

PACIFIC LUMBER COMPANY

Reorganization Plan (9/30/07)

Certain Key Provisions¹

I. Executive Summary

A. Treatment of Creditors

- In short, the Plan promises to pay all creditors in full, except –
 - Unsecured creditors who are not current vendor/suppliers (including former employee severance claims) – these creditors will receive three-year promissory notes (IOUs).
 - Scopac Noteholders – they will receive new seven-year promissory notes in exchange for their current notes. Within two years, Palco intends to pay off one set of these new notes – up to \$388 MM – with land sale proceeds.
- See section **II** for details

B. How Palco Proposes to Fund the Plan

- Palco proposes to borrow \$200-250 MM (or more) in bank loans; sell the Marbled Murrelet Conservation Areas (\$400 MM), 21,760 acres for residential development (\$680 MM), the Hole in the Headwaters (\$36 MM), and Scotia (\$62 MM); and increase revenue by reinstating the second shift at the mill.
- See section **III** for details

¹ DISCLAIMERS: This is a summary of only certain points in PL's 9/30/07 Plan. This summary does not cover all of the Plan's provisions and omits several provisions that may be important to some constituencies. PL is certain to revise the Plan, the Disclosure Statement, and its projections, so this summary may be out-of-date soon.

C. Miscellaneous Provisions (see section IV); Preliminary Notes and Questions (see section V)

II. Treatment of Certain Creditors²

A. Administrative Creditors (professionals, other post-bankruptcy expenses); tax claims; Palco secured debt (Bank of America, Marathon DIP):

- Paid in full when Plan is confirmed (Bank of America to be paid from SAR reserve account; Marathon may agree to treatment different from immediate payment in full).
- Note: professional fees alone are projected to total \$15.5 MM.

B. Workers compensation and pension claims:

- Under the Plan, Palco will continue paying all workers comp and pension claims as it did before bankruptcy.

C. “Convenience Claims” (any claim of less than \$10K, including claims whose holders are willing to reduce to \$10K):

- Paid in full, without interest, when Plan is confirmed.

D. Trade claims:³

- Paid in full, without interest, when Plan is confirmed.
- Estimated total: \$5.5 MM.

² The Plan classifies creditors by debtor and then by type of creditor. For example, in the Plan, tax claims against Palco are separately classified from other claims against Palco claims and from tax and other claims against the other debtors (Scopac, etc.). This separate classification may be significant for voting purposes.

³ Presumably, “trade claims” (in **D**) include all claims of current vendors/suppliers to Palco, Scopac, and the other companies, and “other unsecured claims” (in **E**) includes everyone else. As noted, Palco has classified former employee severance claims with “other unsecured claims.”

- E.** Unsecured prepetition claims other than trade claims:
- These claims will receive three-year promissory notes (IOUs), paying 8.25% interest, with quarterly interest payments and semi-annual principal payments.
 - Estimated total: \$4.2 MM.

 - Note: Former employee severance claims are included in this group, unless they are “convenience claims” – that is claims less than or reduced to \$10K (see **C** above).
- F.** Scopac noteholder claims (existing junk bonds totaling \$788 MM):
- Noteholders will receive \$788 MM in new secured promissory notes, of two separate types:
 - “Timberland Notes” – \$400 MM
 - 7-year term; 8.5% interest.
 - Payments of interest only until maturity.
 - Interest expense: \$36 MM/year.

 - “Development Notes” – \$388 MM
 - 7-year term; 10.5% interest, increasing to 12.5% after two years, unless Palco has paid off \$300 MM.
 - Payments of interest only for 36 months; then, \$25 MM/year in principal payments.
 - Interest expense: \$40.75/year for first three years, assuming no paydown.

 - Note: The idea is that Palco will replace the existing notes with new notes in an identical total amount, but will quickly (2-3 years) pay off most of the Development Notes with land-sale proceeds.

 - Note: Under the Plan, a noteholder may elect to accept payment of his existing note at a discount (67%) instead of

accepting new Timberland and Development Notes. Palco may borrow an additional \$75 MM in “Exit Financing” (see below) to fund these purchases. The amount of new notes would be reduced by the amount of old notes paid off at a discount.

III. Means of Execution

- A.** Palco proposes to fund its Plan and subsequent operations through “Exit Financing” (described in **B** below), land sales (see **C** below), and increased mill operations (see **D** below).
- B.** Exit Financing. Palco will borrow \$250-275 MM from one or more banks (plus up to \$75 MM, if some noteholders agree to accept a discounted payoff for their existing notes):
- \$150MM term loan.
 - \$100-125 MM revolving loan.
- C.** Land Sales. Palco proposes the following sales:
- Marbled Murrelet Conservation Areas (called “Ancient Redwood Groves” in the Plan) –
 - 6,600 acres.
 - Sale to occur in 2009.⁴
 - Expected proceeds: \$400 MM (\$60K/acre).
 - Net proceeds to be applied to New “Development Notes” (85%) and to reduce new Exit Financing (15%).
 - Redwoods Ranch Development
 - 21,760 acres adjoining Ancient Redwood Groves.
 - To be sold in 136 160-acre parcels.
 - Sale to occur in 2012-15.
 - One-house on each parcel (Palco calls this a “conservation plan”).

⁴ All dates assume that the Plan is confirmed in January 2009. If confirmation is delayed, the dates will be pushed back.

- Expected proceeds: \$5 MM/parcel (\$36.7K/acre); total: \$680 MM (plan says \$780 MM, but that looks like computational error).
- Hole in the Headwaters
 - 1,393 acres.
 - Sale to occur between 2009-12
 - Expected price: \$36 MM (\$25.8K/acre)
- Scotia
 - Gross sales price: \$78 MM. Expected net proceeds: \$62 MM.
- Note: Palco will use 85% of any land sale proceeds to redeem the new Development Notes and 15% to pay down the Exit Financing.

D. Increased mill operations

- Palco projects almost doubling revenues from 2008 (\$79 MM estimated) to 2009 (\$144 MM estimated), in part from the reintroduction of a second shift at the mill.

III. Miscellaneous Provisions

- A.** Under the Plan, Palco, Scopac, and the other debtors will be merged into a single company (undoing the separation of Scopac when the current notes were issued). The single, combined company will be liable for the Exit Financing and the new Timberland and Development Notes.
- B.** Palco claims to have a 50-year timber harvest plan, prepared by KPMG and other consultants, at below legally permissible harvest rates.

IV. Preliminary Notes and Questions

1. At confirmation, Palco will have approximately \$250-275 MM in Exit Financing and \$788 MM in new Timberland and Development Notes. The new Notes alone will require interest payments of \$76 MM/year for the first two years, or until the first land sales occur. Will operations during those two years support that level of debt?
2. Are proposed land sales feasible at the projected prices and within the projected time periods?
3. Are the 2009 increased revenue projections reasonable (\$144 MM, based in reinstating second mill shift)? What assumptions underlie \$144 MM figure – Harvest rate? Timber sale prices? Construction market, etc?
4. The Plan does not appear to consider the possible effect of the EPIC, qui tam lawsuits, or other litigation on Palco's future operations.