No. 08-27

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

The Bank of New York Mellon Trust Company, N.A. (f/k/a The Bank of New York Trust Company, N.A.), as Indenture Trustee, *et al.*

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

BRIEF OF THE UNITED STATES OF AMERICA IN OPPOSITION TO APPELLANT'S EMERGENCY MOTION FOR STAY AND INJUNCTION FILED BY INDENTURE TRUSTEE

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(1) 08-27; *The Bank of New York Mellon Trust Company, N.A. (f/k/a The Bank of New York Trust Company, N.A.), as Indenture Trustee, et al. v. Marathon Structured Finance Fund L.P., Mendocino Redwood Company LLC And the Official Committee of Unsecured Creditors.*

(2) The United States incorporates by reference the lists of interested persons provided by the other filers

INTEREST OF THE UNITED STATES

On August 17, 2007, the Department of Justice filed protective proofs of claim for the U.S. Fish and Wildlife Service ("FWS") and the National Marine Fisheries Service ("NMFS"), which contend that Debtors must comply with their obligation under section 9 of the Endangered Species Act ("ESA") to refrain from "taking" listed species of fish and wildlife, unless such taking occurs pursuant to an "Incidental Take Permit" (or "ITP") issued under authority of section 10 of the statute. See 16 U.S.C. §§ 1531 et seq. (Bankruptcy Proofs of Claim 617 to 619). On April 4, 2008, the United States filed comments and limited objections to various proposed Plans of Reorganization with respect to their compliance with non-bankruptcy law. (Bankruptcy Court Docket No. 2599).

Debtors' environmental obligations relate to the 1999 "Headwaters Agreement." The FWS and NMFS ("Federal Wildlife Agencies") entered into this contract with the Debtors, the State of California, and others, to protect the environment and natural resources at issue in this matter, which encompass some of the largest remaining stands of old growth forests in the State. An important component was the development of a Habitat Conservation Plan ("HCP"), authorized pursuant to ESA section 10, 16 U.S.C. § 1539(a)(1)(B), designed to ensure the conservation and recovery of

the listed fish and wildlife species that would be affected by the Debtors' proposed timber harvesting and associated activities. The Debtors agreed to protect the species, and the Federal Wildlife Agencies issued the associated incidental take permits.

The federally-listed species of fish and wildlife at issue include the coho salmon (*Oncorhynchus kisutch*), Chinook salmon (*O. tshawytscha*), northern California steelhead (*O. mykiss*), northern spotted owl (*Strix occidentalis caurina*), marbled murrelet (*Brachyramphus marmoratu*s), and the western snowy plover (*Charadrius alexandrinus nivosus*). The Federal Wildlife Agencies have a strong interest in a prompt and successful reorganization of the debtors in a manner that will best ensure the recovery of these species, and full and continued compliance with the HCP and other related environmental requirements applicable to these lands.

SUMMARY OF THE ARGUMENT

The United States Department of Justice, on behalf of the Federal Wildlife Agencies, hereby files this response in opposition to the Indenture Trustee's ("IT") Emergency Motion for Stay and Injunction. The Federal Wildlife Agencies believe that the Mendocino/Marathon Plan – as confirmed by the Bankruptcy Court's June 6, 2008 Order – provides for compliance with the HCP and the associated Incidental Take Permits ("ITPs") currently in place

for the approximately 211,000 acres of redwood forests and other forestlands at issue in this case. Continued implementation of the terms of the HCP, as proposed under the MRC/Marathon Plan, will provide for the uninterrupted protection of the threatened and endangered fish and wildlife species listed above. Grant of a stay that could lead to a delay of that plan, or even worse, its withdrawal, may cause substantial harm to the species that the Federal Wildlife Agencies are charged with protecting.

STANDARD OF REVIEW

The Bankruptcy Court's decision denying a stay pending appeal is reviewed for "an abuse of discretion" – a standard which is "highly deferential." See, e.g., In re Target, 372 B.R. 866, 870 (E.D. Tn. 2007); see also, Sierra Club, Lone Star Chapter v. Ceder Point Oil Co., 73 F.3d 546, 579 (5th Cir. 1996). Further, the Bankruptcy Court's Findings of Fact cannot be overturned unless "clearly erroneous." Fed. R. Bankr. P. 8013; In re First South Savings Ass'n, 820 F.2d 700, 711 (5th Cir. 1987).

ARGUMENT

This Court should not disturb the Bankruptcy Court's judgment denying a stay pending appeal. As the Bankruptcy Court correctly concluded, the IT has not satisfied any of the four factors necessary to obtain a stay: (1) a substantial likelihood of success on the merits; (2) irreparable injury if the stay

is not granted; (3) showing that the grant of a stay will not substantially harm other parties; and (4) showing that the grant of a stay would serve the public interest. See Arnold v. Garlock Inc., 278 F.3d 426, 438 (5th Cir. 2001). In particular, the United States addresses the IT's failure to satisfy the third and fourth factors, because the grant of a stay will result in harm to the environment.

A stay would create substantial uncertainty regarding the future of these lands and the threatened and endangered species and ecosystems they support. In fact, there is a significant risk that the MRC/Marathon plan would be withdrawn if a stay is issued. See July 15, 2008 Order of the Bankruptcy Court at 9, ¶ 20. Withdrawal of this plan would leave the future ownership and management of these lands – and the imperiled species that depend on them – an open question.

