

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF TEXAS  
CORPUS CHRISTI DIVISION

IN RE:

SCOTIA DEVELOPMENT LLC,  
THE PACIFIC LUMBER COMPANY,  
BRITT LUMBER CO., INC.,  
SALMON CREEK LLC,  
SCOTIA INN INC., and  
SCOTIA PACIFIC COMPANY LLC,

DEBTORS.

Chapter 11  
Case Nos. 07-20027 through 07-20032  
(Jointly Administered)

**JOINT DISCLOSURE STATEMENT IN SUPPORT OF THE RESPECTIVE PLANS OF REORGANIZATION PROPOSED BY (1) MENDOCINO REDWOOD COMPANY, LLC AND MARATHON STRUCTURED FINANCE FUND L.P.; (2) THE BANK OF NEW YORK TRUST COMPANY, N.A., INDENTURE TRUSTEE FOR THE TIMBER NOTES; AND (3) THE DEBTORS AND MAXXAM INC., MAXXAM GROUP HOLDINGS INC., AND MAXXAM GROUP INC.**

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Dated: February 29, 2008

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### **EXHIBITS TO JOINT DISCLOSURE STATEMENT**

<u>Exhibit Designation</u>	<u>Exhibit Title</u>
Exhibit AA	Solicitation Letter of Official Committee of Unsecured Creditors
Exhibit A-1	First Amended Joint Plan of Reorganization for the Debtors Proposed By Mendocino Redwood Company, LLC and Marathon Structured Finance Fund L.P.
Exhibit A-2	Uniform Glossary of Defined Terms for MRC/Marathon Plan
Exhibit A-3	Statement of Position of MRC and Marathon
Exhibit A-4	(a) Newco Projected Financial Information for MRC/Marathon Plan (b) Townco Projected Financial Information for MRC/Marathon Plan
Exhibit B-1	First Amended Chapter 11 Plan for Scotia Pacific Company, LLC Proposed By The Bank of New York Trust Company, N.A., Indenture Trustee for the Timber Notes
Exhibit B-2	Statement of Position of Indenture Trustee
Exhibit B-3	Proposed Monthly Cash Flows - Sources and Uses of Cash for Indenture Trustee Plan
Exhibit C-1	Second Amended Joint Plan of Reorganization for the Debtors Proposed by the Debtors and MAXXAM Entities
Exhibit C-2	First Alternative Plan of Reorganization for the Palco Debtors Proposed by the MAXXAM Inc., MAXXAM Group Holdings Inc., and MAXXAM Group Inc.
Exhibit C-3	First Alternative Plan of Reorganization for Scotia Pacific Company LLC Proposed by the Debtors and MAXXAM Entities
Exhibit C-4	Uniform Glossary of Defined Terms for Debtors' Plans
Exhibit C-5	Statement of Position of the Debtors
Exhibit C-6	(a) Pro Forma Financial Projections for Debtors Plan (b) Pro Forma Financial Projections for Alternative Plans
Exhibit D	Order Approving Joint Solicitation Procedures and Joint Disclosure Statement (without exhibits)
Exhibit E	Liquidation Analysis

## INTRODUCTION

Three separate sets of Plan Proponents have each proposed a plan or plans for reorganizing some or all of the Debtors. The three Plan Proponents are the following entities:

- (1) Mendocino Redwood Company, LLC (“MRC”) and Marathon Structured Finance Fund L.P. (“Marathon”);
- (2) The Bank of New York Trust Company, N.A. (the “Indenture Trustee”), Indenture Trustee for the Timber Notes; and
- (3) Scotia Development LLC (“Scotia Development”), The Pacific Lumber Company (“Palco”), Britt Lumber Co., Inc. (“Britt”), Salmon Creek LLC (“Salmon Creek”), and Scotia Inn Inc. (“Scotia Inn”) (the “Palco Debtors”) and Scotia Pacific Company LLC (“Scopac”), as debtors and debtors in possession (collectively, the “Debtors”), together with MAXXAM Inc. (“MAXXAM”), MAXXAM Group Holdings Inc. (“MGHI”), and MAXXAM Group Inc. (“MGI”) (the Debtors, MAXXAM, MGHI, and MGI are referred to herein as the “Joint Debtor Proponents”).

MRC and Marathon have proposed, and are soliciting acceptances of, the *First Amended Joint Plan of Reorganization for the Debtors*, as amended (the “MRC/Marathon Plan”). A copy of the MRC/Marathon Plan is attached hereto as Exhibit A-1.

The Indenture Trustee has proposed, and is soliciting acceptances of, the *First Amended Chapter 11 Plan for Scotia Pacific Company, LLC* (“the Indenture Trustee Plan”). A copy of the Indenture Trustee Plan is attached hereto as Exhibit B-1.

The Joint Debtor Proponents have proposed, and are soliciting acceptances of, the *Second Amended Joint Plan of Reorganization for the Debtors*, as amended (the “Debtors Plan”), and alternatively, the *First Alternative Plan of Reorganization for the Palco Debtors*, as amended (the “Palco Alternative Plan”) and the *First Alternative Plan of Reorganization for Scotia Pacific Company LLC*, as amended (the “Scopac Alternative Plan”). Copies of the Debtors Plan, the Palco Alternative Plan, and the Scopac Alternative Plan are attached hereto as Exhibits C-1, C-2 and C-3. The Palco Alternative Plan and the Scopac Alternative Plan are referred to collectively herein as the “Alternative Plans.”

The MRC/Marathon Plan, the Indenture Trustee Plan and the Debtors Plan (along with the Palco Alternative Plan and the Scopac Alternative Plan) are referred to collectively herein as the “Plans.”

***Each of the Plans contain certain defined terms, which are referenced either in the body of the Plans or in an appendix referenced in the Plans. Capitalized terms used in this Joint Disclosure Statement that are not defined herein have the meanings ascribed in the respective Plans or the appendices thereto, as applicable. Please consult each of the Plans and the defined terms for each for the meaning of capitalized terms used herein, as applicable.***

This solicitation is being conducted in order to obtain sufficient acceptances to enable one of the Plans to be confirmed by the Bankruptcy Court pursuant to the provisions of section 1129 of the Bankruptcy Code.

