

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF TEXAS  
CORPUS CHRISTI DIVISION

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

\*\*\*\*\*

CONFIRMATION HEARING

TAKEN ON APRIL 9, 2008

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On the 9th day of April, 2008, the above entitled and numbered cause came on to be heard before said Honorable Court, RICHARD S. SCHMIDT, United States Bankruptcy Judge, held in Corpus Christi, Nueces County, Texas.

Proceedings were reported by machine shorthand.

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JEFFREY L. JOHNSTON

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19 Q. Okay. Before I -- before I forget, I'm going  
02:59 20 to --

21 MR. NEIER: May I approach the witness,  
22 Your Honor?

23 THE COURT: You may.

24 Q. (By Mr. Neier) Mr. Johnson, I'm showing you  
02:59 25 what's been previously marked as MMX 3. I would ask you

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1 to take a look at it and see if you recognize it.

2 A. Yes, this is my declaration.

3 Q. And is it true and correct?

4 A. It appears to be, yes.

02:59 5 MR. NEIER: Your Honor, I would ask that  
6 MMX 3 be moved into evidence.

7 THE COURT: Any objection?

8 MR. CLEMENT: No objection.

9 THE COURT: All right.

03:00 10 Q. (By Mr. Neier) Now, in addition to your  
11 valuation of Newco on a proforma basis, did you review  
12 any other materials of experts in these cases?

13 A. Yes. I reviewed what I would call the Daniel's  
14 securities valuation, which was Mr. Daniel's analysis of  
03:00 15 the new timber notes, the value of the new timber notes.

16 I also reviewed the affidavit of Mr. Zelin on the same  
17 subject. And I reviewed Mr. Daniel's enterprise value of  
18 Scopac.

19 Q. Okay. With respect to the first thing that you  
03:00 20 mentioned, I believe was Mr. Daniel had performed a



23 MR. CLEMENT: Objection, leading.

24 THE COURT: Don't lead the -- well, of  
03:02 25 course, you can really lead an expert witness, but try to

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1 ask the question.

2 Q. (By Mr. Neier) You mentioned that you had had  
3 some -- or noticed something with respect to the  
4 comparable or guideline companies used in Mr. Daniel's  
03:02 5 evaluation of the new timber notes. What is it that you  
6 noticed?

7 A. Well, as I indicated, that the debt that  
8 Mr. Daniels analyzed in valuing the new timber notes,  
9 that that was not the debt of other timber companies or  
03:02 10 other comparable companies, so the flaw, in my view, in  
11 that analysis is that he was really comparing apples to  
12 oranges and the -- if the intent was to do a comparable  
13 debt analysis, I don't think that was accomplished.

14 Q. Okay. Why are these companies not comparable,  
03:03 15 in your view?

16 A. Well, the timber related companies are unique.  
17 They -- they obviously are -- have long-term assets.  
18 They have unique assets. And therefore, the debt that  
19 can be associated with those assets, I believe, should be  
03:03 20 evaluated on an apples to apples basis. And I don't --

21 Q. And the companies that you mentioned earlier  
22 are not timber companies? That is, the comparable  
23 companies used by Mr. Daniel in this security valuation?

24 A. That's correct.



1 Q. And how much are the existing timber notes in  
2 face amount? Or how much debt obligations is there  
3 presently on the timberlands or backed by the  
4 timberlands?

03:05 5 A. Approximately \$714 million dollars in  
6 principal, that's the number I understand.

7 Q. And how much debt obligation will there be with  
8 that same collateral with respect to the new timber  
9 notes?

03:05 10 A. \$325 million.

11 Q. Now, is there anything else with respect to the  
12 Daniels securities valuation that you thought was at  
13 issue?

14 A. Well, my other comment with respect that is  
03:06 15 Mr. Daniels, as I mentioned, also performed a valuation  
16 of Scopac where he had to make an assumption about the  
17 cost of debt for Scopac. There was a rather significant  
18 consistency in his assuming cost of debt for his Scopac  
19 valuation, which was 7 percent, relative to the interest  
03:06 20 rate he was assigning to the new timber notes in his  
21 securities valuation, which ranged from 8 and a half to  
22 12 and a half percent. So I believe there's an inherent  
23 inconsistency in those two valuations by Mr. Daniel.

24 Q. Okay. And with respect to -- I think you  
03:06 25 mentioned the Zelin affidavit and the securities





2 A. Yes.

3 Q. And were you able -- I'm sorry. Before I get  
4 to that, were you able to form your own conclusion with  
03:08 5 respect to the value of the new timber notes?

6 A. Yes.

7 Q. And what was that conclusion?

8 A. That conclusion was the new timber notes are  
9 worth somewhere between \$266 million and \$326 million.  
03:08 10 Again, the face amount of those obligations is \$325  
11 million. So a range of 266 to 326 or a midpoint of  
12 approximately \$289 million.

13 Q. Okay. Now, you mentioned that you had also  
14 looked at Mr. Daniels valuation of Scopac. That is, the  
03:09 15 existing Scopac; is that right?

16 A. Yes.

17 Q. And did you -- were you able to form any  
18 conclusions or do you have any observations with respect  
19 to Mr. Daniels valuation of Scopac?

03:09 20 A. Yes. First of all, I believe the valuation of  
21 Scopac is overstated because Mr. Daniel did not account  
22 for income taxes in his valuation of Scopac.

23 Q. In what manner did he not account for income  
24 taxes?

03:09 25 A. Well, Mr. Daniel effectively treated Scopac as

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1 a tax exempt entity. In his appraisal report he  
2 indicated that he assumed it will be a tax efficient  
3 entity. That is, a pass-through entity that's subject to



6 through its taxes, what is the amount that Mr. Daniel has  
7 overstated his valuation, in your words?

8 A. Again, by ignoring taxes completely in his  
9 valuation, I believe all other things being equal, his  
03:11 10 value -- his valuation conclusion is overstated by  
11 approximately \$164 million.

12 Q. Now, do you have any other observations with  
13 respect to Mr. Daniels valuation of Scopac?

14 A. Yes. I believe that Mr. Daniels also  
03:12 15 improperly applied a market multiple method in his  
16 valuation conclusion. And what I mean by that is  
17 Mr. Daniels selected four so-called guideline of  
18 comparable companies as one means of valuing Scopac.  
19 Each of these companies, by the way, is in the timber  
03:12 20 business, although I have some criticism about how just  
21 how comparable they are to Scopac.

22 But putting that aside for a moment,  
23 Mr. Daniel, instead of taking the mean or the average of  
24 these four companies, he identified as comparable in  
03:12 25 determining his valuation conclusion, he selected the

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1 high end of the range in -- for these guideline  
2 companies. So thereby, skewing the valuation result to  
3 the high end in contrast to taking some average or mean.

4 Q. And with respect to this valuation of  
03:13 5 Mr. Daniels, are there any other observations you were  
6 able to reach?

7 A. Another approach that Mr. Daniels used was to



03:15 10 any direct examination of this witness? All right.  
11 Cross-examination. Mr. Clement.  
12 CROSS-EXAMINATION  
13 BY MR. CLEMENT:  
14 Q. Mr. Johnston and Your Honor, we'll be using  
03:15 15 three documents primarily during this cross-examination.  
16 The first one is Marathon Exhibit 3, and that's  
17 Mr. Daniel's proffer.  
18 MR. CLEMENT: Your Honor, the other two  
19 are Mr. Daniel's two exhibits, that is Indenture Trustee  
03:15 20 Exhibit 13 and 12.  
21 THE COURT: Are they Mr. Daniels'  
22 exhibits? That's your -- which exhibits are they now,  
23 Marathon?  
24 MR. CLEMENT: Marathon Exhibit --  
03:16 25 THE COURT: 12 and 13?

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1 MR. CLEMENT: Marathon Exhibit 3, which is  
2 Mr. Johnston's proffer.  
3 THE COURT: Got that one.  
4 MR. CLEMENT: And Indenture Trustee  
03:16 5 Exhibits 12 and 13. And Your Honor, what I found is if  
6 you pull these things out, it becomes a lot easier to  
7 deal with.  
8 THE COURT: Well, okay, I can find them.  
9 So it's 12 and 13?  
03:16 10 MR. CLEMENT: Yes, Your Honor. We have  
11 got people trying to put these up in the screen, and



14 the exhibits, Your Honor, and it's hard to find. It's  
03:19 15 not easy to point to any page. But it says at the  
16 beginning of the first page "expert rebuttal report of  
17 Jeffrey L. Johnston."

18 THE COURT: And you think it's halfway  
19 through.

03:19 20 MR. CLEMENT: Halfway through the  
21 exhibits.

22 THE WITNESS: It's after the numbers.

23 THE COURT: I got it.

24 Q. (By Mr. Clement) Mr. Johnston, when we start  
03:19 25 here on your expert rebuttal report in paragraph 2(c),

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1 you start by criticizing Mr. Daniel. Actually, let's  
2 flip back. This is the executive summary. Let's flip  
3 back to analysis, which is on page 2. And you start by  
4 criticizing Mr. Daniel for saying that none of the  
03:20 5 companies annualized -- analyzed in Daniel's security  
6 valuations are timber related companies. Now, his  
7 securities valuation is this short one, Exhibit 13; is  
8 that correct?

