No. ______________________________

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Scotia Pacific Company, LLC,

Appellant-Petitioner,

v.

Marathon Structured Finance Fund L.P., Mendocino Redwood Company LLC, and The Official Committee of Unsecured Creditors,

Appellees-Respondents.

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

EMERGENCY MOTION FOR STAY AND INJUNCTION FILED BY SCOTIA PACIFIC COMPANY< LLC

[Expedited Ruling Requested on or before July 24, 2008]

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No. ______________________________

IN THE UNITED STATES COURT OF APPEALS
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Scotia Pacific Company, LLC,

Appellant-Petitioner,

v.

Marathon Structured Finance Fund L.P., Mendocino Redwood Company LLC, and The Official Committee of Unsecured Creditors,

Appellees-Respondents.

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

(1) 08-__________; *Scotia Pacific Company, LLC vs. Marathon Structured Finance Fund L.P., Mendocino Redwood Company LLC, and The Official Committee of Unsecured Creditors*

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

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/s/ Kathryn A. Coleman
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CERTIFICATE PER FIFTH CIRCUIT LOCAL RULE 27.4

The counsel for Scotia Pacific Company, LLC's co-appellant the Indenture Trustee has contacted counsel for appellees about this motion and expects that an opposition will be filed.

/s/ Kathryn A. Coleman
Kathryn A. Coleman
Attorney for Petitioner

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To the Honorable United States Court of Appeals for the Fifth Circuit:

Scotia Pacific Company, LLC ("Scopac") hereby joins in the relief requested in the *emergency* motion filed by The Bank of New York Mellon Trust Company, N.A., as Indenture Trustee (f/k/a **The Bank of New York Trust Company, N.A.)** requesting that this Court (or any one of its judges) issue a status quo order *on or before July 24, 2008,* including (1) a stay of the Bankruptcy Court's order confirming the plan of reorganization, and (2) an injunction prohibiting appellees from consummating the terms of the plan of reorganization pending this appeal.

PRELIMINARY STATEMENT

This case presents the classic situation in which a stay pending appeal is appropriate:

1. Irreparable Harm. Without a stay, under the plan of reorganization, Scopac's stock will be cancelled and all of its timberlands and other assets will be transferred to Marathon and MRC. Once consummated, the transfers would be extremely complicated to unwind and therefore any appellate review would be meaningless. Therefore, the appellants will suffer the irreparable harm of loss of appellate review, if this Court does not grant a stay pending appeal;

2. Likelihood of Success On The Merits. The Confirmation Order departs from decades of bankruptcy jurisprudence on an issue at the very core of the Bankruptcy Code: whether and under what circumstances a secured creditor

can be forced to accept treatment accorded it in a plan it votes against. The serious and very real legal questions on appeal satisfy the "likelihood of success on the merits" requirement as applied in the Fifth Circuit;[1]

3. Harm To Non-Appealing Parties. The appellants have offered several elements of protection to the non-appellant constituencies to ensure that no other party will suffer substantial harm as a result of the stay. The protections offered provide assurance that Scopac continues to harvest timber and to meet its environmental compliance obligations, and assurance that Palco will maintain its going-concern value, pay the costs of its operations going forward, and sustain no further losses during the pendency of the stay. In addition, to ensure that administrative creditors are protected in the unlikely event that the acquirer, Mendocino Redwood Company ("MRC"), elects to walk away from these timberlands it has coveted since at least 2006, and the appeal does not succeed, Scopac has asked the Bankruptcy Court to authorize it to sell Scopac's assets in a sale under Section 363 of the Bankruptcy Code. The requested sale terms include full payment of administrative creditors, and the possibility that Palco assets can be sold as well. One highly credible purchaser for certain Palco assets has already

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[1] See, e.g., *Arnold v. Garlock, Inc.,* 278 F. 3rd 426, 439 (5th Cir. 2001)(quoting *Ruiz v. Estelle,* 650 F.2nd 555, 565, (5th Cir. 1981).

offered to buy those assets and has pledged to keep that offer open for at least six months; and

4. The Public Interest. Granting a stay pending appeal serves the public interest because the Confirmation Order effectuates a result that no secured creditor would have anticipated: first, collateral is being sold and there is no ability for the secured creditor to credit bid, and second, equityholders are receiving value even though the claims of creditors are not being paid in full. The result in this case, if allowed to stand, will have a profound effect on the credit markets and secured lending. Therefore, it is in the public interest to ensure full appellate review. However, a full review is not possible unless a stay is granted.

Scopac's co-appellant, the Indenture Trustee, has argued points 1, 2 and 4 above. In the interest of brevity, Scopac focuses here on the issues raised in point 3.