## OVERVIEW OF THE PROPOSED PLANS

Each of the Plan Proponents believes that their respective Plans should be confirmed by the Bankruptcy Court. The position statements of each of the Plan Proponents as to each of the competing Plans are attached hereto as Exhibits A-3, B-2 and C-5. (The position statement of the Official Committee of Unsecured Creditors is attached hereto as Exhibit AA). The following chart summarizes the principal terms of each of the proposed Plans (the descriptions for each of the Plans below have been prepared by the respective Plan Proponents; the Plan Proponents only agree with the descriptions below for their respective Plans):

**PLAN COMPARISON CHART**

<b>TOPICS</b>	<b>MRC/MARATHON PLAN</b>	<b>INDENTURE TRUSTEE PLAN</b>	<b>DEBTORS PLAN</b>	<b>PALCO ALTERNATIVE PLAN</b>	<b>SCOPAC ALTERNATIVE PLAN</b>
Which Debtors does the plan affect?	All Debtors.	Only Scopac.	All Debtors.	Only the Palco Debtors (Palco, Britt, Scotia Inn, Salmon Creek and Scotia Development).	Only Scopac.
Does the plan contemplate any material changes in the Debtors' business operations?	Yes.	Scopac will continue operations substantially in its current manner until its sale as a going concern on the plan's Effective Date.	No.	Yes.	Yes.
How will the plan be implemented (sale, reorganization, etc.)?	<p>The Debtors will be reorganized into two entities as follows:</p> <ul style="list-style-type: none"> <li>Newco will consist of the Debtors' Scotia Mill and commercial timberland assets. The Mill and commercial timberland operations will be integrated and managed by MRC consistent with MRC's track record in Mendocino County.</li> <li>Townco will consist of the town of Scotia, including residences, the power plant and other assets not associated with the Scotia Mill and commercial timberland assets.</li> </ul>	<p>The Plan Agent appointed under the plan will conduct, with the assistance of a Sales Agent, a commercially reasonable sale of Scopac as a going concern.</p>	<p>Reorganization, with joint ownership among secured creditors and existing equity.</p>	<p>The Palco Business will be transferred to Marathon; Reorganized Palco will retain its Interests in Reorganized Scopac and all rights to the Headwaters Litigation.</p>	<p>The Commercial Timberlands will be transferred to the Prepetition Indenture Trustee (Noteholders); Reorganized Scopac will retain the MMCAs, the Redwood Preserve Development, and rights in the Headwaters Litigation</p>

<b>TOPICS</b>	<b>MRC/MARATHON PLAN</b>	<b>INDENTURE TRUSTEE PLAN</b>	<b>DEBTORS PLAN</b>	<b>PALCO ALTERNATIVE PLAN</b>	<b>SCOPAC ALTERNATIVE PLAN</b>
Does the plan provide assurances for continued operation of the Scotia sawmill	Yes. The Plan provides that MRC and Marathon will change the strategic approach of the Scotia Mill, invest up to \$7.5 million in capital in the Scotia Mill, and share MFP's distribution infrastructure with the Scotia Mill. Long term success of the Scotia Mill is a critical element of the reorganization plan developed by MRC and Marathon.	Not applicable.	Yes.	Yes.	Not applicable.
Is financing required to consummate the plan?	No.	No.	Yes.	Yes.	No.
If so, what financing is required?	None.	Not applicable.	\$90 million (\$40MM for Palco and \$50MM for Scopac).	\$110 million.	Not applicable.
What conditions or contingencies must be met for any financings associated with the plan?	None.	Not applicable.	Plan confirmation and a willing lender or lenders.	Plan confirmation of the Palco Alternative Plan and the Scopac Alternative Plan, plus a willing lender or lenders.	



TOPICS	MRC/MARATHON PLAN	INDENTURE TRUSTEE PLAN	DEBTORS PLAN	PALCO ALTERNATIVE PLAN	SCOPAC ALTERNATIVE PLAN
Who will control the Debtors after the plan is confirmed?	The Scotia Mill and commercial timberland assets will be controlled by a Board of Directors that largely overlaps with the Board of Directors that controls MRC, and run day to day by a management team that is drawn from both MRC and MFP. The town of Scotia will be managed by an affiliate of Marathon.	The Plan Agent under the direction of a Post-Confirmation Board consisting initially of representatives of Scopac's secured creditors and thereafter of representatives of Scopac's unsecured creditors.	Shared control among Reorganized Palco, MAXXAM, Marathon, and the Prepetition Timber Noteholders.	MAXXAM.	Reorganized Palco.
How does the plan treat priority and administrative claims?	Paid in full in cash.	Paid in full in cash on the Effective Date.	Paid in full on the Distribution Date.	Paid in full on the Distribution Date.	Paid in full on the Distribution Date.

TOPICS	MRC/MARATHON PLAN	INDENTURE TRUSTEE PLAN	DEBTORS PLAN	PALCO ALTERNATIVE PLAN	SCOPAC ALTERNATIVE PLAN
<p>How does the plan treat the general unsecured creditors of the affected debtor(s)?</p>	<p>Allowed Palco Trade Claims and Allowed Palco General Unsecured Claims will be paid a Pro Rata share of \$10.1 million plus a Litigation Trust Participation for any remaining amount owed, and the recovery is estimated to be 75-90%.</p> <p>Allowed Scopac Trade Claims will be paid a Pro Rata share of \$500,000 plus a Litigation Trust Participation for any remaining amount owed, and the recovery is estimated to be 75-90%.</p> <p>Allowed Scopac General Unsecured Claims will receive a Litigation Trust Participation, and the estimated recovery is unknown.</p> <p>Deficiency claims for the Marathon DIP Loan and Term Loan shall be waived and receive no recovery.</p>	<p>Anticipated to be paid at approximately 100% from a \$1.45 million fund set aside for the benefit of general unsecured creditors of Scopac.</p>	<p>Semi annual payments of interest only at rate of 8.25%, plus all principal on the seventh anniversary of the Effective Date.</p>	<p>Semi annual payments of interest only at rate of 8.25%, plus all principal on the seventh anniversary of the Effective Date.</p>	<p>Paid in full on the Distribution Date.</p>

<b>TOPICS</b>	<b>MRC/MARATHON PLAN</b>	<b>INDENTURE TRUSTEE PLAN</b>	<b>DEBTORS PLAN</b>	<b>PALCO ALTERNATIVE PLAN</b>	<b>SCOPAC ALTERNATIVE PLAN</b>
How does the plan treat Marathon's term loan in the amount of \$85 million?	In full satisfaction of its Palco DIP Loan Claim and Palco Term Loan Claim and contributing a portion of the cash contribution to Newco, Marathon shall receive (1) 100% equity ownership interest of Townco, (2) 15% equity ownership interest in Newco (subject to adjustment), and (3) a note from Newco in the aggregate principal amount equal to the amount of the Mill Working Capital and secured solely by Liens on the Mill Working Capital.	Not applicable.	Transfer of the Town Assets to Marathon and 17.7% of the common stock of Reorganized Palco in full satisfaction of the term loan debt.	Marathon will receive title to the Palco Town Assets and the Scotia Mill in full satisfaction of the term loan debt.	Not applicable.
How does the plan treat Marathon's DIP loan in the amount of \$75 million?	See above.	Not applicable.	45.7% of the common stock of Reorganized Palco in full satisfaction of the debt.	Paid in full on the Distribution Date with the proceeds of the Alternative Exit Facility.	Not applicable.
How does the plan treat Bank of America?	All principal and non-default interest rate paid on Distribution Date. Accrued default interest paid over time in 12 monthly payments.	Bank of America's claim will be paid in full in Cash on the Effective Date in accordance with the terms of the Indenture and Deed of Trust.	Paid in full (at the non-default interest rate) on the Distribution Date.	Not applicable.	Paid in full (at the non-default interest rate) on the Distribution Date if the Palco Alternative Plan is confirmed; otherwise Bank of America will receive \$20 million and a six-month note for the balance of its claim.