9 A. Correct.

03:20 10 Q. His longer valuation of Scopac is Exhibit 12,  
11 the fatter one, correct?

12 A. Correct.

13 Q. You say "in the Daniel Scopac valuation he used  
14 four timber related companies." Now, let's turn, if we  
03:20 15 would, please, to page 20 in the big fat one, Exhibit 12.





18 page 40 in this same big fat Daniel analysis, it says  
19 "discounted cash flow guideline company for weighted  
03:22 20 average cost to company analysis." Do you see that?  
21 A. Yes.  
22 Q. The same four companies, right?  
23 A. Yes.  
24 Q. Four timber REITs. Now, isn't it a fact that  
03:23 25 Mr. Daniel assumed that if you have a stand-alone Scopac

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1 that the best thing it could do to maximize value was to  
2 organize itself as a REIT, a timber REIT, so it wouldn't  
3 have to pay what amounts to corporate income tax,  
4 correct?  
03:23 5 A. I don't know why Mr. Daniel made that  
6 assumption.  
7 Q. Well, I will assert it. It is true, is it not,  
8 do you have any reason to dispute the assertion that  
9 Mr. Daniel chose to organize Scopac on a stand-alone  
03:23 10 basis as a timber REIT in order to save taxes?  
11 A. As I say, I don't know why he did that.  
12 Q. Next, if you assume that that's how you're  
13 going to organize Scopac on a stand-alone basis, doesn't  
14 it make sense to use as comparables other timber REITs  
03:23 15 that are organized in the same fashion?  
16 A. Not necessarily.  
17 Q. Do you know whether there is any difference in  
18 the leverage ratio for timber REITs versus ordinary real  
19 estate REITs, do you know?







1 simply showed how much coverage one gets from the  
2 EBITDA's projected in that business plan versus the debt  
3 that you're going to put on Newco?

4 A. Yes, that's correct.

03:29 5 Q. And it shows across the bottom of the page that  
6 in year one the debt will be 13.9 times EBITDA, correct?

7 A. Correct.

8 Q. Year two, 11.9 times EBITDA?

9 A. Yes.

03:29 10 Q. Year three, 11.2 times EBITDA?

11 A. Yes.

12 Q. Year four, 10.7 times EBITDA?

13 A. Yes.

14 Q. It never drops below 10, does it?

03:30 15 A. In these -- in this period, no.

16 Q. Now, sir, the debt-to-capital ratio that you  
17 are proposing in Newco is more like 80 debt and 20  
18 capital than what Mr. Daniel was looking at for a  
19 reorganized Scopac, which was only about 20 percent debt  
03:30 20 load; isn't that a fair characterization?

21 A. There is significantly more debt assumed in  
22 Newco than in Mr. Daniel's vision of Scopac.

23 Q. So when Mr. Daniel was looking for ways to  
24 evaluate these notes that are proposed to be given to the  
03:30 25 timber noteholders on Newco, which is a merger of Palco



1 A. The range on this page is 10 to 12, 10.5 to 12.

2 Q. Moving on to page 14. "The following table  
3 describes all secured leverage loans since August 22nd,  
4 2007 where the leverage through the security was greater  
03:33 5 than five times." Here we've got greater than 10 times,  
6 correct, with Newco?

7 A. Yes.

8 Q. So he's looked at things even down to greater  
9 than five times and he's come up with a range there  
03:33 10 between 9.3 and on the high end, 17.1, correct?

11 A. For companies that are not similar to Newco,  
12 yes.

13 Q. If you look at all of the debt that has been  
14 issued since August of 2007 that's five times levered or  
03:33 15 higher, that's the range, isn't it?

16 A. I haven't double-checked whether this is all  
17 the debt that's been issued but that's the range that's  
18 indicated.

19 Q. Moving on to page 16, "average yield to worst  
03:34 20 of outstanding senior secured notes by leverage." Now,  
21 this thing shows that if it's more than five times  
22 levered, the interest rates are in the range of 8.4  
23 percent and if it's more than six times levered the  
24 interest rate is about 9 percent and if it's over 7, the  
03:34 25 interest rate is 16.1 percent. Now, sir, I suggest to

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1 you that if you pick comparable companies based upon the





4 income tax?

03:36 5 A. Again, Mr. Lamont valued a piece of real  
6 estate. He didn't value a business which pays taxes or  
7 subject to taxes.

8 Q. And isn't it a fact that Mr. Yerges similarly  
9 assumed that the trees would be in a so-called tax  
03:37 10 efficient entity such as a REIT that doesn't pay any  
11 corporate income tax?

12 A. Again, Mr. Yerges valued real estate. He did  
13 not value a business like I did.

14 Q. Now, sir, let's move on to the question of  
03:37 15 whether you got any comparables that are better than what  
16 Mr. Daniel used when he picked them based upon leverage  
17 size.

18 So what, sir, are the comparables that you  
19 think he should have used for evaluating the discount or  
03:37 20 the interest rate of the timber notes that you're going  
21 to hand out?

22 A. Well, as I indicated in my rebuttal report,  
23 there are a number of sources of information in this  
24 case, all of which pertain to timber related businesses  
03:38 25 that are a source for that information. An example of

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1 that would be the -- would be the -- one example would be  
2 the four companies that Mr. Daniel did use as  
3 comparables. And the cost of debt associated with those  
4 companies.

03:38 5 Q. What do you think that is?



8 report of the yield to maturity on the debt for these  
9 companies. So yes, there is a difference. I don't know  
03:41 10 if the difference is due to when the measurement  
11 occurred, but I believe the methodology to determine the  
12 rate in both cases was the same.

13 Q. Isn't it a fact, sir, that Mr. Daniel laid out  
14 in detail on pages 61 through 64 exactly how he got to  
03:41 15 the 6.9 number and that you've given us no detail beyond  
16 a report last Friday night claiming that you got  
17 something from Bloomberg that came out to 6.19; isn't  
18 that true?

19 A. That is true.

03:42 20 Q. Would you be surprised if Mr. Daniel has done  
21 the arithmetic and concluded he was absolutely right  
22 after all and that you failed to make proper adjustments  
23 when you came to your 6.19?

24 A. I don't know if that would surprise me or not.

03:42 25 Q. Now, what else, sir, do you think Mr. Daniel

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1 has done wrong in his valuation of the timber notes?

2 A. Well, I'd like to continue in answering your  
3 first question.

4 Q. Sir, the question was what else do you think  
03:42 5 Mr. Daniel has done wrong? Your counsel can bring out  
6 anything further you would like to volunteer. What else  
7 do you think Mr. Daniel has done wrong in his valuation  
8 of the new timber notes?

9 A. The other -- one of the other observations I







16 into account exactly as I just described and came to the  
17 conclusion that what was the dominant factor was the  
18 ability to earn cash and service the debt, especially in  
19 today's marketplace?

03:48 20 A. Well, if that's the same way of saying and  
21 ignoring the collateral, then it wouldn't surprise me.

22 Q. Would it surprise you if I told you that the  
23 foregoing was true and that that is the manner in which  
24 he took into account the quality of this particular  
03:48 25 timber collateral?

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1 A. No.

2 Q. Now, what else do you think Mr. Daniel did  
3 wrong?

4 A. Well, as I comment in my rebuttal report and  
03:49 5 this relates to the subject, I believe, we were just  
6 covering. One of Mr. Daniel's -- one of the things  
7 Mr. Daniels highlights is the leverage ratio that Newco  
8 will -- Newco will have. And one of the things I point  
9 out in my report is that when it comes to REITs, that the  
03:50 10 leverage ratio of Newco relative to REITs that are other  
11 real estate based companies is actually very much in  
12 line. One of the things that I looked at in this regard  
13 was the leverage ratio of numerous REITs, over 200 REITs,  
14 and what the current interest rate on that debt is. And  
03:50 15 what the current leverage ratio of those REITs are. And  
16 the average leverage of those REITs was approximately  
17 11.5 times EBITDA. This compares to a little over 10, as





03:52 20 that is, real estate companies of which I believe Newco  
21 falls within a broad class, are highly levered companies.  
22 Nine, 11.5, 10.7, I think within a range, we can call  
23 those highly levered, albeit for that industry it appears  
24 to be more of the norm.

03:53 25 Q. Isn't it a fact that that, too, is misleading

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1 for the following reason: That most of the companies  
2 that you get when you look for REITs are office building,  
3 real estate type REITs and not timber REITs?

4 A. I would think that most of the companies in  
03:53 5 that population are not timber REITs, there aren't that  
6 many timber REITs.

7 Q. There you go. And isn't it a fact that the  
8 leverage ratio on the regular real estate REITs is a lot  
9 higher than the leverage ratio on the timber REITs?

03:53 10 A. I have not made that analysis because I haven't  
11 evaluated every timber REIT, but I think the point is  
12 that the real estate related companies are typically  
13 highly levered.

14 Q. And isn't it a fact that the reason that the  
03:54 15 real estate REITs are so much higher levered than the  
16 timber REITs is the following: REITs have to distribute  
17 a lot of their income or else they don't get to be REITs  
18 anymore; is that correct?

