" or "going concern" value in connection with a motion for relief from the automatic stay on the ground that the movant is inadequately protected. See, *e.g.*, *Downey Sav. & Loan Ass'n* v. *Helionetics, Inc. (In re Helionetics, Inc.)*, 70 B.R. 433, 439-40 (Bankr. C.D. Cal. 1987); *First Trust Union Bank* v. *Automatic Voting Machines* (*In re Automatic Voting Mach. Corp.)*, 26 B.R. 970, 972 (Bankr. W.D.N.Y. 1983).

C. The Bankruptcy Court Improperly Allowed Hindsight Analysis To Obscure The Timberlands' Petition Date Value

The bankruptcy court's valuation of the Timberlands on the Petition Date was also legally flawed because it was based on a hindsight-driven valuation that did not reflect how an appraiser (or a buyer) would have evaluated the Timberlands

at that time. Section 507(b) safeguards the value of a secured creditor's collateral; in the Timberlands' case, the value protected is what a reasonable buyer would have paid for them on the Petition Date *knowing what a reasonable buyer would have known on that date*. In assessing the Timberlands' value on the Petition Date, however, the bankruptcy court skewed its analysis—and committed legal error—by improperly relying on data known (and knowable) only in hindsight, months *after* the Petition Date.

At the 507(b) Hearings, the court posed the critical question: Could it rely on information available only in hindsight when valuing the Timberlands? See Appellant 210 at 57:16-58:4. Over Appellants' objection, the court came to the wrong conclusion by allowing the introduction of, and improperly relying on, such data. But this Court has held that, when a court makes valuations as of a particular moment, "permitting the exercise of judgment in hindsight conflict[s] with basic economics." *Jimmy Swaggart Ministries* v. *Hayes (In re Hannover Corp.)*, 310 F.3d 796, 802 (5th Cir. 2002). Rather, "the facts must be considered as they existed at the time." *Brimberry* v. *Comm'r of Internal Rev.*, 588 F.2d 975, 979 (5th Cir. 1979).

In this case, the court relied on the opinion of MRC/Marathon's sole valuation expert, Richard LaMont, who improperly premised his estimate of the

Timberlands' Petition Date value on (1) reducing Petition Date log prices to reflect a *post-petition* economic slowdown that was not anticipated as of the Petition Date; (2) assuming a substantially lower harvest rate as of the Petition Date by incorporating *post-petition* decreases from the originally anticipated rate; and (3) asserting that an increase in forest size increased the Timberlands' value based on an admittedly "backwards looking" estimate of actual *post-petition* growth.

LaMont changed his pricing methodology to reflect timber price decreases that occurred only after Scopac's bankruptcy petition. In December 2006—just before Scopac's January 2007 petition—LaMont conducted seven appraisals of other timberland properties. Appellant 211 at 389:8-11. In all seven of those appraisals, LaMont assumed then-prevailing timber prices and projected that those prices would remain constant (in real terms) into the future. *Id.* at 391:24-392:10. Thus, even though LaMont *himself* had prepared a number of timberland appraisals in December 2006 that assumed the log prices would remain *flat*, his analysis of value as of the January 2007 Petition Date—*i.e.*, only one month later—assumed a sharp *decline* in log prices (depressing the starting value for purposes of measuring diminution in value).

LaMont accomplished that transformation by changing his pricing assumptions for *January 2007* in two important respects *after* MRC/Marathon

retained him in the spring and early summer of *2008* to estimate what Scopac's Timberlands were worth on the Petition Date (nearly 18 months earlier). First, he used prices from the *Pacific Rim Reporter* (a publication MRC/Marathon provided to him that he had never used to appraise timberlands before, see Appellant 212 at 27:9-25) rather than prices published by California's State Board of Equalization (SBE). The SBE prices, however, were those that Palco—Scopac's principal buyer—actually paid for Scopac's timber under its purchase agreement, see Appellant 172 at 79:6-10, and that LaMont himself had used before in "several" other appraisals, see Appellant 211 at 396:17-397:8. He switched to the *Pacific Rim Reporter* prices for an entirely impermissible reason: He believed that the 10-15% lower prices in that publication "seemed appropriate *given the market that we are in*." *Id.* at 403:15-18 (emphasis added). But the market conditions at confirmation were decidedly unlike those Scopac faced back in January 2007.

Second, LaMont dropped those timber prices by *another* 10% to reflect the "2007 average" price. Appellant 211 at 389:8-21; Appellant 276 at ¶ 21. That too was improper; a Timberlands appraiser in January 2007 would not have *known* the average log prices for the entire 2007 calendar year, let alone adjusted an appraisal to account for them. LaMont conceded that his contemporaneous, December 2006 appraisals had assumed "flat" prices, and that he changed that assumption in his

Timberlands valuation as of January 2007 to reflect a deepening recession that was not apparent until the spring of 2007, at least four months *after* the Petition Date. Appellant 211 at 391:24-393:12.