<b>TOPICS</b>	<b>MRC/MARATHON PLAN</b>	<b>INDENTURE TRUSTEE PLAN</b>	<b>DEBTORS PLAN</b>	<b>PALCO ALTERNATIVE PLAN</b>	<b>SCOPAC ALTERNATIVE PLAN</b>
How does the plan treat the claims of the Indenture Trustee?	Unless the Timber Noteholders elect otherwise under 1111(b)(1)(A)(i) of the Bankruptcy Code prior to the agreed deadline of March 2, 2008 at 5:00 p.m. Central time, the Timber Noteholders shall, subject to the New Timber Note Adjustment, receive a Pro Rata share of \$175 million in Cash plus a Pro Rata share of New Timber Notes in the principal amount of \$325 million accruing interest at 5.5% per annum and secured by the Timberlands.	Paid from the proceeds of the sale after payment of senior classes and setting aside funds (including those for unsecured creditors) as required under the Plan.	49% of the New Scopac Common Stock, 375 million shares of the New Scopac Preferred Stock, and \$225 million in New Timber Notes.	Not applicable.	Transfer of the Commercial Timberlands
What happens to Maxxam's ownership interests in Palco?	Maxxam will not receive any distributions.	Not applicable.	Diluted to 36.6% ownership of Reorganized Palco.	Retained.	Not applicable.
What happens to Palco's ownership interests in Scopac?	Palco will not receive any distributions.	In the event all Scopac creditors are paid in full, Palco will be paid in cash from the remaining proceeds of sale and distributions from the Liquidation Trust and Litigation Trust.	Diluted to 51% ownership of Reorganized Scopac.	Retained	Retained.
Does the plan purport to alter any of the regulatory rights of the California State Agencies?	No.	No. The sale of Scopac as a going concern will be subject to existing regulatory rights and agreements.	No.	No.	No.

<b>TOPICS</b>	<b>MRC/MARATHON PLAN</b>	<b>INDENTURE TRUSTEE PLAN</b>	<b>DEBTORS PLAN</b>	<b>PALCO ALTERNATIVE PLAN</b>	<b>SCOPAC ALTERNATIVE PLAN</b>
Does the plan purport to alter any of the regulatory rights of the Federal Government?	No.	No. The sale of Scopac as a going concern will be subject to existing regulatory rights and agreements.	No.	No.	No.
Does the plan provide for the assumption and continuation of the Debtors' defined benefit pension plan?	Yes.	Not applicable. Scopac does not have a defined benefit pension plan.	Yes.	Yes.	Not applicable. Scopac does not have a defined benefit pension plan.
Does the plan promise to honor the obligations associated with AB 1986	Yes.	Yes.	Yes.	Yes.	Yes.
How will avoidance actions and other claims under Chapter 5 of the Bankruptcy Code be handled?	Trade Avoidance Actions and Avoidance Actions against Marathon and Bank of America are waived. All other Avoidance Actions are assigned to the Litigation Trust.	Preserved. The Plan Agent will prosecute such claims for the benefit of Scopac's unsecured creditors.	Released.	Released.	Released.
What will happen to any other estate litigation claims, including the Debtors' lawsuit against the State of California alleging, among other claims, breach of the Headwaters Agreement?	Actions for (i) accounts receivable, (ii) breach of the Headwaters Agreement, and (iii) non-monetary relief will be retained by the Debtors' estates and assigned to Newco or Townco, as applicable. All other affirmative actions will be assigned to the Litigation Trust.	Scopac's interests in other estate litigation will be contributed to a Litigation Trust whose beneficiaries will be, per the absolute priority rule, the creditors and shareholders of Scopac.	Retained by Reorganized Debtors.	Retained by Reorganized Palco.	Retained by Reorganized Scopac.

TOPICS	MRC/MARATHON PLAN	INDENTURE TRUSTEE PLAN	DEBTORS PLAN	PALCO ALTERNATIVE PLAN	SCOPAC ALTERNATIVE PLAN
Does the plan contain any releases or exculpation provisions? If so, who is covered?	Releases and discharges for the Debtors and Reorganized Entities. Releases and exculpations for the Plan Proponents, the Committee and its members.	The plan grants certain releases to the Plan Agent and the Plan Proponent, their professionals and other agents.	The following parties are released from potential claims brought by the Debtors and certain limited claims brought by third parties: (i) Debtors, (ii) Non-Debtor Affiliates, (iii) Committee and its members, (iv) Marathon, (v) Prepetition Indenture Trustee, (vi) each holder of an Allowed Scopac Timber Noteholder Claim and (vii) each of the foregoing parties' officers, directors, employees and professionals.	The following parties are released from potential claims brought by the Debtors and certain limited claims brought by third parties: (i) Debtors, (ii) Non-Debtor Affiliates, and (iii) each of the foregoing parties' officers, directors, employees and professionals.	The following parties are released from potential claims brought by the Debtors and certain limited claims brought by third parties: (i) Debtors, (ii) Non-Debtor Affiliates, and (iii) each of the foregoing parties' officers, directors, employees and professionals.

## THE PURPOSE OF DISCLOSURE STATEMENTS IN BANKRUPTCY

This Joint Disclosure Statement describes the history of the Debtors, their businesses, and the progress of their Reorganization Cases to date. This Joint Disclosure Statement also provides information about each of the Plans, including alternatives to the confirmation of each. Specifically, this Joint Disclosure Statement informs the holders of claims and interests of their rights under each Plan. It also, in the case of holders of claims or interests that are “impaired,” provides them with information to assist in making an informed judgment regarding whether they should vote to accept or reject each Plan. Finally, this Joint Disclosure Statement provides information to assist the Bankruptcy Court in determining whether each Plan complies with the provisions of chapter 11 of the Bankruptcy Code and should be “confirmed,” i.e. approved and made effective.

By order dated February 29, 2008, attached hereto as Exhibit D (without exhibits), the Bankruptcy Court approved this Joint Disclosure Statement, in accordance with section 1125 of the Bankruptcy Code, as containing “adequate information” to enable a hypothetical, reasonable investor typical of holders of claims against the Debtors to make an informed judgment as to whether to vote to accept or reject each Plan. The Bankruptcy Court also authorized the use of this Joint Disclosure Statement in connection with the solicitation of votes with respect to each Plan. **APPROVAL OF THIS JOINT DISCLOSURE STATEMENT, HOWEVER, DOES NOT CONSTITUTE A DETERMINATION BY THE BANKRUPTCY COURT AS TO THE FAIRNESS OR MERITS OF ANY PLAN.** No solicitation of votes on any Plan may be made except pursuant to this Joint Disclosure Statement and section 1125 of the Bankruptcy Code.

This Joint Disclosure Statement is not intended to replace a careful and detailed review and analysis of each Plan by each holder of a claim or interest but instead is intended only to aid and supplement that review. Any description of each Plan is a summary only. Holders of claims and interests and other parties in interest are cautioned to review each Plan and any related attachments in their entirety for a full understanding of each Plan’s provisions. This Joint Disclosure Statement is qualified in its entirety by reference to the full text of each Plan, the Plan Supplement and the exhibits and attachments thereto. If any inconsistency exists between the terms of each Plan and this Joint Disclosure Statement, the terms and provisions of the particular Plan will control.