19 A. Yes, I believe that's correct.

03:54 20 Q. So it's hard to have much retained capital if  
21 you're a REIT; is that correct?



24 A. I think in the case of the four that we've been  
03:56 25 talking about, that's true.

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1 Q. Thank you. What else has Mr. Daniel done  
2 wrong?

3 A. I think those cover the main areas with respect  
4 to the securities valuation.

03:56 5 Q. Anything else he's done wrong with respect to  
6 his valuation of Scopac?

7 A. Yes.

8 Q. What's that?

9 A. The items I discussed with Mr. Neier.

03:56 10 Q. Which is?

11 A. Well, the first of which was the failure to  
12 provide for income taxes in his valuation of Scopac.

13 Q. Now, let's be clear about what that generality  
14 that I heard you use four or five times really means.

03:57 15 What you're saying is that Mr. Daniel did not take into  
16 account the income tax that the owner of the investment  
17 would pay; is that correct?

18 A. That relate to corporate earnings, yes.

19 Q. Isn't it a fact that the -- by the vast  
03:57 20 majority, all valuations that are done in bankruptcy  
21 court that are intended to be enterprise valuations focus  
22 on the cash flow thrown off by the company and do not  
23 focus on the tax paid by the owner of the investment?

24 A. Well, what we're -- when we're talking about  
03:58 25 tax efficient or pass-through entities, I certainly hope













7 in your opinion, is necessary for this Newco note, one  
8 percent?

9 A. Well, using the American Ag proposal as an  
04:08 10 indicator of that, the spread over the 30 year treasury,  
11 I believe, would be approximately 255 basis points.

12 Q. Over ten year treasuries?

13 A. No, over 30 year treasuries.

14 Q. Over 30 year?

04:08 15 A. Yeah.

16 Q. Now, do you think that's an appropriate risk  
17 factor for this business, more than ten times levered for  
18 the next four years?

19 A. Well, apparently American Ag does because  
04:08 20 that's the proposal they made.

21 Q. Are you aware of the following: That MRC's  
22 primary lender is American AgCredit?

23 A. I'm aware there's a relationship there, yes.

24 Q. Are you aware that Mr. Dean asked American  
04:08 25 AgCredit to give this term sheet in order to find out

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1 what the rate was in the market?

2 A. That's not my understanding of why it was  
3 provided.

4 Q. Are you aware that there was no negotiation  
04:09 5 between MRC and its lender, American AgCredit, about  
6 giving this term sheet?

7 A. I don't understand the question, no  
8 negotiation. I don't know what you mean.



11 MR. NEIER: He works for the debtors, Your  
12 Honor, he wants to cross the witness.

13 THE COURT: Okay. I guess that's true.

14 We have three sides to this. Go ahead. I think it might  
04:11 15 be better if the debtors did their cross before the  
16 parent on these, but that may not be true. But if you  
17 have a problem with that, we'll talk about it later. But  
18 go ahead.

19 MR. NEIER: I will just tell you that  
04:11 20 there's been a general agreement among the parties  
21 that --

22 THE COURT: It would be this direction?

23 MR. NEIER: No, it's a triangle so  
24 whenever one witness is up, the other two sides get  
04:11 25 together and figure out who will go first.

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1 THE COURT: Okay. That's fine. That's a  
2 great way to do it. It's nice to know that some of you  
3 in various ways you're working together.

4 MR. NEIER: Against each other, Your  
04:12 5 Honor.

6 THE COURT: Right.

7 CROSS-EXAMINATION

8 BY MR. LAMB:

9 Q. Mr. Johnston, I don't think we've met. I'm  
04:12 10 George Lamb and I represent the Pacific Lumber Company.  
11 I just want to talk to you about your valuation of the  
12 new timber notes that the noteholders are receiving. As



04:13 15 Q. And the ranges of reasonableness that they have  
16 come up with are significantly lower than the range of  
17 reasonableness that you have come up with, correct?

18 A. I think that's a fair statement.

19 Q. Having looked at the two ranges that Zelin and  
04:13 20 Daniel came up with, did you look at those and then go  
21 back and take a good hard look at your range of  
22 reasonableness?

23 A. Well, I certainly considered what they did.

24 Indeed, part of the basis for my opinion is to the value  
04:14 25 is based on what they or their co-experts did. For

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1 example, one of the bases for my conclusion of value is  
2 using the cost of debt for the guideline companies that  
3 Mr. Daniel selected. Another bases for my conclusion of  
4 value is the cost of debt that Mr. Daniel selected in his  
04:14 5 Scopac valuation. And another basis for my conclusion of  
6 value is the cost of debt that Mr. Yerges selected in his  
7 timberlands valuation.

8 So I believe I certainly took into account the  
9 other work they've done in this matter as well as the  
04:15 10 work they did specifically in valuing the securities.

11 Q. Let me ask it a different way. Have you looked  
12 at their valuations and said, boy, the two other experts  
13 who took two different approaches to valuation have come  
14 up with a range that's considerably lower than mine,  
04:15 15 maybe there's something wrong with mine, let me review it  
16 again and see? Have you done that kind of self-critical



19 stand by mine.

04:17 20 Q. And both of their ranges of reasonableness are,  
21 in your view, unreasonable?

22 A. I don't believe they're correct.

23 Q. Are they reasonable?

24 A. No.

04:17 25 Q. On page 4 of your rebuttal, paragraph 2, maybe

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1 we can enlarge it a little bit. You had a discussion  
2 with Mr. Clement about the leverage here. It says,  
3 "Mr. Daniel highlights the claimed high leverage of Newco  
4 in his securities valuation report. Specifically at page  
04:17 5 5 he notes that leverage through the new timber notes  
6 would never be lower than 10.7 times EBITDA during the  
7 period 2008 to 2012." Then you say, though, that that's  
8 not unusual because you've looked at 200 REITs. How many  
9 of those 200 were timber REITs?

04:18 10 A. I don't know.

11 Q. Were any of them timber REITs, do you know?

12 A. I don't know.

13 Q. Are you aware of any timber REIT with a  
14 leverage of 10.7 times EBITDA?

04:18 15 A. Not specifically, I don't know one way or the  
16 other.

17 Q. What's Plum Creek's leverage?

18 A. Well, I'd have to find it for you in these  
19 materials. I don't know it offhand.

04:19 20 Q. Does 4.5 sound about right?





23 equates to a BBB plus to BBB credit rating. I then said,  
24 let's try to convert that into what an interest rate in  
04:21 25 the new timber notes would be, which have a 35-year

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1 maturity. So I went and looked at the longest maturity  
2 in treasury securities, which is 30 years, and I looked  
3 at the credit -- or the spread for BBB plus to BBB  
4 30-year -- above 30-year treasuries, and that was  
04:21 5 approximately 255 bases points. So the conclusion was  
6 using the American Ag proposal as one indication, that --  
7 what the cost may be on the new timber notes, that  
8 converted to a 6.95 percent interest rate.

9 Q. You expressed earlier the importance of apples  
04:22 10 to apples. Is taking a bank's expression of interest  
11 rate and turning it into a corporate bond rating apples  
12 to apples?

13 A. I think the methodology that I have applied  
14 here is -- does just that. I don't think there's --

04:22 15 Q. Do you think you can apply a corporate bond  
16 rating from a bank's expression of interest on a bank  
17 loan?

18 A. Well, let me -- let me answer it this way. The  
19 short answer is yes because the -- what my analysis does  
04:22 20 is say what is the corporate bond rating given this  
21 spread. And that's how the spread tables are prepared.  
22 That is, the spread above particular treasury securities.  
23 So you can actually go to the table and locate the  
24 applicable credit rating and then extract it or



1 MR. LAMB: Thank you.

2 THE COURT: Any other agreements about who  
3 was going to go before?

4 MR. NEIER: Well, we have other people,  
04:24 5 Your Honor. I don't know if anybody else wants to --

6 THE COURT: Anybody else interested before  
7 the last redirect? All right. You're up.

8 REDIRECT EXAMINATION

9 BY MR. NEIER:

04:25 10 Q. Mr. Johnston, can you go to Exhibit 13 of the  
11 indenture trustee exhibits. That's the -- what  
12 Mr. Clement referred to as the small report or the thin  
13 report, whatever. Do you have that?

14 A. Yes.

04:26 15 Q. Now, this is the report on the securities  
16 valuation, correct?

17 A. Yes.

18 Q. That was prepared by Houlihan Lokey, correct?

19 A. Yes.

04:26 20 Q. And by Mr. Daniel, correct?

21 A. Yes.

22 Q. Okay. Can you turn to page 14 of that report?

23 Do you have that?

24 A. Yes.

04:26 25 Q. Are these the comparable companies that



1 Q. And X-Rite, Inc., is that in the timber  
2 business?  
3 A. No.  
4 Q. What business is that in?  
04:27 5 A. General manufacturing.  
6 Q. And Remy International, another company in  
7 Chapter 11, I believe. Is that company in the timber  
8 business?  
9 A. They're an automotive company.  
04:28 10 Q. Do you see any timber related companies used in  
11 Mr. Daniel's securities valuation company comparable  
12 analysis?  
13 A. No.  
14 Q. Is Scopac today a timber REIT?  
04:28 15 A. No.  
16 Q. Scopac today is not a timber REIT?  
17 A. That's correct.  
18 Q. What is it?  
19 A. Scopac is a timberland company, it's not a  
04:28 20 REIT.  
21 Q. So Mr. Daniel didn't evaluate Scopac today as  
22 it exists today, correct?  
23 A. That's correct.  
24 Q. So his valuation is something other than what  
04:28 25 the debtor is today, Scopac?