The Federal Wildlife Agencies and the State of California are responsible for fulfilling the Congressional goal of conserving the ecosystems upon which endangered and threatened species depend. See 16 U.S.C. § 1531(b). In that regard, the Federal Wildlife Agencies oversee the ITP holders' implementation of the HCP to ensure that the obligations under the ITPs are being met. There is presently at least a $14 million backlog of roadwork, much of which is required to meet the environmental obligations in

the HCP. See California State Agencies App., Exhibits 6- 7; Trial Transcript May 1, 2008, beginning page 95, line 13 to page 96, line 10. As further described in the HCP, road upgrading, storm-proofing, and maintenance are important from an environmental standpoint, *inter alia*, because failure to perform road improvements and maintenance can cause unnecessary erosion, thereby producing harmful levels of sediment runoff into streams that provide important habitat for the federally-listed salmonids.[1]

Similarly, compliance monitoring under the HCP could suffer if this Court were to grant a stay. The HCP includes a requirement for independent monitoring. See Trial Transcript July 10, 2008, beginning page 187, line 3 to page 190, line 6. Compliance monitoring under the HCP is required to provide the Federal Wildlife Agencies with needed information to determine how well PALCO/SCOPAC is implementing the terms of the HCP, and hence protecting the species. The Federal Wildlife Agencies use this information to determine

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[1] In the event that this Court were to grant a stay, despite our objection, the Indenture Trustee should be required to post a bond that will provide for expedited performance of the backlogged road work and ensure compliance with all environmental requirements in the interim. The Bankruptcy Court found that any bond would need to include $9.5 million for the backlogged road work (down from $14.5 million of the total backlog, given that the DIP budget includes $5 million for roadwork). See Findings of Fact and Conclusions of Law on the Emergency Motion of the Indenture Trustee for Stay Pending Appeal (July 15, 2008) at 19-20.

whether suspension or revocation of the ITPs is required, as well as to assess liquidated damages. The Federal Wildlife Agencies are concerned that a stay would result in a reduction in funds for compliance monitoring, if any stay were to extend past January 1, 2009. See Trial Transcript July 10, 2008, page 188, lines 21-22. This could result in a significant breach of the HCP.[2]

Moreover, as the Federal Wildlife Agencies emphasized throughout the proceedings in Bankruptcy Court, any new owner or owners must be able to take on the responsibilities of the HCP and the associated ITPs. See 16 U.S.C. § 1539(a)(1)(B) (providing for issuance of permits for taking of listed species incidental to an otherwise lawful activity). The Federal Wildlife Agencies have strict regulations governing the issuance (or transfer) of ITPs under the ESA. Under the FWS regulations, the Director of the FWS must deny an ITP if any of the disqualifying factors in 50 C.F.R. § 13.21(c) are present, and may deny the ITP if, for example, the "applicant is not qualified." 50 C.F.R. § 13.21(b)(5); see also 50 C.F.R. § 222.303(e)(1)(v) (NMFS ITP regulations containing the same requirement). The Federal Wildlife Agencies have

[2] Nowhere, does the IT's motion pending before this Court expressly address the arguments presented by the United States and the State of California, in the briefing before this Court, as well as in the proceedings below, that a stay will result in environmental harms related to the backlog of road work and decreased compliance monitoring.

reviewed and tentatively approved the qualifications of the MRC/Marathon Plan companies (which would acquire ownership of the timberlands) as meeting the requirements of the HCP and the ITPs for timber harvesting and associated activities. Withdrawal of the MRC/Marathon plan would create uncertainty as to whether another entity would be so qualified.

Even if the MRC/Marathon plan is not withdrawn, a stay would entail a significant risk of short-term adverse impacts associated with any failure to fully implement the HCP during the appeal process (such as the roadwork backlog and potential reduction of independent compliance monitors) on account of the financial situation of the Debtors.

Finally, the Federal Wildlife Agencies also oppose Appellant's request in the alternative for an interim stay through September 4, 2008. Even a short stay raises at least some risk of MRC and Marathon jointly withdrawing their plan. Appellant takes the Bankruptcy Court's findings out of context in noting that "there exists a 60-day window – from the date of the July 8th confirmation order – during which MRC remains absolutely bound under the MRC/Marathon plan." See Appellant's Motion at 20. While this is true, MRC and Marathon may jointly withdraw at any time. In fact, the Bankruptcy Court found as follows:

> If the MRC/Marathon Plan is stayed pending appeal, there is a substantial risk that MRC and/or Marathon may be unwilling

> or unable to proceed with the MRC/Marathon Plan at or before the conclusion of any appeal. There is no dispute that if a stay is in place in 60 days following the date of the Confirmation Order, MRC has an absolute right to withdraw from the MRC/Marathon Plan. *Moreover, MRC and Marathon can jointly withdraw the MRC/Marathon Plan at any time prior to its going into effect*.

July 15, 2008 Order of the Bankruptcy Court at 9, ¶ 20 (emphasis added).

CONCLUSION

For the foregoing reasons, this Court should deny Appellant's Emergency Motion for Stay and Injunction.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that the facts supporting the United States Opposition to the Emergency Consideration of the Motion are true and complete and that the Fifth Cir. R. 27.3 requirement of electronic notice to the clerk's office and opposing counsel has been complied with.

_____*Bradford McLane*_____________
BRADFORD T. MCLANE

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of July, 2008, I have served upon the following, by electronic mail, copies of this brief. Pursuant to Fifth Circuit Rule 27.3, the Motion was served on all parties at the same time it was filed with the Court.

/s Bradford McLane
BRADFORD T. MCLANE