Certain of the statements contained in this Joint Disclosure Statement are forward-looking projections and forecasts based upon certain estimates and assumptions. Such statements may prove to be wrong or materially different from actual future results, and there can be no assurance that such statements will reflect actual outcomes. The statements contained in this Joint Disclosure Statement, moreover, are made as of the date hereof unless otherwise specified herein, and the delivery of this Joint Disclosure Statement does not imply that there has been no change in the information set forth herein since such date.

Holders of claims against the Debtors are encouraged to read and carefully consider the matters described in this Joint Disclosure Statement before voting. Each holder of a claim should also consult such holder’s attorney, accountant, tax advisor, and/or financial advisor as to the effect of each Plan on such holder, including without limitation the tax effects of each Plan. In making a voting decision, each holder must rely on the holder’s own examination of the Debtors and the terms of each Plan, including the merits and risks involved.

*This Joint Disclosure Statement may not be relied upon for any purpose other than to determine whether to vote in favor of or against each Plan, and nothing contained herein will constitute an admission of any fact or liability by any party, or be admissible in any proceeding involving the Debtors or any other party, or be deemed evidence of the tax or other legal consequences or effects of the reorganization of the Debtors. Specifically, the discussion regarding regulatory and environmental obligations is not an admission by any party, including the relevant state and federal regulators, that the statements are correct statements of the law or any parties’ legal obligations that can be used in any proceeding regarding these obligations. Moreover, the Bankruptcy Court’s approval of this Joint Disclosure Statement will not be construed as approval or adoption of any Plan Proponent’s position on regulatory or environmental obligations under state and federal law. Nothing in the Plans, this Joint Disclosure Statement, or other plan documents will constitute an admission by any person of any fact or liability, stipulation, or waiver in any contested matter, adversary proceeding, or other causes of action or threatened causes of action.*

No statement or information concerning the Debtors (particularly as to future business, results of operations or financial condition, or with respect to distributions to be made under each Plan) or their assets, properties, or businesses that is given for the purpose of soliciting acceptances of any Plan is authorized, other than as set forth in this Joint Disclosure Statement.

## **SUMMARY OF VOTING PROCEDURES**

All known holders of claims in impaired classes that are entitled to vote on each Plan have been sent Ballots with voting instructions and copies of this Joint Disclosure Statement. All holders of impaired claims should read their Ballots carefully and follow the voting instructions accurately. Holders of claims should use only an official Ballot.

### **A. WHO CAN VOTE?**

The Bankruptcy Code provides that the only classes of claims that are entitled to vote on each Plan are those that are both (i) “impaired” by each Plan and (ii) entitled to receive a distribution under each Plan. Classes of claims or interests that are “unimpaired are deemed to vote “yes,” while classes that will receive nothing at all are deemed to vote “no.”

Under the MRC/Marathon Plan, only Claims in Classes 3, 4, 5, 6, 7, 8 and 9 are Impaired and, accordingly, the Holders of Claims in those Classes are the only Holders of Claims entitled to vote to accept or reject the MRC/Marathon Plan. Because Claims and Interests in Classes 1 and 2 are unimpaired by the MRC/Marathon Plan, the Holders of Claims and Interests in such Classes are conclusively presumed by operation of the Bankruptcy Code to have accepted the MRC/Marathon Plan. Holders of Claims and Interests in Classes 10, 11 and 12 will receive no distribution and are deemed to reject the MRC/Marathon Plan.

Under the Indenture Trustee Plan, Claims in Class 1 and Class 2(a) are not impaired. Pursuant to section 1126(f) of the Bankruptcy Code, Claimholders within Classes 1 and 2(a) are conclusively presumed to have accepted the Indenture Trustee Plan, and therefore are not entitled to vote to accept or reject the Indenture Trustee Plan. Claims in Classes 2(b)(1), 2(b)(2), 2(b)(3), 2(c), 3, and 4 are impaired under the Indenture Trustee Plan and are entitled to vote to accept or reject the Indenture Trustee Plan. Pursuant to section 1126(g) of the Bankruptcy Code, holders of Claims and Interests in Classes 5, 6, and 7 are conclusively presumed to have rejected the Indenture Trustee Plan, and therefore are not entitled to vote to accept or reject the Indenture Trustee Plan.

Under the Debtors Plan, Claims in Palco Class 1 and Scopac Class 1 are unimpaired. Under the Alternative Plans, Claims and Interests in Palco Classes 1, 2, and 9 and Scopac Classes 1, 2, and 9 are unimpaired. The Holders of Claims and Interests in those Classes are conclusively presumed by operation of the Bankruptcy Code to have accepted the respective Plan. All other Claims and Interests under the Debtors Plan and the Alternative Plans are Impaired, and, accordingly, the Holders of Claims in those Classes (Palco Classes 2, 3, 4, 5, 6, 7, 8, and 9 and Scopac Classes 2, 3, 4, 5, 6, 7, 8, and 9 under the Debtors Plan, and Palco Classes 3, 4, 5, 6, 7, and 8 and Scopac Classes 3, 4, 5, 6, 7, and 8 under the Alternative Plans) are the only Holders of Claims or Interests entitled to vote to accept or reject the Debtors Plan, the Palco Alternative Plan and the Scopac Alternative Plan.

For purposes of voting, the Bankruptcy Court has established February 25, 2008, as the Record Date on which a creditor or holder of an Interest in a Debtor must have been the holder of that Claim or Interest against a Debtor in order to be entitled to vote to accept or reject each Plan.

### **B. WHAT IS THE DEADLINE FOR VOTING?**

In order for your vote to be counted for voting purposes, Ballots accepting or rejecting each Plan must be *physically* received by the Balloting Agent no later than 4:00 p.m., prevailing Central Time, on March 25, 2008. Please allow adequate time for delivery.

Although electronic filing is available for other types of pleadings in these cases, it is not available for the submission of Ballots. To ensure the integrity of the voting process, all Ballots must be submitted as originals and



must bear an original signature in order to be counted. Late Ballots will be given no effect. Please plan on voting so that the Ballots can be received in time to be counted.

**C. WHERE AND HOW DO I RETURN MY BALLOT?**

Ballots should be returned to Logan & Company, Inc., the Balloting Agent at:

Logan & Company, Inc.  
546 Valley Road  
Upper Montclair, New Jersey 07043  
Attn: Palco Voting Department

In order to have your vote count, you must sign and return the Ballot accompanying this Joint Disclosure Statement to the Balloting Agent by the deadline set forth above. You may return your Ballot by mail, hand delivery, or overnight courier. However, the Balloting Agent is not able to accept Ballots by email or facsimile. A pre-addressed, postage-prepaid envelope is included for your convenience.

**D. CAN MY ATTORNEY VOTE FOR ME?**

Yes, under certain circumstances. If you (i) have authorized your attorney to vote for you, and (ii) have not changed those arrangements, your attorney may vote as your agent. If your attorney votes on your behalf, you do not need to complete a Ballot. If you have not authorized your attorney to vote for you, only you may vote on each Plan.