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1 A. Yes.  
2 Q. It's what the debtor could become under the



04:30 5 cost of debt and the difference between 6.9 and 6.19. Do  
6 you recall that testimony?

7 MR. CLEMENT: Your Honor, I'll keep this  
8 short. Your Honor ruled yesterday that if rather than  
9 have us do redirect and recross, that we object. And I

04:30 10 have refrained so far.

11 THE COURT: So you think he's getting  
12 beyond your questions?

13 MR. NEIER: I'm asking about --

14 MR. CLEMENT: Your Honor, the reason he's  
04:31 15 getting beyond is there have been four questions in a row  
16 that misassert what I said, what went on earlier. Now, I  
17 didn't want to break up the flow, but if that's what's  
18 going to continue, I will need to do recross.

19 MR. NEIER: He can object to whatever he  
04:31 20 wants.

21 THE COURT: If he misasserts to something  
22 you said, you should object. So make sure you are  
23 careful about the way you state his assumptions.

24 MR. NEIER: Okay.

04:31 25 THE COURT: All right?

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1 MR. NEIER: Yes, Your Honor.

2 Q. (By Mr. Neier) Do you recall when Mr. Clement  
3 asked you some questions about the cost of debt and  
4 Mr. Daniel, I believe, using a number of 6.9 and you  
04:31 5 using a number 6.1 number?

6 A. That's correct.





9 point were the four "timber companies" that Mr. Daniel  
04:33 10 looked at in his Scopac valuation. Those had an interest  
11 rate associated with them of 6.19 percent according to  
12 Bloomberg.

13 The second methodology was an average of those  
14 four companies and the other six companies that I used as  
04:33 15 guideline companies in my valuation of Newco, the  
16 combination of those ten companies had a cost of debt of  
17 about 5.56 percent.

18 The third data point I looked at were actual  
19 reported yields to maturity on 16 issues of debt by  
04:33 20 timber related companies consisting of Plum Creek,  
21 Potlatch, Green Year and West Fraser Timber. Those 16  
22 specific debt issues had a yield at maturity of 5.92  
23 percent.

24 Q. Those are all timber related companies, I  
04:34 25 assume?

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1 A. That's correct. And all of my data points, all  
2 of the information to form the base of my opinion in some  
3 way relate to timber companies. The fourth methodology  
4 was the 7 percent cost of debt Mr. Daniel used in his  
04:34 5 Scopac valuation. The fifth methodology was the 6.65  
6 percent cost of debt Mr. Yerges used in his timber  
7 valuation. The sixth methodology was my own 6.75 percent  
8 selected cost of debt in my valuation of Newco. And then  
9 lastly, the American Ag 6.95 percent cost of debt that  
04:34 10 was imputed by me from the indication of interest.



13 tax efficient enterprise in bankruptcy, you ought to look  
14 at who's paying the taxes?  
04:36 15 A. You need to consider the taxes that are paid on  
16 those earnings. And that's certainly true in a tax  
17 efficient enterprise.  
18 Q. Would an investor, an average investor, who was  
19 investing in a tax efficient enterprise, would they  
04:36 20 ignore the taxes that they have to pay?  
21 A. Of course not.  
22 Q. In evaluating their investment?  
23 A. Of course not.  
24 Q. Now, let's go to the big report, or the fat  
04:36 25 report as Mr. Clement referred to Indenture Trustee

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1 Exhibit 12. This is Mr. Daniel's valuation of Scopac,  
2 correct?  
3 A. Yes.  
4 Q. And he used company comparables in this  
04:37 5 analysis, correct?  
6 A. Yes.  
7 Q. And one of those was Plum Creek, correct?  
8 A. That's correct.  
9 Q. Is there anything in Mr. Daniel's report that  
04:37 10 indicates that debt is BBB rated? And I would refer you  
11 to -- well, you can look at the entire report, but I  
12 would refer you to page 56 of Exhibit 12, Indenture  
13 Trustee Exhibit 12.  
14 A. I don't see any reference to the credit rating







21 MR. KRUMHOLZ: Do you want to talk about  
22 that issue now?

23 MR. BRILLIANT: Your Honor, during the  
24 break we talked to the noteholders' counsel. As Your  
05:08 25 Honor knows, we all agree that we would do proffers. You

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1 already admitted yesterday Mr. Dean's proffer. And then  
2 he would be cross-examined. During the opening statement  
3 and in other people's proffers, there are issues that we  
4 would want Mr. Dean to testify on in rebuttal. And the  
05:08 5 issue is to whether or not we can do that today.

6 THE COURT: Do you have an agreement? I  
7 don't have any problem. If something comes up, I don't  
8 have any problem unless you-all have some problem. I  
9 prefer you get all the direct testimony out. We've  
05:08 10 already seen that there's some additional testimony that  
11 you have. I prefer you get it out right now, but what do  
12 you think?

13 MR. CLEMENT: Your Honor, I have the  
14 following thoughts. Your Honor ruled yesterday  
05:08 15 essentially that Mr. Dean wasn't going to be testifying  
16 as an expert on valuations, that he would testify about  
17 his view as it related to good faith about whether he was  
18 proposing a fair price and that sort of thing.

19 So first off, he's not an expert. The  
05:08 20 agreement we have is that only experts will be proffered.  
21 Now, I suppose what they're saying is there's testimony  
22 here that they can only get in that goes beyond the





05:08 25 about?

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1 MR. BRILLIANT: I don't think so, Your  
2 Honor. Let me give you an example. A few moments ago I  
3 believe Mr. Clement asked Mr. Johnston whether there's a  
4 financing contingency in the deal. There is not. I  
05:08 5 would like to ask Mr. Dean about that whether there's a  
6 financing contingency in the deal.

7 THE COURT: He testified there's no  
8 financing contingency. What else?

9 MR. BRILLIANT: They have raised the issue  
05:08 10 in their objection, which we first got on Friday, as to  
11 whether there's an antitrust issues with respect to --

12 THE COURT: He's an antitrust lawyer?

13 MR. BRILLIANT: No, but he's got expertise  
14 and he has knowledge as to whether he  
05:08 15 believes --

16 THE COURT: Well, he doesn't believe  
17 there's any antitrust consideration. What else.

18 MR. BRILLIANT: There's going to be this  
19 issue about American AgCredit which was raised and to how  
05:08 20 that letter came about and who is American AgCredit. I  
21 would like to ask him about that.

22 THE COURT: Who is American AgCredit?

23 MR. BRILLIANT: American AgCredit is  
24 Mendocino's bank. It's one of the largest's lenders.

05:08 25 THE COURT: You can say that's where that



1 THE COURT: Okay. So let's put him on.  
2 We're ready to cross-examine him.  
3 MR. BRILLIANT: In addition to his written  
4 proffer --  
05:08 5 THE COURT: He would testify as you said  
6 he would.  
7 MR. BRILLIANT: He's testified as I said  
8 he would. Thank you, Your Honor.  
9 THE COURT: Let's go forward. If you  
05:08 10 would raise your right hand to be sworn.  
11 (Alexander Dean is sworn in.)  
12 MR. CLEMENT: Your Honor, I want to be  
13 sure that -- I'm told that this fire insurance issue is  
14 an opinion that he has that we have --  
05:08 15 THE COURT: Well, you get to cross him  
16 about it.  
17 MR. CLEMENT: So I want to be sure that  
18 that opinion is not admitted into evidence until we've  
19 have a chance to cross-examine him.  
05:08 20 THE COURT: I think you get to  
21 cross-examine him, but he would have testified that in  
22 his opinion as running a forester business, he doesn't  
23 get fire insurance and nobody in the industry does.  
24 That's just -- and it would be extraordinary if he did.  
05:08 25 That's what he would testify to. Now, you can cross him

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4 I'm aware that's the number I said, yes.

05:08 5 Q. Do you want to get it in front of you.

6 THE COURT: They're now showing you right  
7 there in front. Can you see that?

8 THE WITNESS: Yes. Thank you.

9 A. Yes.

05:08 10 MR. BRILLIANT: Your Honor, if it helps  
11 the witness, I'll give him a hard copy.

12 THE COURT: Go right ahead.

13 Q. (By Mr. Clement) Mr. Dean, that number you  
14 just gave now for the Scopac timberlands \$398 million  
05:08 15 dollars. Let's round up to \$400 million. In the year  
16 2005, 2006 you negotiated with Palco concerning the  
17 purchase of the Scopac timberlands, didn't you?

18 A. In 2005 and 2006 we had extensive conversations  
19 with Maxxam about the purchase of Palco stock.

05:08 20 Q. And the Palco stock would have included the  
21 underlying stock that Palco owned in the timberlands,  
22 correct?

23 A. Yes, that's correct.

24 Q. Now, you negotiated where you had about a 25  
05:08 25 page term sheet, didn't you?

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1 A. Yeah. We talked about that last night. That's  
2 my best recollection, yes.