ARGUMENT

I. THE PROTECTIONS OFFERED BY THE APPELLANTS ENSURE THAT ALL NON-APPELLANTS ARE APPROPRIATELY PROTECTED AGAINST THE CONSEQUENCES OF A FAILED APPEAL.

A. The Protections Offered by Scopac and the Indenture Trustee Ensure That The Losses at Palco Will Cease, Ongoing Expenses Will Be Paid, and The Debtor Companies Will Be Able to Continue to Operate During The Pendency of The Appeal.

1. MRC and Marathon are entitled to maintenance of the status quo at Palco and at Scopac, so that if the appellants are wrong and MRC/Marathon are eventually able to consummate their plan, the purchasers receive the benefit of their bargain, i.e. the asset they are buying has not deteriorated as a result of the pendency of the stay pending appeal.[2] The record of the proceedings held in the Bankruptcy Court as to the appellants' request for a stay pending appeal is clear that the soundness of the companies' operations and their compliance with their environmental obligations during the pendency of the stay are not in doubt; the only issue is ensuring log supply to Palco to enable it to mill lumber and sell it into the market.

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[2] In agreeing to buy Palco, MRC/Marathon are acquiring a money-losing operation. Maintenance of the status quo, therefore, does not entail making Palco profitable.

2. In order to effectuate that result, Scopac proposed the following "Log Discount Program," which would be in effect as long as the appellants are pursuing an appeal of the Plan Confirmation Order:

a. Beginning in June 2008 and ending in June 2009, Scopac will provide Palco each month with the least of (i) 5 million board feet ("MMBF"), (ii) all redwood logs available for delivery from Scopac to Palco, and (iii) the amount of redwood logs required by Palco to maintain its operations; and

b. Scopac will waive payment from Palco for the monthly value of logs supplied under this Log Discount Program, except to the extent of amounts that Scopac owes Palco, which will be offset against Scopac's obligation to pay for these services.

3. Revenue from logs milled and lumber sold by Palco will permit Palco to pay all of its reasonable ongoing costs and expenses during the pendency of the appeal.

4. Because it has agreed to provide logs to Palco without receiving payment for them, Scopac will need financing in order to maintain its liquidity. Lehman Commercial Finance, Inc. ("Lehman") has offered financing to Scopac, in the amount of $25 million with provision for an increase if more funding is needed and is approved by the Bankruptcy Court, for twelve months. Proceeds of the Lehman financing will be used to fund Scopac's ongoing operations in a manner that allows Scopac not to incur any further administrative claims at Scopac's estate

other than the costs of the financing, which will ultimately be borne by the Indenture Trustee's beneficiaries.

5. The Indenture Trustee has agreed that under any scenario, the diminution in the Noteholders' collateral by virtue of logs being delivered by Scopac to Palco without a resulting payment obligation, and the debt incurred by Scopac under the DIP, will come out of the Noteholders' recovery.

B. Scopac Has Suggested Ample Protection For Administrative and General Unsecured Creditors From Any Decision By MRC Not to Consummate Its Plan

1. As described in A. above, the Lehman DIP and the Log Discount Program work together to ensure that the two debtor companies' value is maintained. The next element is protection against the possibility that MRC decides not to buy these assets after all and walks away from the deal, the appeal is ultimately unsuccessful.[3]

2. Scopac has sought authority to sell its assets pursuant to Section 363 of the Bankruptcy Code if they are not sold to MRC/Marathon. Scopac has asked that the Bankruptcy Court include Palco assets in such a sale and that it require that

[3] The Indenture Trustee forcefully argues that Palco creditors are not entitled to any protection during the pendency of the appeal. In the event that this Court does not accept that argument, the unsecured creditors are the only constituency that could make even a colorable argument for protection.

any buyer in such a sale, even if it is paying the acquisition price via credit bid, be required to ensure that administrative and priority claims are paid in full, in cash.

3. If such a sale is allowed and consummated, then the only creditors who would receive payment under the MRC/Marathon plan who would not be paid out of the proceeds of the sale are the unsecured creditors of Palco, who would be receiving a gift from Marathon under the MRC/Marathon Plan in the amount of $10.1 million.

4. MRC is not entitled to any protection during the pendency of the appeal, as it is not a creditor of the estates and if it decides not to consummate the Marathon/MRC plan, that is a voluntary decision that does not give rise to any damages.

5. Going forward, Marathon will be paid the interest owing it under the Palco DIP Loan. Marathon is not entitled to any further protection because, under the MRC/Marathon Plan, Marathon only receives an equity interest in payment of its DIP Loan and the Town assets in satisfaction of its pre-petition term loan, in addition to being required to lend $25 million to Newco. Moreover, Marathon is not entitled to any protection in respect of its debtor-in-possession financing facility, which comes due at the end of July 2008, because even had the MRC/Marathon plan been confirmed, Marathon would not have received any payment in respect of the DIP loan.