**E. I AM AN ATTORNEY VOTING ON BEHALF OF MY CLIENT—WHAT DO I NEED TO DO?**

Attorneys voting on behalf of clients must use and complete the Ballot sent to the client. Attorneys may vote only for those clients from whom the attorney has obtained authorization to do so.

Ballots cast by attorneys on behalf of their clients must be received by the Debtors' Balloting Agent at the address listed on the Ballot by no later than 4:00 p.m., prevailing Central Time, on March 25, 2008. Ballots may be returned by mail, hand delivery, or overnight courier. However, the Balloting Agent is unable to accept Ballots by email or facsimile. Please allow enough time for delivery.

**F. WHAT DO I DO IF I RECEIVED MORE THAN ONE BALLOT?**

It is possible for a single person or entity to hold claims or interests in more than one class or against more than one of the Debtors. If so, you may be entitled to vote in more than one class, and you should have received more than one Ballot. Please review each of the Ballots carefully and consult with your legal and financial advisors for further advice if necessary. A vote on one Ballot will be effective only in the class or classes specified in that Ballot. In order to have your vote count in more than one class, if applicable, you must submit more than one Ballot.

**G. WHAT DO I DO IF I DID NOT RECEIVE A BALLOT WITH MY SOLICITATION PACKAGE OR DID NOT RECEIVE A BALLOT FOR EACH CLASS IN WHICH I AM ENTITLED TO VOTE, OR NEED A REPLACEMENT BALLOT?**

If you are a holder of a claim entitled to vote on any of the Plans and (1) did not receive a Ballot, (2) received a damaged Ballot, or (3) lost your Ballot (and you are not voting through your attorney), you should contact the Balloting Agent, at 1-800-224-7654, or by email at [palco@loganandco.com](mailto:palco@loganandco.com).

Extra copies of Ballots also may be downloaded at no charge to you from the Balloting Agent's website: [www.loganandco.com](http://www.loganandco.com). You must take care to download the correct Ballot for the class(es) in which you are entitled to vote.

If you have any questions about the procedures for voting on any of the Plans, you should contact your attorney or the Balloting Agent.

For detailed voting instructions, see the instructions accompanying your Ballot. Please read and follow the instructions closely to ensure that your vote is counted.

## SECTION 1.

### GENERAL INFORMATION AND HISTORICAL BACKGROUND

*This section contains general information and historical background about the Debtors. All capitalized terms not defined in this section shall have the meanings ascribed in the Debtors Plan.*

#### **1.1 The Debtors' 140-Year History.**

The Debtors trace their roots back to 1863, during an era when the Civil War was raging, the Pony Express was just being replaced by the transcontinental railroad, and Arizona had just become a U.S. Territory. That same year, A. W. McPherson and Henry Wetherbee bought 6,000 acres of land along the Eel River in Humboldt County, California for \$1.25 per acre. It was the beginning of what would one day become Palco.

Over the next 20 years, McPherson and Wetherbee took on new partners, bought more land, and built sawmills and shipping facilities. In 1882, they began logging operations in Humboldt County and started building the town of Forestville, which would serve as the company's headquarters and provide housing for its employees. A few years later, the town's name was changed to Scotia.

By 1888, McPherson's and Wetherbee's original vision had become a reality. Palco had 300 employees and was shipping 20 million board feet a year, making the company the largest producer of lumber in Humboldt County. The town of Scotia began to grow and prosper, boasting a post office, a Western Union station, its own school district, and a church.

#### **1.2 Business Activities of the Debtors.**

##### **(a) Overview of the Palco Debtors' Business.**

The Palco Debtors are one of the largest producers of redwood lumber in the State of California. The Palco Debtors own approximately 10,000 acres of commercial timberlands and manage approximately 200,000 acres of commercial timberlands owned by Scopac, all of which are located in Humboldt County along the northern California coast, an area with very favorable soil and climate conditions for growing timber.

Palco owns (directly) substantially all of the assets in the town of Scotia, California, including a sawmill and other industrial use facilities, a cogeneration plant, 270 homes, various commercial properties, and all of the land associated with these assets. A number of Palco's employees live in Scotia. Palco also owns and operates, through Britt, a sawmill in Arcata, California. During 2007, Palco idled the Arcata sawmill and moved a portion of its operations to the town of Scotia. In addition, Palco owns marketing and distribution operations, all located in the town of Scotia.

Lumber is the principal product of Palco and Britt. Palco also derives revenue from a variety of other sources such as the sale of electricity from its co-generation plant, the sale of wood chips and logs, and the lease of various residential and commercial properties. Palco and Britt normally offer a variety of lumber, including different grades of redwood and Douglas-fir. However, due to continued low prices for Douglas-fir lumber, Palco and Britt do not expect to process any Douglas-fir logs into lumber through at least mid-2008.

Palco's log needs in particular had historically been satisfied almost entirely by timber harvested from the Timberlands and, following Scopac's formation, purchased from Scopac. More recently, during heavy production periods, Palco has had to supplement the logs it purchases from Scopac with third-party log purchases.

The housing, construction and remodeling markets are the primary markets for the lumber products of Palco and Britt. Their accounts are primarily wholesale, followed by industrial end users, manufacturers, retailers and exporters.

**(b) Overview of Scopac's Business.**

Scopac's primary asset is approximately 200,000 acres of commercial timberlands and the exclusive right to harvest approximately 10,000 acres of timberlands owned by Palco and its subsidiary, Salmon Creek. The timber harvested from Scopac's Timberlands is primarily redwood and Douglas-fir logs. These logs are generally sold to the Palco Debtors pursuant to the New Master Purchase Agreement.

Scopac is primarily responsible for attaining the various federal, state and regulatory permits and approvals necessary to conduct timber harvesting operations on the Timberlands. The availability of timber for harvest depends in large part upon the ability to obtain regulatory approval of THPs prepared by Scopac's foresters.

**(c) Overview of the Timber Industry.**

**(1) Timber Generally.**

Timber generally is categorized by species and the age of a tree when it is harvested. "Old-growth" trees are often defined as trees that have been growing for approximately 200 years or longer, while younger trees typically are called "young growth" or "second growth." The forest products industry grades lumber into various classifications according to quality. Based on the absence or presence of knots, all grades of lumber fall into two broad categories: "upper" and "common." Old-growth trees have a higher percentage of upper-grade lumber than young-growth trees.

Scopac's merchantable timber is comprised of redwood, Douglas-fir, and other conifer timber. The conifers consist (by volume) of approximately 66% redwood, 30% Douglas-fir, and 4% other conifer timber.

**(2) Timber Operations in Northern California.**

California law requires large timberland owners, including the Debtors, to demonstrate that their timber operations will not decrease the sustainable productivity of their timberlands. The applicable regulations require timber companies to project timber growth and harvest on their timberlands over a 100-year planning period and to demonstrate sustained yield. "Sustained yield" means that their projected average annual harvest for any decade within the 100-year planning period will not exceed the average annual growth level at the end of the 100-year planning period. A timber company may comply with this requirement by submitting a sustained yield plan to the CDF, the California Department of Forestry and Fire Protection, for review and approval or by following alternative procedures. Federal and state laws also provide for the protection and conservation of wildlife species that have been designated as endangered or threatened, certain of which are found on the Timberlands. See "Regulatory and Environmental Factors" below.