3 Q. Many of those negotiation took place through  
4 UBS?

05:08 5 A. Yes, particularly in 2006. UBS was an



8 taking would value the properties between \$600 and \$760  
9 million." That's correct, isn't it?

05:08 10 MR. SCHREIBER: Your Honor, we object as a  
11 hearsay statement. It calls for hearsay, what UBS said.

12 MR. CLEMENT: I'm asking the question,  
13 Your Honor.

14 Q. (By Mr. Clement) Isn't it a fact, sir, that  
05:08 15 UBS correctly did the arithmetic based upon what you told  
16 them and came to the conclusion that you had valued the  
17 property at 600 to 760?

18 MR. SCHREIBER: Objection to THE  
19 foundation of that question.

05:08 20 THE COURT: I think you can ask him what  
21 he offered. I don't know that you can ask him what UBS  
22 estimated from their offer. I mean, I think you can --  
23 you know, I don't know. Has anybody objected to the  
24 admission of Exhibit 90?

05:08 25 MR. SCHREIBER: It hasn't been offered for

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1 evidence yet, Your Honor.

2 THE COURT: Well, so do you object to it?

3 MR. SCHREIBER: It's a hearsay document  
4 right now, as far as I'm concerned.

05:08 5 THE COURT: Okay. But it's not a document  
6 that was manufactured by Mr. Clement last night and  
7 disguised as a UBS summary of a bunch of bidding that  
8 took place about five years ago, is it?

9 MR. SCHREIBER: I don't think so, Your





12 me to expand.

13 Q. Isn't it a fact, sir, that that's what --

14 THE COURT: Your lawyer is going to get to  
05:08 15 ask you all the questions he wants.

16 A. The answer is no. What this says is that UBS  
17 estimates -- oh, if it says that we discussed 7 to 9  
18 percent and a real discount rate and zero real price  
19 appreciation without regard to what the harvest rate  
05:08 20 would be, it's quite possible that we could have  
21 discussed those range of valuations, yes.

22 Q. And isn't it a fact, sir, that you testified  
23 last night in your deposition that you told UBS that the  
24 value was not any greater than the debt on the company at  
05:08 25 that time?

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1 A. Yes, that is correct. I stand by that.

2 Q. And how much was the debt on the company at  
3 that time?

4 A. As we talked about a couple times last night, I  
05:08 5 don't recall the exact amount of the debt on the company.  
6 I would guess it was 100 million or less than what it is  
7 today, but I actually don't recall.

8 Q. Well, let's see what it is today. It's about  
9 750 million petition date debt to the timber noteholders  
05:08 10 and about 165 million petition date debt to Marathon. So  
11 you add those to up and you get about 900 million; is  
12 that correct?

13 A. Yeah.







05:13 20 Q. Yes.  
21 A. Yes, the answer is yes.  
22 Q. Now, that 600 million board feet timberland is  
23 built up over a ten-year period at the rate of about 60  
24 million board feet a year; is that right?  
05:14 25 A. Approximately, yes.

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1 Q. Now, you talk about this in the disclosure  
2 statement, do you not, on page 54 of the disclosure  
3 statement? Do you have the disclosure statement?  
4 A. I don't know.  
05:14 5 MR. BRILLIANT: Can we give the witness a  
6 hard copy?  
7 THE COURT: Sure. It's on the screen.  
8 Q. (By Mr. Clement) "Since 2003, MRC's annual  
9 harvest has averaged 33.4 million board feet of conifer,  
05:15 10 redwood and Douglas Fir. EBITDA attributable solely to  
11 MRC's harvest and its fiber based share of the related  
12 mill and distribution business. Net capital is average  
13 4.7 million a year. While some might consider this level  
14 of earnings modest in the size of MRC, meeting the high  
05:15 15 standards of FSC management requires than traditional  
16 approach. And these cash returns are supplemented by  
17 growth and timber volume that is not harvested. In MRC's  
18 case, the extra timber grown, but not harvested, has  
19 averaged roughly 60 million board feet a year since MRC's  
05:15 20 inception." Is all that true?  
21 A. I wrote all that, and it's all true.



24 show up in current cash flow?

05:17 25 A. I understand your math, but I disagree with

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1 your logic.

2 Q. How much do you think is the value of the \$600  
3 million of board feet of timber that is built up at the  
4 rate of 60 million a year at MRC since you took over ten  
05:18 5 years ago?

6 A. The answer to that question depends on when the  
7 timber is harvested. And the 600 million board feet of  
8 growth on MRC's land is spread all across the forest. We  
9 haven't attempted to estimate the increase in value in  
05:18 10 the way you're describing. It is -- it is worth  
11 something, probably quite a bit, but we haven't -- we  
12 have not attempted to put a dollar amount on it, and I  
13 don't have one for you.

14 Q. So your \$400 million valuation in Scopac  
05:18 15 timberlands is premised on cash flows that are occurring,  
16 plus some substantial amount, I think as you just  
17 described, would get you a number higher than \$400  
18 million, wouldn't it?

19 A. I'm sorry. Can you repeat your question?

05:19 20 Q. Well, let me put it this way. Your \$400  
21 million of value for the Scopac timberland, plus my \$300  
22 million, roughly calculated, on the growth that you're  
23 talking about, would get you up about \$700 million,  
24 wouldn't it?

05:19 25 THE COURT: Maybe I'm misunderstanding.









2 Q. Which gives it a right to foreclose and take  
3 over the mill, correct?

4 A. I'm not an expert on all their rights, but I  
05:23 5 assume that would be true, yes.

6 Q. Did Marathon consult you as a co-plan proponent  
7 before it took this very significant action?

8 A. I was told about this some time either before  
9 or after it happened in an advisory way. I was told this  
05:23 10 was happening, yes.

11 Q. So they just haul off and did it without asking  
12 you if it was okay?

13 A. Yes.

14 Q. Now, when they get this collateral back, are  
05:24 15 they going to refrain making investment in the mill  
16 unless they can control the Scopac timberlands?

17 A. I don't believe that Marathon will make an  
18 investment in the mill in the absence of a long-term  
19 supply of logs.

05:24 20 Q. So they're going to let their own collateral  
21 die unless they can control the indenture trustee's  
22 collateral of the timberlands; is that your testimony?

23 A. My testimony is that further investment in the  
24 mill in the absence of a long-term fiber supply  
05:24 25 agreement, a long-term log agreement, would be a -- for

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1 anybody, Marathon or anybody else, would be an uneconomic  
2 decision.

3 Q. As co-proponent, are you proposing to make an



6 A. Yes.

7 Q. So that's par plus a little bit, correct?

8 A. Yes.

9 Q. Is your investment firm, Sansome Partners,  
05:26 10 willing to buy these notes at par immediately after  
11 they're issued?

12 A. No.

13 Q. Am I correct that Mr. Johnston is MRC's expert  
14 witness concerning the value of these timber notes?

05:27 15 A. He's Marathon's expert. And so yes, I suppose,  
16 by relation.

17 Q. Does he rely in part for his opinion on a  
18 recent term sheet from American AgCredit?

19 A. Yes. He just testified to that.

05:27 20 Q. American AgCredit is MRC's lender, isn't it?

21 A. Yes.

22 Q. Does MRC have any financing contingency about  
23 putting its \$200 million in here?

24 A. No.

05:27 25 Q. Did you do any negotiations with American

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1 AgCredit about that offer?

2 A. I had a couple of conversations with Sean  
3 O'Day, who's the senior credit officer overseeing timber  
4 loans for American AgCredit recently, and Sean has been a  
05:28 5 part of dialogue with us thinking about Pacific Lumber  
6 Company since 2004. He actually came to our first  
7 meeting that was hosted by Maxxam in the fall of 2004.









14 Q. And then it showed up in Mr. Johnston's report,  
05:33 15 and he relied upon it to conclude, as was gone into his  
16 cross-examination, that Newco would be a BBB credit;  
17 isn't that correct?

18 A. It showed up in Mr. Johnston's report as a  
19 reflection of how the market might view the timber notes  
05:33 20 with us as an operator. And that's being, to some  
21 extent, validated by what American AgCredit has put  
22 forth.

23 Q. Now, sir, you say on -- is it fair to say that  
24 you do not assert that the timber notes are worth  
05:34 25 anything more than \$325 million?

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1 A. Yes.

2 Q. And add to that \$175 million of cash that will  
3 be paid to the timber noteholders. When we do the  
4 arithmetic, that's \$500 million; is that correct?

05:34 5 A. Yes.

6 Q. So in the best case, assuming the timber notes  
7 are worth face, in the best case, you're offering the  
8 timber noteholders no more than \$500 million; is that  
9 correct?

05:34 10 A. That is correct.

11 Q. Now, sir, turn with me, if you would, please,  
12 to page 44 of your proffer. Pull up G if you would,  
13 please. Now, this is your proffer. You signed it; is  
14 that correct?

05:35 15 A. Yes.



18 A. I don't really know enough to know about the  
19 offer you're referring to. If somebody is at the closing  
05:36 20 table with \$600 million, that's a better deal than 500,  
21 although I actually don't know for sure because I don't  
22 know what the costs and expenses are of a Chapter 7  
23 proceedings. I have no experience with that. But today  
24 I actually -- I think this is true.