Those were not small errors. LaMont calculated that his Petition Date valuation of the Timberlands would have been approximately $15 million higher had he used pricing assumptions comparable to those he actually used in his December 2006 appraisals. See Appellant 212 at 109:24-25. The bankruptcy court nonetheless erroneously allowed his changed assumptions to affect its Petition Date valuation of the Timberlands.

In a second critical error, the LaMont valuation assumed (for no apparent reason) that the harvest rate estimated as of confirmation would also have been the projected harvest rate on the Petition Date. But LaMont had determined the harvest rate as of confirmation—60 million board feet per year—based primarily on data provided by Scopac's Chief Financial Officer *in December 2007* about Scopac's *actual* harvest in 2007. LaMont admitted that, when he prepared a business plan for Marathon to operate Scopac shortly before learning that information, he assumed an annual harvest rate of *78 million* board feet per year. But he nevertheless used a different, *much lower*, annual harvest rate for his Petition Date analysis in connection with the Section 507(b) proceedings, based on

post-petition harvest data. See Appellant 211 at 373:20-377:8. An accurate Petition Date valuation would have incorporated the harvest rate an investor would have projected for the Timberlands back in January 2007—before timber harvesting slowed.

Evidence demonstrated that harvest rates far in excess of 60 million board feet were being forecasted around the Petition Date. In a March 1, 2007, affidavit in support of its motion for a Cash Collateral Order, Scopac's Vice President—who was responsible for all growth modeling at the company—affirmed to the bankruptcy court that Scopac intended to harvest *100 million* board feet in both 2007 and 2008. Dkt-376 at ¶¶ 5, 12. Similarly, MRC Chairman Sandy Dean forecasted in April 2006 that Scopac would operate on a 90-million-board-feet harvest rate, rising over five years to as much as 100 million board feet. Appellant 417 at UBS000672. LaMont had himself contributed to a November 2007 business plan for Scopac that used a more modest harvest rate of 78 million board feet—one that was still much higher than LaMont assumed at the 507(b) Hearings. See Appellant 211 at 373:20-25. A higher projected harvest rate on the Petition Date means a significantly higher value; a tree you can harvest this year has a greater present value than a tree you will not get around to harvesting for a few years. As Dean conceded at the 507(b) hearing, it would make "a big difference"

if LaMont's Petition Date valuation had reflected at least a 90-million-board-feet harvest rate. Appellant 210 at 144:3-9.

Finally, when LaMont valued the Timberlands in support of confirmation in 2008, he assumed that their growth rate would equal their harvest rate—that is, that for each tree harvested in a year, a tree would grow to replace it. Appellant 212 at 32:3-32:21. When he valued the Timberlands as of the Petition Date, he also assumed that a Petition Date appraiser would likewise have used a growth rate equal to the harvest rate. But at the 507(b) hearing, he nevertheless asserted that—based on *actual* observed growth and harvest rates while the automatic stay was in place—the Timberlands *grew* net of harvest post-petition, and for that reason would appraise for more at confirmation than on the Petition Date. *Id.* at 32:22-34:13. LaMont admitted, however, that this was a "backwards-looking" addition to his methodology, based entirely on his estimation of actual, *post-petition* growth rather than estimates contemporaneous with the Petition Date. *Id.* at 85:11-15. By employing hindsight evidence of actual timber growth in this manner, LaMont could claim that, although no appraiser *either* on the Petition Date *or* at confirmation would have estimated any growth above harvest when valuing the Timberlands, actual 2007 and 2008 growth nonetheless increased their value by $5 to $7 million during the pendency of the bankruptcy case. Appellant 276 at ¶¶ 25-

26. Such use of the evidence was contrary to law, and the bankruptcy court improperly relied on this evidence, concluding when holding that the Timberlands did not decline in value that "the forests grew so that there are more trees." Appellant 213 at 25:3.

CONCLUSION

For the foregoing reasons, this Court should reverse the 507(b) Order and remand to the bankruptcy court for the allowance of the Indenture Trustee's 507(b) Claim for $38.6 million on account of the diminution in value of its interest in the Cash Collateral, plus the amount of diminution in the Timberlands' fair market value (free from adjustments in hindsight) between the Petition Date and confirmation.

Dated: January 19, 2010

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on January 19, 2010, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit by using the CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the CM/ECF system. I further certify that some of the participants in this case are not CM/ECF users. Pursuant to a written agreement between the parties, I have served the Appellants' Brief on the counsel listed below via electronic mail.

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitations of FED. R. APP. P. 32(a)(7)(B) because this brief contains 13,973 words, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of FED. R. APP. P. 32(a)(5) and the type style requirements of FED. R. APP. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2003 in 14-point Times New Roman typeface.

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