**(d) Harvesting Practices.**

**(1) Regulatory Approval of Timber Harvest Plans.**

Before harvesting timber in California, companies must obtain the approval of the CDF for a detailed THP, or timber harvest plan, for the area to be harvested. A THP must be submitted by a Registered Professional Forester and must include, among many other things, information regarding the method of proposed timber operations for a specified area, whether the operations will have any adverse impact on the environment and, if so, the mitigation measures to be used to reduce the impact. The CDF's evaluation of THPs incorporates review and analysis by several California and federal agencies as well as the review of public comments. The number of Scopac's approved THPs and the amount of timber they cover can vary significantly from time to time, depending on the timing of agency review and other factors. Timber covered by an approved THP typically is harvested within a one-year period after harvesting begins.

(2) **Selections for Harvest.**

Scopac maintains a geographical information system covering the Timberlands. Scopac's geographical information system covers numerous aspects of these timber properties, including timber type, site productivity class, wildlife and botanical data, geological information, roads, rivers and streams. By monitoring and updating this data base and conducting field studies, Scopac's foresters are better able to develop detailed THPs addressing various regulatory requirements, including those contained in the HCP, or Habitat Conservation Plan, applicable to the Timberlands.

(e) **Production Facilities.**

(1) **Overview of Sawmills.**

Palco owns a sawmill in the town of Scotia, California. Through Britt, Palco also owns a sawmill in Arcata, California, which is idle (see "Britt Operations" below).

(2) **Britt Operations.**

Britt has historically processed small-diameter redwood logs into fencing and decking products for sale to retail and wholesale customers. While Britt owns a sawmill in Arcata, California, as noted above, the mill has been idled, and the fence processing portion of Britt's operations has been moved to Scotia.

(3) **Lumber Drying.**

Subject to market conditions and lumber supply, Palco dries a portion of its lumber before it is processed or sold. Air or kiln-dried lumber generally commands higher prices than "green" lumber, which is lumber sold before it has been dried. Drying also allows Palco to compete in additional markets due to lower shipping costs resulting from the moisture and weight reduction that occurs in the drying process. Palco owns and can operate up to 31 kilns having an annual capacity of approximately 38 million board feet.

(4) **Cogeneration Plant.**

Palco owns and operates a cogeneration power plant that is fueled by the wood residue from company logging and lumber production operations and third-party purchases. The operations of Palco and Britt supplied 53% of the fuel for the Debtors' combined operations in 2006. The power plant is capable of producing up to 32.5 megawatts per hour and generates substantially all of the energy requirements of Scotia, California. Palco also sells surplus power to Pacific Gas and Electric Company. In 2006, the sale of surplus power accounted for approximately 6% of Palco's total revenues.

(f) **Lumber Sales.**

(1) **The Primary Markets.**

The housing, construction and remodeling markets are the primary markets for the lumber products of Palco and Scopac. The companies' accounts are primarily wholesale, followed by industrial end users, manufacturers, retailers, and exporters.

Palco's redwood and Douglas-fir lumber is sold throughout the entire United States, as well as to export markets. Common grades of redwood lumber are sold principally west of the Mississippi River, with California sales by Palco accounting for approximately 81% of common redwood sales in 2006. Common grades of Douglas-fir lumber are also sold primarily in California. In 2006, Palco's largest three customers accounted for approximately 13%, 9% and 7%, respectively, of total net lumber sales. Exports of lumber accounted for less than 1% of the companies' total net lumber sales in 2006. Palco markets its products through Palco's own sales staff, which focuses primarily on domestic sales.

The following table sets forth the distribution of lumber production by Palco (on a net board-foot basis) and revenues by product line during 2006:

Product	Year Ended December 31, 2006		
	% of Total Lumber Production Volume	% of Total Lumber Revenues	% of Total Revenues
Upper grade redwood lumber .....	2%	5%	4%
Common grade redwood lumber .	66%	76%	66%
Total redwood lumber .....	68%	81%	70%
Upper grade Douglas-fir lumber..	–	–	–
Common grade Douglas-fir lumber	32%	19%	17%
Total Douglas-fir lumber.....	32%	19%	17%
Other grades of lumber .....	–	–	–
Total lumber.....	100%	100%	87%
Logs .....			3%
Wood chips.....			2%

**(2) Redwood Lumber.**

Redwood lumber has historically has been the largest product category of Palco. Redwood is commercially available only along the northern coast of California and possesses certain unique characteristics that permit it to be sold at a premium over many other wood products.

Upper-grade redwood lumber, which is derived primarily from larger-diameter logs and is characterized by an absence of knots and other defects, a near absence of sapwood, and a tighter grain, is used primarily in distinctive interior and exterior applications. Common-grade redwood lumber, historically Palco's largest-volume product, has many of the same aesthetic and structural qualities as upper-grade redwood, but has some knots, greater sapwood, and a coarser grain. Such lumber is commonly used for construction purposes, including outdoor structures such as decks and fencing.

**(3) Douglas-Fir Lumber.**

Douglas-fir lumber is used primarily for new construction and some decorative purposes and is widely recognized for its strength, hard surface and attractive appearance. Douglas-fir timber is grown commercially along the west coast of North America and in Chile and New Zealand. Upper-grade Douglas-fir lumber is derived primarily from larger-diameter Douglas-fir timber and is used principally in finished carpentry applications. Common-grade Douglas-fir lumber is used for a variety of general construction purposes and is somewhat interchangeable with common grades of other whitewood species, although the strength of Douglas-fir makes it more desirable in certain applications.

(4) **Log Purchases.**

During 2006, Palco purchased approximately two-thirds of its logs from Scopac and one-third of its logs from third parties. Palco does not have any significant long-term contractual relationships with third parties relating to the purchase of logs.

(5) **Wood Chips.**

Palco produces softwood chips from the wood residue from its milling operations. Palco sells these chips to third parties for the production of wood pulp and paper products. Subject principally to economic feasibility, Palco also produces and sells wood chips from hardwood trees to third parties.

(6) **Competition.**

Palco sells its lumber in highly competitive markets. Competition generally is based on a combination of price, service, product availability, and product quality. Palco's products compete not only with other wood products but with metals, masonry, plastic, and other construction materials made from non-renewable resources. The level of demand for Palco's products is dependent on such broad factors as overall economic conditions, interest rates, and demographic trends. In addition, competitive considerations, such as total industry production and competitors' pricing, as well as the price of other construction products, affect the sales prices for their lumber products. Competition in the common-grade redwood and Douglas-fir lumber market is intense, with numerous large and small lumber producers. Palco and Britt primarily compete with the northern California mills of Simpson, Redwood Empire, Sierra Pacific, and Canadian cedar lumber producers, as well as other imports and non-wood alternatives.