05:37 25 Q. Mr. Dean, do you remember the three or four

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1 points that were proffered for you by your counsel?

2 A. If you remind me, I'll be able to talk about  
3 them.

4 Q. Well, he was proffering your testimony, so what  
05:37 5 was he saying about your testimony?

6 THE COURT: Well, you need to remind him.  
7 I understand he didn't see it, it's not written down.  
8 One was value for insurance. Do you want to do that one  
9 first? And then we'll remember the next one.

05:37 10 THE WITNESS: That would be very helpful.  
11 Thank you.

12 THE COURT: Do you remember what he said  
13 about insurance?

14 Q. (By Mr. Clement) What, if any, facts do you  
05:37 15 know about insurance on the Scopac property?

16 A. When we started in the timber business ten  
17 years ago, we thought about the risks of owning large  
18 stocks of timber. And we investigated the insurance  
19 market, and we also talked to other operators,



22 market share will you have?

23 A. I'm not aware of anybody who would calculate

24 market share based on acreage. So Green Diamond would

05:39 25 have a similar amount of acreage. And then I bet we

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1 would own a third of the acreage or something like that

2 that's in commercial production today.

3 THE COURT: I think you confused acreage

4 because he was in the million. He was thinking about

05:39 5 board feet. So you might talk about market share in

6 terms of board feet, what percentage you would have of

7 that.

8 A. You know, so --

9 Q. Do you know?

05:40 10 A. I don't know exactly. I do know that Green

11 Diamond would still be about 60 percent bigger than us,

12 so we would be a number two player.

13 Q. So you would take the number two and three

14 players and combine them; is that correct?

05:40 15 A. Yes.

16 Q. And have you sought HSR approval?

17 A. No.

18 Q. When are you going to?

19 A. The transaction may be exempt from Hart Scott.

05:40 20 I don't know the answer to that for sure. That's

21 something that has been studied. We are prepared to seek

22 it if we have the approval of the Court for the plan.

23 Q. Do you know as you sit here in the witness



1 their acreage is in Humboldt, and it's 450,000. They  
2 also operate sawmills.

3 CROSS-EXAMINATION

4 BY MR. DOREN:

05:42 5 Q. Does Green Diamond also clearcut?

6 A. Yes. Green Diamond, although a family owned  
7 business, has a traditional approach. They do  
8 clearcutting.

9 Q. And do you know if clearcut spaces tend to  
05:42 10 regenerate redwood faster than selective cut spaces?

11 A. Most foresters, I think, would feel that the  
12 additional light that is on the forest floor from a  
13 clearcut will allow some faster growth of redwood  
14 seedlings, yes.

05:42 15 Q. So the inventory, if you will, will mature more  
16 quickly in a clearcut space, correct?

17 A. I think Dr. Barrett testified to this, too, in  
18 his deposition a while back. The overall rate of growth  
19 of a forest will be a little bit faster under a pure --  
05:43 20 if you could have a pure clearcutting harvest management  
21 regime, the overall growth rate of the forest would be a  
22 little bit faster than what it would be under -- what  
23 people call an uneven aged management regime.

24 Q. And are you familiar with the fact that  
05:43 25 clearcut spaces also provide habitat in terms of foraging













9 about 19,000 board feet -- or 19,000 board feet per acre?  
05:50 10 A. I'll trust that you did the math, yes.  
11 Q. That, again, rings true to you?  
12 A. Yes.  
13 Q. And in your proffer, you testify that Mendocino  
14 Redwood has grown the volume on its land by some 25  
05:50 15 percent since 1998, correct?  
16 A. Yeah. I think it's actually a little more, but  
17 25 is a good number.  
18 Q. And that's about 600 -- 600 million board feet;  
19 is that right?  
05:51 20 A. Correct.  
21 Q. And, again, that's from the depressed level at  
22 which it was purchased from Louisiana Pacific?  
23 A. Yes.  
24 Q. Or the heavily cut over level. I don't mean to  
05:51 25 change up terms on you.

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1 A. Yeah. And heavily cut over is -- it's all  
2 relative. There was two billion board feet of trees  
3 spread across the property, but we felt there certainly  
4 should be more over time.  
05:51 5 Q. Two billion board feet spread over about  
6 230,000 acres?  
7 A. 2.1 to be exact, yes.  
8 Q. As opposed to the four billion spread over  
9 209,000 for Scopac, correct?  
05:51 10 A. Correct.













21 much a function of the standing inventory on the  
22 property. They're really a function of how roads were  
23 built and maintained across the property. And the roads  
24 on our property were built and maintained to standards  
05:59 25 that would be very similar to most other properties in

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1 the redwood region.

2 Q. All right. So it wasn't the harvesting, it was  
3 the way the roads had been built in the past?

4 A. Yeah. It is important to know the forest first  
05:59 5 started being managed in 1850. Road standards are  
6 evolved quite a bit over time.

7 Q. Again, I'm not judging it, I'm just trying to  
8 understand it.

9 A. Yeah.

05:59 10 Q. And, in fact, 40 percent of the money you spent  
11 on it, you got from folks you call restoration partners,  
12 other people interested in keeping the 70,000 dump trucks  
13 worth of soot from going into the streams, right?

14 A. Yeah, people who see the good ecological value  
05:59 15 for dollars spent.

16 Q. Now, is the significant reason that MRC is  
17 interested in the Scopac property because Scopac stands  
18 are better stocked and more mature than those on MRC's  
19 lands?

05:59 20 A. Our interest in reorganizing Palco and Scopac  
21 is much broader than just -- it's much broader than just  
22 the timber that's on the lands.



06:01 25 Q. Now, in your proffer you testified that MRC

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1 does not believe the company Scopac has a reliable way to  
2 predict the adjacency constraints of clearcutting methods  
3 going forward. You say MRC doesn't believe that. Do you  
4 have any personal knowledge about that one way or the  
06:01 5 other?

6 A. I do.

7 Q. And do you think that's from discussions with  
8 your foresters?

9 A. My knowledge of this is based on a number of  
06:02 10 things. It's based on my discussions with Palco and  
11 Scopac over a long period of time now. It's based on  
12 discussion with my own foresters and their discussions  
13 with Palco foresters. It's based on discussions with  
14 former employees of Palco. Based on discussions with  
06:02 15 neighboring landowners of Palco. It's -- there's  
16 probably other folks who have shared information with me  
17 on this as well.

18 Q. Sure. So let's go back where you come here and  
19 explain that it does, in fact, have means of addressing  
06:02 20 adjacency issues around clearcuts, you would have to  
21 revisit those conclusions based on that past information,  
22 correct?

23 A. I would not.

24 Q. You would not. Okay. In paragraph 64, you  
06:02 25 state that "I understand that the debtors harvest rate



1 is that correct?

2 A. It might be possible to use an optimization  
3 model by someone who's very familiar with their  
4 constraints on their property. But in general, my  
06:04 5 experience with them has been that they give very  
6 misleading results.

7 Q. But it could be useful in the right hands; is  
8 that what you're saying?

9 A. I do think that they are a tool that can add  
06:05 10 some value, but in general, our experience, particularly  
11 in the redwood business, is that they give misleading  
12 results.

13 Q. In your opinion, particularly in the redwood  
14 business, should any expert opinion offered in this case  
06:05 15 that's based on an optimizer, particularly by an expert  
16 that isn't very familiar with the land, be disregarded or  
17 heavily discounted?

18 A. I've read the various expert reports on  
19 harvesting, and it is my opinion that they, in a variety  
06:05 20 of ways, fail to capture the constraints that exist on  
21 this property, yes.

22 Q. And that includes Mr. Lamont's report?

23 A. This was something that was asked last night.  
24 I think Mr. Lamont has put forth a more conservative  
06:06 25 harvest estimate than the other folks who have relied on





3 harvested in those watersheds. And that's one of the  
4 reasons why the harvest in those watersheds has come down  
06:07 5 so much.

6 Q. And in your opinion, as you call it, have you  
7 taken into account the 2007 watershed analyses approved  
8 for Scopac's lands?

9 A. You know, I know that there is a little bit of  
06:08 10 timber left to be approved through watershed analysis.

11 Q. What research have you done on that?

12 A. Well, if we looked in my proffer, you would see  
13 that there's about 200 million board feet of inventory  
14 that's still tied up waiting for watershed analysis to  
06:08 15 occur.

16 Q. Do you know the status of the watershed  
17 analyses that are going forward in 2008?

18 A. You know, I was told from Dr. Barrett's proffer  
19 that there was -- you know, has been or will be good  
06:08 20 success on freeing up that remaining inventory.

21 Q. You also state in paragraph 65 of your proffer  
22 that Palco does not use Dr. Reimer's model to dictate or  
23 even guide harvesting in the near term. Who told you  
24 that?

06:09 25 A. I read it in his report.

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1 Q. In Dr. Reimer's report?

2 A. Yes.

3 Q. Okay. So if in fact Scopac does use  
4 Dr. Reimer's model to guide its harvesting, you would



7 to 10, but yes.

