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## 2. **FORESTS: Calif. vows to protect Headwaters deal from Pacific Lumber bankruptcy**

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The state of California has intervened in the bankruptcy case recently filed by Pacific Lumber Co. and affiliates, with the intent of ensuring continued adherence to a controversial deal covering hundreds of thousands of acres of Northern California forest lands.

The Headwaters Agreement preserved old-growth redwood forests in Humboldt County, Calif., while applying special environmental protections and strict harvest limits on more than 200,000 acres of commercial timber lands held by Pacific Lumber and its corporate parent Maxxam.

Mike Chrisman, secretary of the California Resources Agency, sent a letter this week to concerned lawmakers, promising "to be dogged and unyielding in our efforts to protect California's interests" in ensuring that Pacific Lumber follows its obligations under the agreement. In addition, Chrisman wrote, the state attorney general and state agencies are working together on a coordinated legal strategy.

The attorney general has intervened in the bankruptcy case on behalf of the state and will soon be filing a motion to have the case moved to a California court, he said. "We expect and will make every effort to ensure that all obligations to California will be honored and remain in effect through this proceeding," he wrote.

Under the deal finalized in 1999 -- brokered by Sen. Dianne Feinstein (D-Calif.) -- the state and federal governments paid \$480 million to acquire 7,400 acres of old-growth redwood forest, while Pacific Lumber agreed to strict timber harvest limits in a habitat conservation plan for 210,000 acres of redwood and Douglas fir. The habitat plan also included a 50-year set-aside of another 8,000 acres in a dozen parcels as habitat for the marbled murrelet.

On Jan. 19, Pacific Lumber and five subsidiaries, including the Scotia Pacific Co., filed for Chapter 11 protection in the U.S. Bankruptcy Court for the Southern District of Texas, claiming that state restrictions on their ability to cut and sell timber have reduced revenues significantly while increasing costs to the point that the firms cannot make interest payments on about \$714 million in outstanding debt.

### 'The most stringent environmental restrictions ever'

The companies said in court documents that the Headwaters Agreement "resulted in the most stringent environmental restrictions ever placed on timber harvesting." However, they blamed California and federal agencies for not living up to the deal while allowing some state water boards that are not signatories to the agreement to impose further restrictions and obligations that have made their operations economically nonviable.

The bankruptcy filing followed a December 2006 lawsuit that Pacific Lumber and Scotia Pacific had filed against California in a Fresno Superior Court alleging a breach of the Headwaters Agreement regarding management of the timber lands. George O'Brien, president and CEO of Pacific Lumber, said, "Our companies have lived up to their obligations, but unfortunately the state and its agencies have not."



Giant redwood trees in the Headwaters Forest of California were preserved in a controversial 1999 deal with Pacific Lumber. Now that the company has filed for bankruptcy protection, some worry that agreements to protect its other timber lands are at risk. Photo courtesy of BLM.

Supreme Court, which accepted the matter for argument but has not set a schedule for hearing. Because of the case, the state harvest permit has been stayed.

Another suit against the company alleged that it was building roads and conducting timber harvesting without valid water permits, and seeks civil penalties amounting to about \$27,500 per day. Although a court determined that timber operations may be exempt from federal discharge standards, it narrowly interpreted the exemption such that culverts and ditches may require permits. A trial in that case is pending, the company said.

## Money-losing deal

For months, Maxxam has been warning investors that the pending water regulations and litigation could severely affect the ability of its timber subsidiaries to meet their financial obligations and may result in bankruptcy. In the latest quarterly filing to the U.S. Securities and Exchange Commission, Maxxam said that its revenues from timber sales during the first nine months of 2006 were down about 20 percent compared to the same period a year before, and that it was experiencing a loss on timber operations for the year. Even as the lumber companies were selling property to raise enough money to pay interest on their massive loans, they reported selling the land at a net loss.

Under Chapter 11, the companies may be able to combine their finances and put existing debts on hold while erecting a wall to protect the parent corporation. It is possible that the firms could ask a judge to release them from contracts, like the Headwaters Agreement, in order to remove limitations on revenue generation from timber sales. Additionally, sale of the companies or their properties could become part of a reorganization plan.

Maxxam spokeswoman Andrea Arnot, however, said that those matters have not yet been raised in the case and that the company is keeping all of its options open.

Although a bankruptcy court has extremely broad powers to ensure that protected companies may continue operating while they work toward reorganization, there is conflicting precedent with regard to a judge's ability to overrule state regulatory and police powers. The state of California successfully argued this point when utility Pacific Gas & Electric went into Chapter 11 in 2001. However, determinations in one federal district may not necessarily hold in another.

Still, in explaining the state's legal position to lawmakers, Resources Agency head Chrisman said that "obligations to comply with state and federal law remain, notwithstanding the bankruptcy filing. The state and federal governments are still able to enforce their laws through their respective regulatory powers, that include, but are not limited to the state and federal Endangered Species Acts."

Chrisman also said that the promised habitat protections for the marbled murrelet were recorded as covenants on Pacific Lumber's properties that will last for 50 years beginning in 1999, "to ensure protection in the event of bankruptcy or change of ownership. The habitat conservation plan is still in effect, even though the company has filed for bankruptcy."

O'Brien added that over the past seven years, the companies have spent more than \$60 million on environmental mitigations related to the agreement.

The chief concerns for Pacific Lumber include water quality requirements being imposed by the North Coast Water Board that have limited timber harvesting by about half the level allowed under the state's Department of Forestry-approved plans and permits. The water board was not part of the original agreement and is considering taking further actions against the companies for sediment from its operations that is affecting streams in several watersheds in violation of Clean Water Act standards.

In addition, environmental activists have challenged the legality of timber harvest permits issued by the state's departments of Forestry and Fish and Game. In 2003, a trial court declared the permits invalid, but that ruling was overturned two years later by the state appeals court. The plaintiffs, the Environmental Protection Information Center along with several labor unions, have further appealed the case to the state