(7) **Seasonality and Current Market Conditions.**

First-quarter lumber sales historically have been lower due largely to the general decline in construction related activity during the winter months and current market conditions. According to the California Redwood Association, redwood lumber sales in 2007 were down 20% compared to 2006. The demand for lumber is affected primarily by the level of new construction activity and, to a lesser extent, by remodeling and repair activity and other industrial uses.

Decreases in the level of residential construction activity or repair and remodeling activity generally reduce demand for logs and wood products. In addition, timber owners generally increase production volumes for logs and products during favorable price environments. Such increased production could, when coupled with declines in demand for these products in general, lead to oversupply and lower prices.

(g) **Regulatory and Environmental Factors.**

*This Joint Disclosure Statement contains a discussion of the Debtors' position on the regulatory and environmental factors relevant to the Plans. The state and federal regulators do not necessarily agree with the Debtors' positions as described herein and much of the interpretation of the laws, regulations, and agreements is the subject of pending litigation. Nothing contained herein is to be construed as an admission or agreement by the state and federal regulators to the Debtors' positions as stated in this section of the Joint Disclosure Statement. Similarly, the Bankruptcy Court's approval of this Joint Disclosure Statement is not to be construed as any finding by the Bankruptcy Court that the Debtors' positions are correct or that can be used by any party in interest in any other case or proceeding.*

(1) **General.**

The businesses of Palco and Scopac are subject to a variety of California and federal laws and regulations, as well as the comprehensive multi-species HCP, dealing with timber-harvesting practices, threatened and endangered species and habitat for such species, and air and water quality. Compliance with such laws and regulations also has played a significant role in the Debtors' businesses. The California Forest Practice Act and

related regulations enforced by the CDF set forth detailed requirements for the conduct of timber-harvesting operations in California. These requirements include the obligation of timber companies to obtain regulatory approval of THPs containing detailed information about areas proposed to be harvested. California law also requires large timberland owners, including Palco and Scopac, to demonstrate that their proposed timber operations will result in (but not exceed) the maximum sustainable production of their timberlands over time.

Palco and Scopac are subject to the federal Endangered Species Act and the California Endangered Species Act, which provide in general for the protection and conservation of specifically listed wildlife and plants. Palco and Scopac are also subject to the California Environmental Quality Act, which provides for protection of the state's air and water quality and wildlife, the California Porter-Cologne Water Quality Control Act and federal Clean Water Act, which require that Palco and Scopac conduct operations so as to reasonably protect the water quality of nearby rivers and streams, and the streambed alteration agreement and other provisions of the California Fish and Game Code, which govern modifications to streams and establish additional requirements for the protection of birds of prey and other species. Compliance with such laws and related regulations and judicial and administrative interpretations, together with other regulatory and environmental matters, have resulted in substantial restrictions on the scope and timing of harvesting and other operations on the Timberlands. Additional regulatory programs, such as the federal Clean Water Act's Section 404 permitting program and Section 401 water quality certification process, the California Planning and Zoning Law, Subdivision Map Act, Timberland Productivity Act, and Humboldt County entitlement processes under its General Plan, Zoning Ordinance and other regulatory programs, would apply to any real estate development (or other non-timber activities) on the Timberlands.

## (2) Environmental Plans.

As noted above, Palco and Scopac are subject to the federal and California Endangered Species Acts, which provide for the protection and conservation of wildlife species that have been designated as endangered or threatened, certain of which are found on the Timberlands. These laws generally prohibit certain adverse impacts on such species (referred to as a "take"), except for incidental take that does not jeopardize the continued existence of the affected species and occurs as a result of operations that comply with an approved HCP, or habitat conservation plan, and related ITP, or incidental-take permit. A habitat conservation plan analyzes the impact of the incidental take and specifies a procedure to monitor, minimize and mitigate the impact. As part of the Headwaters Agreement, the federal and state governments approved the HCP covering the Timberlands and related state and federal ITPs in connection with certain Environmental Plans.

The federal and state governments also approved the SYP, a sustained yield plan, for the Debtors that satisfied the State of California's requirement that timberland owners demonstrate that their timber operations will not decrease the sustainable productivity of their timberlands. In December 2005, a California appellate court reversed a trial court decision that had invalidated the Debtors' SYP and the ITPs issued by California in connection with the Environmental Plans that were approved as part of the Headwaters Agreement. The plaintiffs appealed the appellate court decision to the California Supreme Court, which has accepted the appeal for review. As a result of the trial court's decision, Scopac from October 2002 until March 2005, obtained review and approval of its THPs under an alternative procedure in the California forest practice rules known as "Option C." Option C is available to landowners who, like Palco and Scopac, have submitted an "Option A" plan to the CDF for review. An approved Option A plan is an alternative to obtaining approval of sustained yield plan. The CDF approved Palco's Option A plan in March 2005. Scopac currently is relying upon the Option A plan to obtain THP approvals.

In connection with approval of the Environmental Plans, California and federal agencies issued ITPs with respect to certain threatened, endangered, and other species found on the Timberlands. The permits were to cover the 50-year term of the HCP and allow incidental take of 17 different species covered by the HCP, including nine species which are found on the Timberlands that have been listed under the federal Endangered Species Act and/or the California Endangered Species Act. The agreements that implement the Environmental Plans also provide for various remedies (including the issuance of written stop orders and liquidated damages) in the event of a breach by Palco, Scopac, or Salmon Creek of these agreements or the Environmental Plans.

Under the HCP, harvesting activities are prohibited or restricted on certain areas of the Timberlands. Some of these restrictions continue for the entire 50-year term of the HCP. For example, several areas (containing substantial quantities of timber, including old-growth redwood and Douglas-fir timber) are designated as habitat

conservation areas for the marbled murrelet, a coastal seabird, and certain other species. Harvesting in certain other areas of the Timberlands currently is prohibited while these areas are evaluated for the potential risk of landslide. Further, additional areas alongside streams have been designated as buffers, in which harvesting is prohibited or restricted in order to protect aquatic and riparian habitat. Restrictions on harvest in streamside buffers and potential landslide-prone areas may be adjusted up or down, subject to certain minimum and maximum buffers, based on the ongoing watershed-analysis process described below. The adaptive-management process described below may also be used to modify many of these restrictions.

The first analysis of a watershed, Freshwater, was released in June 2001. This analysis was used by Palco, Scopac, and Salmon Creek and the government agencies to develop proposed harvesting prescriptions. Since then, watershed analysis has been completed and prescriptions approved for four additional watersheds: Van Duzen in January 2004, Lower Eel-Eel Delta in March 2004, Elk River in November 2005, and Upper Eel in March of 2007. In addition, prescriptions for the Bear River watershed have been tentatively approved by the agencies pending completion of an analysis of the effects of these prescriptions on terrestrial wildlife. The Freshwater, Van Duzen, Lower Eel, Elk River, Upper Eel, and Bear River prescriptions each resulted in a reduction in the size of the streamside buffers set forth in the Environmental Plans and also provide for geologic reviews in order to conduct harvesting activities on some potential landslide-prone areas in lieu of no-harvest restrictions. This effectively reduced both constrained acreage and HCP-related operational restrictions in these watersheds.