8 Q. So this is really -- item 4 is really a  
9 business decision being made by Mendocino about how much  
06:11 10 timber it wants to cut on the site rather than how much  
11 timber it could cut on the site, correct?

12 A. It's a forest policy management decision. You  
13 can go back over acres every few years if you want to.  
14 We think it's bad forestry. So does the state, by the  
06:11 15 way.

16 MR. DOREN: I'll move to strike as  
17 nonresponsive, the last comment.

18 Q. (By Mr. Doren) If we could please go on to  
19 item 11 on page 28. If you could blow that up, Eric.  
06:11 20 Item 11 reads "when unconstrained acres available for  
21 harvest retain an average of 40 percent of stand volume  
22 for selection harvest silviculture (refrain from  
23 clearcutting)." Did I read that correctly?

24 A. Yes.

06:11 25 Q. Now, I want to make sure I understand. Does

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1 this mean that of all the acres that are otherwise  
2 unconstrained from harvest, 40 percent of those would be  
3 set aside from clearcutting and used for selective  
4 harvest?

06:12 5 A. No. What it means is that of all of the acres  
6 that are unconstrained, we would apply a selection  
7 harvest to those acres. And so over a 15-year period, we  
8 would harvest all the acres and retain roughly 40 percent



11 the properties, the unconstrained properties than you do  
12 in Mendocino's properties?

13 A. No, that would not be correct. On Mendocino's  
14 property, where we have well stocked stands, stands that  
06:14 15 would have significant redwood and Douglas Fir volume.

16 The most heavy harvest prescription that we use is  
17 selection harvesting. We might take 50 or 60 percent of  
18 the volume. But we don't practice variable retention,  
19 which we take 80 percent of the volume, say, at the most.  
06:14 20 For clearcutting, which we take 90 or 100 percent of the  
21 volume. We don't practice those on well stocked conifer  
22 stands.

23 Q. But you do in other areas of your property,  
24 correct?

06:14 25 A. Well, where we have acres that have significant

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1 amounts of tan oak where really the only way to get the  
2 conifer forest back is to do a more significant harvest.  
3 That's a place where we will use variable retention.

4 Q. And you use variable retention harvest on  
06:14 5 conifer stands as well, correct?

6 A. Not on well stocked conifer stands.

7 Q. Now, again, the notion of setting aside 40  
8 percent of the unconstrained timber and eliminating  
9 413,000 board feet is a business decision that you would  
06:15 10 make in terms of how you would like to manage the Scopac  
11 property, correct?

12 A. 413 million feet.



06:16 15 pretty good stands. And they tend to be a little bit  
16 older and better stocked. And older and better stocked  
17 stands, we think, are probably growing a little bit less  
18 than the forest as a whole because the forest as a whole  
19 has a lot of younger trees. So younger trees grow  
06:17 20 faster, older trees grow slower.  
21 Q. We start shrinking while we get older and trees  
22 tend to grow a little slower?  
23 A. They slow down, just like people.  
24 Q. And how did you come up with the 3.5 percent  
06:17 25 average growth rate across the property?

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1 A. That is a -- that is a best estimate arrived at  
2 between me and my foresters.  
3 Q. Okay. And do you know what that estimate was  
4 based on?  
06:17 5 A. We've spent an extensive amount of time and  
6 effort measuring our own growth rate on our property.  
7 Our property in Mendocino County has soils that are a  
8 little less good for growing trees; still excellent tree  
9 growing territory, but not as good as Humboldt County.  
06:17 10 So in that sense, we are a little slower than Humboldt  
11 County. But in general on our property, our trees are  
12 younger than Pacific Lumber Company's trees. So we spent  
13 some time talking about this and it came up. It's a  
14 subjective judgment.  
06:18 15 Q. And the subjective judgment, if I'm hearing  
16 you, was to take the growth rate you're experiencing down





19 County, correct?

06:19 20 A. For the reasons that I identified, yes.

21 Q. And in general -- and in fact, you recall that

22 Mr. Lamont said that in general, Humboldt County is

23 considered to be a site two redwood area while Mendocino

24 County is considered to be a site three redwood area,

06:19 25 correct?

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1 A. Yes.

2 Q. And again, 2 being, as you've already

3 described, kind of the more productive area in terms of

4 growth, right?

06:19 5 A. Site 1 is the best; 2 better; 3 good.

6 Q. Now, as I looked at your projections, I saw you

7 cutting a harvest rate that's around -- and I'm sorry,

8 this would be for Scopac's properties -- a harvest rate

9 of around 50 percent of the growth on the property for

06:20 10 the first 15 years, correct?

11 A. I know that to be true in the first ten years.

12 I think in years 11 through 15, the harvest rate is

13 beginning to increase. And so the percentage of growth

14 will be declining.

06:20 15 Q. And by the 16th year, you're harvesting about

16 80 percent of the growth, correct?

17 A. I would have to look at the model, but that

18 sounds about right.

19 Q. And so if the initial cut had been 80 percent

06:20 20 of the growth, meaning there's still a 20 percent margin



23 that's similar to the program that you're describing.

24 Q. Okay. And these are trees that grow faster  
06:22 25 than natural redwoods; is that correct?

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1 A. These are seedlings that are being created by  
2 some form of either genetic cloning or genetic  
3 engineering to try and pick the best trees to come up  
4 with the seedlings to plant in the forest, yes.

06:22 5 Q. And is your -- and again, I've been using the  
6 term rotation age but is the harvest age you look to for  
7 those also 50 years?

8 A. You know, we'll see in 40 or 50 years how  
9 the -- we call them seedlings that come out of our  
06:23 10 cuttings program similar to the cultivars. We'll see in  
11 40 or 50 years, you know, if those trees are ready to  
12 harvest faster than the trees that have been regenerated  
13 naturally. That's a long way from now.

14 Q. So you call the genetically improved redwoods  
06:23 15 seedlings that come out of your cutting program?

16 A. Yes.

17 Q. Okay.

18 A. They're -- the seedlings are generated by  
19 cutting little pieces of redwood off of bushes that have  
06:23 20 been selected to have good genetics.

21 Q. You've used SBE pricing when assessing the  
22 likely prices of redwood, correct?

23 A. Are you referring to my proffer?

24 Q. Yes. I'm sorry.



1 for redwood logs in year one of \$850. But when we put  
2 together our plan in January, we --

3 Q. Sir, my question is simply: Did you use -- for  
4 the first five years are you using pricing based on what  
06:25 5 Mendocino Redwood expects to get for its own logs in  
6 Mendocino County?

7 A. The folks who estimated that price looked at  
8 what we get in Mendocino County and thought about how  
9 would that relate to what logs will be in Humboldt  
06:25 10 County, yes.

11 Q. And did the price go up or down for Humboldt  
12 County?

13 A. Versus Mendocino County?

14 Q. Yes.

06:26 15 A. I think it's about the same.

16 Q. So your folks, the folks at Mendocino Redwood  
17 looked at what Mendocino was receiving for logs in  
18 Mendocino County and what they expect in this year and  
19 apply that essentially without adjustment to Humboldt  
06:26 20 County?

21 A. They also looked at what we buy logs for. We  
22 buy logs as well.

23 Q. And took that price and applied it to Scopac,  
24 correct?

06:26 25 A. Yes.



2 reasonable driving distance where the transportation cost  
3 will outweigh the value of the logs.

4 Q. And in your opinion, what is a reasonable  
06:27 5 distance?

6 A. Well, the closest is the best.

7 Q. What's too far? Would you drive 100 miles to  
8 get your logs milled if there were a mill closer?

9 A. Only if the mill that was 100 miles away had a  
06:28 10 significant cost advantage over the mill that was closer.

11 Q. All things being equal, you'd go closer?

12 A. If -- if two mills had the same cost advantage,  
13 the mill that's closest will be the mill that is  
14 successful buying the logs generally.

06:28 15 Q. Fair enough. People will be drawn to them from  
16 the local market, correct?

17 A. It's just a matter of economics.

18 Q. Your Douglas Fir pricing, how do you pick --  
19 now, as I understand it, from reading your proffer, you  
06:28 20 assume that Doug Fir pricing will track inflation for the  
21 next 50 years; is that correct?

22 A. After we get past the five-year estimate that's  
23 in the disclosure statement, after that, we assume that  
24 Douglas Fir prices would track inflation, yes.

06:29 25 Q. And right now Doug Fir pricing is at about a 20

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1 year low, right?

2 A. It's very low, yeah. Yes.

3 Q. Kind of so low there's no way for it to go but





6 generally and you added a one percent California premium,  
7 if you will?

8 A. Actually, so there's a lot of subjectivity in  
9 this, but we think that the California regulatory  
06:30 10 environment, the political environment of this property  
11 in particular, the physical condition of this property,  
12 probably merit more than a one percent premium and we  
13 offset that to some degree by the fact that this  
14 timberland that grows redwood which is a species that has  
06:31 15 some uniqueness associated with it and we make a  
16 subjective assessment of 7.

17 Q. Did you consider a weighted average cost of  
18 capital of any forest product companies in setting that  
19 discount rate?

06:31 20 A. No.

21 Q. Why not?

22 A. It's not valuable to me.

23 Q. It's not valuable to you?

24 A. Right.

06:31 25 Q. Why not?