6. The PBGC claim does not receive any distribution under the MRC/Marathon plan, as it is a contingent claim; it comes into existence only if the Palco pension plan is terminated. The Palco pension plan will not be terminated during the pendency of the appeal, and the budget provides for the payment of all pension fund contributions due during the pendency of the appeal. If the appeal is unsuccessful but MRC has walked away, then while it is possible that the buyer of Palco's assets could terminate the plan, if it does, the PBGC will assert that Palco, Scopac, and other members of the ERISA control group (both debtors and nondebtors) are jointly and severally liable for the full amount of the PBGC's claim. It is not appropriate for a bond to include protection for non-debtors who are jointly liable on claims against debtors.

7. Moreover, if MRC decides not to consummate the plan of reorganization, unless Marathon forecloses on the mill it is highly likely that the mill assets will be sold at a sale under Section 363 of the Bankruptcy Code. If Sierra Pacific Industries ("SPI"), which has offered to purchase the mill assets, is the buyer in that sale, it will assume the Palco pension plan (see the Declaration of A.A. "Red" Emmerson attached to Scopac's Brief In Support of Joinder In The Indenture Trustee's Emergency Motion for Stay Pending Appeal filed in the District Court).

8. Bank of America will be paid all interest payments owing it during the pendency of the appeal. Furthermore, it is entitled to first payment from the proceeds of the collateral it shares with the Noteholders and therefore will be paid in full under any scenario, even if MRC fails to consummate its plan.

9. Up to $350,000 will be available to pay the restructuring fees of each of Palco and Scopac each month, which should ensure that there will be no meaningful buildup of administrative expenses during the pendency of the appeal.

10. All environmental obligations of the Debtors shall be paid as and when they become due, just as they have been throughout the pendency of these cases.

C. The Fact That The Indenture Trustee Did Not Propose A Plan for Palco Is Irrelevant To The Analysis Of Whether The MRC/Marathon Plan Is Confirmable.

1. The Bankruptcy Judge presiding over this case has repeatedly stated that the Indenture Trustee could have taken a page from Marathon's book and proposed a plan that reorganized both debtors, and that its failure to do so justifies cramming down the MRC/Marathon Plan over the Indenture Trustee's objection. (See, e.g., Findings of Fact and Conclusions of Law On The Emergency Motion of the Indenture Trustee For Stay Pending Appeal and the Petition For Direct Appeal To The Fifth Circuit Court of Appeals, para. 13.)

2. The difficulty with that analysis is that the Scopac and Palco situations are not comparable, and the two debtors' respective secured creditors are not in the same position. A joint reorganization is very much in Marathon's interest because it does not entail upfront expense to Marathon, and most of the asset value is at Scopac, so to gain access to Scopac's assets as a source of recovery enhances Marathon's position.[4]

3. For the Indenture Trustee, on the other hand, a joint reorganization would require an upfront cash expenditure of $75,000,000 to repay the Marathon debtor-in-possession financing, as is required by the Bankruptcy Code in order to confirm a plan, and that expenditure would have netted the Indenture Trustee very little, if any, additional collateral value, because even after the $75,000,000 was paid, the Palco assets would have remained encumbered by $87,000,000 of debt to Marathon for its prepetition claims – debt that would have had to have been dealt with in a plan.

4. The Indenture Trustee's choice not to spend at least $75,000,000 to fund a joint plan whose consummation would not have materially benefited the Indenture Trustee is irrelevant to the confirmability of the MRC/Marathon Plan. Scopac respectfully submits that the fact that a given plan was proposed as part of

[4] The range of values asserted for the Palco assets at the confirmation trial was $110-120 million; for the Scopac timberlands alone, the range was $430-953 million.

a competitive process after the termination of exclusivity does not cure the defects in that plan, nor does it justify punishing the Indenture Trustee by denying a stay of its appeal. In fact, the proposal of this plan following the termination of exclusivity actually raises further important issues that require appellate review.

PRAYER

Scopac asks this Court to expedite consideration of the Indenture Trustee's motion, to act on or before July 24, 2008, and to issue a status quo order staying the bankruptcy court's orders and proceedings and enjoining appellees from effectuating the reorganization pending this appeal. Scopac also joins in the request of the Indenture Trustee for expedited briefing and oral arguments and all other appropriate relief to which it may be entitled.

Dated: July 22, 2008
New York, NY

Respectfully submitted,

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By: *<u>/s/Kathryn Coleman</u>*

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I certify that copies of this motion were served today by e–mail and certified mail, return receipt requested on July 22, 2008, on the persons named below:

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