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1 A. The weighted average cost of capital  
2 calculations that, you know, there's been some discussion  
3 about that in the last two days. I suspect there will be  
4 more about it.

06:31 5 Q. Sadly, probably so.

6 A. It's the kind of thing that could be discussed  
7 for days, weeks, months. It really all depends on the







14 than \$400 million.

06:35 15 Q. Speaking in terms of the value you've applied  
16 to the timberlands.

17 A. Well, a minute ago you asked me a question and  
18 I said that's inaccurate. We have valued the timberlands  
19 at \$400 million, we have put something on top of it  
06:36 20 looking at the value of the MMCAs and then in our  
21 valuation and frankly, we've rounded up quite a bit in an  
22 effort to present the bonds at a very full price. So  
23 that is the price that we are interested in trying to  
24 reorganize the company.

06:36 25 MR. DOREN: Thank you very much, sir. I

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1 pass the witness, Your Honor.

2 THE COURT: All right. Do we have the  
3 other debtor want to ask some questions?

4 MR. LAMB: Yes, Your Honor.

06:36 5 CROSS-EXAMINATION

6 BY MR. LAMB:

7 Q. Good afternoon, Mr. Dean. We spent a lot of  
8 time together already.

9 A. Mr. Lamb, a pleasure.

06:36 10 Q. I want to start with just a couple of questions  
11 about your harvest levels and your valuation model. Your  
12 harvest level is lower than Scopac's expert uses,  
13 correct?

14 A. Yes.

06:37 15 Q. And it's lower than the noteholders' expert



18 Q. Well, you have lowered the harvest level from  
19 Pacific Lumber --  
06:38 20 A. Not in -- not in Elk and freshwater we have  
21 not.  
22 Q. Okay. So you still think there's -- that's  
23 where the regulatory risk is in those two areas?  
24 A. That and in addition, I would say that the  
06:38 25 Habitat Conservation Plan, the compliance with that plan,

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1 has -- will always have risks associated with it.  
2 Q. Let me ask this: Is it not true that your  
3 lower harvest level does lower regulatory risk?  
4 A. It does, yes.  
06:38 5 Q. And you're just not prepared to lower it more  
6 than the one percent?  
7 A. Well, as I think I talked about just a few  
8 minutes ago, the one percent wasn't just regulatory risk.  
9 It's also the on the ground conditions in the forest. So  
06:39 10 if we want to talk about some of what we view to be the  
11 physical or economic constraints to harvest, we could do  
12 that. It's also the political risk associated with the  
13 property. This property has been highly politicized over  
14 the 20 years or so that it has been in its current  
06:39 15 ownership.  
16 Q. You've done a lot of work to undo that if your  
17 plan is confirmed, have you not?  
18 A. We have definitely been involved in a dialogue  
19 with all the stakeholders in part to get feedback on





22 probably can be even more aggressive than American

23 AgCredit.

24 Q. So have you ruled out just borrowing the money

06:41 25 and paying the noteholders if your plan was confirmed?

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1 THE COURT: Well, do you have some idea  
2 that the noteholders will give up if they pay them the  
3 cash rather than the new notes?

4 MR. LAMB: No, I'm just interested in  
06:41 5 getting past the argument about what the new notes are  
6 worth.

7 THE COURT: Okay.

8 Q. (By Mr. Lamb) And cash would solve that?

9 A. I do understand it would help put an end to the  
06:41 10 argument. You know, for -- we might consider making a  
11 change if we thought that it would actually bring  
12 resolution. The notes have given no indication that  
13 anything that would in any way in my view resemble a fair  
14 and full value would satisfy them.

06:42 15 Q. You know they don't like the notes. You know  
16 that for sure?

17 A. I've been getting that feeling.

18 Q. They would like cash better than the notes,  
19 correct?

06:42 20 A. They have not -- they have not -- they have not  
21 talked to me, so I don't know that for certain, but it  
22 would not surprise me to hear it.

23 SPEAKER: Your Honor, I know there's no





















12 Murrelet Conservation Area.

13 Q. About how many acres on the Scopac timberland  
14 are there of MMCAs?

06:56 15 A. It's a little more than 6,000.

16 Q. What are you planning on doing with those?

17 A. I don't know.

18 Q. What value does your plan ascribe to them?

19 A. In the proffer, I think I describe that we  
06:57 20 think that the MMCAs are worth somewhere between \$15 and  
21 \$25 million.

22 Q. And where did you get that number?

23 A. Mostly by reviewing the appraisal that was put  
24 forth by the bonds.

06:57 25 Q. Have you retained an independent expert to

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1 value the MMCAs?

2 A. No.

3 Q. Have you made any promises or representations  
4 to government or environmental officials about what  
06:57 5 you're going to do with the MMCAs?

6 A. No.

7 Q. You don't have any indication at all as to what  
8 your intentions are for the MMCAs?

9 A. We have been asked about the MMCAs in many  
06:58 10 forms, including public forums, and in general, what  
11 we've said to people is that they're off limits for  
12 harvesting for 42 years. We don't really know what is  
13 the best long-term answer for the MMCAs, but we have a















































































07:48 25 Q. If you disagree and if the answer is no, we

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1 will deal with it through our own witness.

2 MR. CLEMENT: Your Honor, we have nothing  
3 further.

4 THE COURT: All right. Now you get to  
07:49 5 redirect. Go ahead.

6 SPEAKER: All right.

7 REDIRECT EXAMINATION

8 BY MR. BRILLIANT:

9 Q. Mr. Dean, you explained, you know, how the  
07:49 10 terminal value works and how the trees that exist at the  
11 end of the 50 years are discounted back.

12 A. Sure. The trees that are not harvested -- the  
13 trees that are -- the growth that's in excess of the  
14 harvest rate is added to the existing inventory on a year  
07:49 15 by year basis. So as the inventory grows, the harvest  
16 rate of the property grows. As the harvest rate of the  
17 property grows, the income off the property grows  
18 annually.

19 And the way the value of these trees is  
07:49 20 captured is that the last year of the model in year 50,  
21 you have a higher harvest rate because of the higher  
22 standing inventory and the higher harvest rate in year 50  
23 produces a higher level of income in year 50 and that is  
24 the income in year 50 is the amount that's capitalized  
07:50 25 for a terminal value assumption which is then discounted





1 used and what is effectively, you know, the multiple that  
2 you're assuming for selling the --

3 A. So it would be one over .07. I think that's 13  
4 times the cash flow in that year.

07:51 5 MR. CLEMENT: Your Honor, you handled the  
6 question beautifully, I have nothing to add to the answer  
7 he gave you. I think Your Honor understands it  
8 perfectly. I will ask no further questions, simply add  
9 or offer Exhibit 90.

07:51 10 THE COURT: Any objections?

11 MR. PENN: Which one is that?

12 MR. CLEMENT: Exhibit 90 is the UBS  
13 document.

14 MR. PENN: Objection, hearsay. Contains  
07:51 15 hearsay. It's full of hearsay.

16 THE COURT: Let's not argue about the  
17 admission of documents today. I don't think -- we sort  
18 of reached the end of my saturation ability, keeping in  
19 mind that while you-all did your depositions, I did equal  
07:52 20 opportunity training. So we can decide which one of us  
21 had the more fun this morning. And I fully support our  
22 equal opportunity program, I'll say on the record also.

23 Anyway, in any event, we'll start again  
24 tomorrow. But I would like to somehow efficiently deal  
07:52 25 with the admission of all of these documents. And

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1 efficiently doesn't really mean going through every one



4 Just so everybody understands, this is not the end of our  
07:53 5 evidence but this is our last witness that we're calling  
6 at this point.

7 THE COURT: Okay.

8 MR. NEIER: Okay. So I wanted everybody  
9 to understand that.

07:53 10 THE COURT: You've got all your documents  
11 to enter and we're not -- we'll go with that tomorrow.  
12 But we're starting tomorrow then with your witnesses; is  
13 that correct?

14 MR. CLEMENT: That's correct.

07:54 15 MR. NEIER: And we are calling other  
16 witnesses on our case but they're being called later, so  
17 we're going to handle --

18 THE COURT: You've agreed to call some  
19 witnesses later.

07:54 20 MR. NEIER: Yeah.

21 THE COURT: I got a frown from over here.

22 MR. NEIER: I'll tell you what they are.  
23 They're principally Mr. Clark, Mr. Barrett or Dr. Barrett  
24 and Mr. O'Brien, who are all going to be called in  
07:54 25 respect to the trustee motion so we'll handle what few

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1 questions we have at that point.

2 THE COURT: Okay.

3 MR. CLEMENT: We don't have any conflict  
4 yet, Your Honor.

07:54 5 THE COURT: Okay. Good. All right.



8 later transcribed from Stenograph to typewriting under my  
9 supervision.

10 I further certify that I am neither attorney or  
11 counsel for, nor related to or employed by any of the  
12 parties to the action in which this deposition is taken,  
13 and further that I am not a relative or employee of any  
14 attorney or counsel employed by the parties hereto, or  
15 financially interested in the action.

16

17 WITNESS MY HAND, this the \_\_\_\_\_ day of  
18 \_\_\_\_\_, 2008.

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