The HCP required Palco, Scopac, and Salmon Creek, together with the government agencies, to establish a schedule resulting in completion of the initial watershed-analysis process for all covered lands within five years. However, the process has required significantly more time than originally anticipated. Accordingly, Palco, Scopac, and Salmon Creek continue to work with the government agencies to establish appropriate timelines and to streamline watershed analyses on the remaining portions of Timberlands to ensure that such studies are time-efficient and cost-efficient and continue to provide scientific results necessary to evaluate potential changes to the harvesting restrictions on those lands. Palco, Scopac, and Salmon Creek had previously received an extension to March 2007 for completion of the watershed-analysis process. An additional request for an extension to March 2008 was submitted to the HCP agencies. Palco, Scopac, and Salmon Creek are currently working under that extension.

The HCP contains an adaptive-management provision that allows Palco, Scopac, and Salmon Creek to propose changes to many of the HCP prescriptions. Palco, Scopac, Salmon Creek, and the government agencies have previously implemented various adaptive-management changes related to wildlife and rare plants, and other changes relating to roads and streamside buffers. These adaptive-management changes have increased the ability to conduct harvesting operations on the Timberlands or reduced operating costs while still meeting the obligations of the Environmental Plans.

The HCP imposes certain restrictions on the use of roads on the timberlands covered by the HCP during several months of the year and during periods of wet weather. However, Palco has conducted, and expects to be able to continue to conduct, some harvesting during these periods. An adaptive-management change approved in 2003 for the road restrictions has improved the ability to construct and use roads on the Timberlands in ways that are consistent with the Debtors' operational needs. The HCP also requires that 75 miles of roads be storm proofed (i.e., reconstructed to reduce sediment generation) on an annual basis and that certain other roads must be improved or repaired. This work is feasible only in the dry periods of the year.

### **(3) Water Quality.**

Laws and regulations dealing with water quality affected, or have the potential to further affect, Palco, Scopac, and Salmon Creek primarily in three areas: (1) efforts by the EPA and the North Coast Water Board to establish total maximum-daily-load limits in watercourses that have been declared to be water-quality impaired; (2) the North Coast Water Board's imposition of waste-discharge reporting requirements, as well as various mitigation, erosion control, and clean-up measures; and (3) the development by the North Coast Water Board and its staff of special permitting requirements for the Freshwater and Elk River watersheds known as watershed-wide waste discharge requirements or WWDRs.



The Federal Clean Water Act requires the EPA to establish total maximum daily levels, or TMDLs, in watercourses that have been declared to be water-quality impaired. The EPA and the North Coast Water Board are in the process of establishing TMDLs for many northern California rivers and certain of their tributaries, including nine watercourses that flow within the Timberlands. The relevant contaminant in the Scopac Timberlands is sediment—dust, dirt, and gravel—that is abundant in watercourses throughout the Scopac Timberlands as a result of various factors including the Debtors’ timber harvesting activities, the area’s normally heavy rainfall, and the presence of relatively easily eroded soil. Palco expects the process of establishing TMDLs to continue into 2010, although the process for some of the affected watersheds could take longer. The EPA has issued a report dealing with TMDLs on three of the nine watercourses in the Timberlands. The agency indicated that the requirements under the HCP would significantly address the sediment issues that resulted in TMDL requirements for these watercourses. The North Coast Water Board is now in the process of establishing the TMDL requirements applicable to two other watercourses, Freshwater and Elk River, with a targeted completion of 2008. Scopac’s scientists are working actively with North Coast Water Board staff to ensure that these TMDLs recognize and incorporate the environmental protection measures of the HCP. The final TMDL requirements applicable to the Timberlands may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the prescriptions to be developed pursuant to the watershed analysis process provided for in the HCP. These requirements could further restrict harvesting on the Timberlands.

For each of the winter periods since 2002, Palco and Scopac have been required to submit reports on sediment discharges and erosion-control practices to the North Coast Water Board in order to conduct winter harvesting operations in the Freshwater and Elk River watersheds. After consideration of these reports, the North Coast Water Board imposed requirements on Palco, Scopac, and Salmon Creek to implement additional mitigation and erosion-control practices in these watersheds for each of these winter operating periods. The North Coast Water Board has also extended the requirements for certain mitigation and erosion-control practices in three additional watersheds (Bear, Jordan, and Stitz Creek). Palco, Scopac, and Salmon Creek and the North Coast Water Board are currently in discussions to determine what these measures will be.

The North Coast Water Board also has issued clean-up and abatement orders for the Freshwater and Elk River watersheds, which are aimed at addressing existing sediment production sites through clean-up actions. The North Coast Water Board has also initiated a process that could result in similar orders for the Bear Creek watershed and is contemplating similar actions for the Jordan and Stitz Creek watersheds. The clean-up and abatement orders for the Freshwater and Elk River have resulted in increased costs that could extend over a number of years. Additional orders for other watersheds (should they be issued) may also result in further cost increases.

On May 8, 2006, the North Coast Water Board adopted WWDRs for the Freshwater and Elk River watersheds. The decision allowed harvesting in these two watersheds, up to approximately 50% of the CDF Harvest Limit, once the staff of the North Coast Water Board reviews and enrolls THPs submitted by Scopac. The North Coast Water Board’s decision also allowed the enrollment of additional THPs, bringing the total to approximately 75% of the CDF Harvest Limit for these two watersheds, upon approval of a monitoring and reporting program by the Executive Officer of the North Coast Water Board staff. The monitoring and reporting program was approved in September 2006, allowing enrollment by the staff of the North Coast Water Board of additional THPs for these two watersheds that were harvested in 2006. This monitoring and reporting program will also govern future THPs in these two watersheds. However, there can be no assurance that additional THPs in these two watersheds will in future years be enrolled or harvested as planned. The North Coast Water Board’s adoption of these WWDRs has been appealed by Palco and third parties to the State Water Board, but the appeals are being held in abeyance pending implementation of the WWDRs. Because historic harvest patterns, adjacency restrictions, and the age classes of trees prevent the ready movement of harvesting activities between watersheds, development of WWDRs and the various other matters described above could result in reduced harvest levels in future years.

Effective January 1, 2004, California Senate Bill 810 provides regional water quality control boards, such as the North Coast Water Board, with additional authority related to the approval of THPs on timberlands within impaired watersheds. Palco and Scopac are uncertain of the operational and financial effects that ultimately will result from Senate Bill 810.

**(h) Position of the California State Agencies and United States Government on Regulatory Matters.**

*This Section 1.2(h) of the Joint Disclosure Statement was prepared by California State Agencies and the United States Government. The Plan Proponents do not necessarily agree with the positions of the state and federal regulators as described herein. Nothing contained herein is to be construed as an admission or agreement by the Plan Proponents to the positions of the state and federal regulators as stated in this section of the Joint Disclosure Statement. Similarly, the Bankruptcy Court's approval of this Joint Disclosure Statement is not to be construed as any finding by the Bankruptcy Court that the positions of the state and federal regulators are correct or that they can be used by any party in interest in any other case or proceeding.*

The US Fish and Wildlife Service (“FWS”), Department of the Interior, and the National Marine Fisheries Service (“NMFS”), Department of Commerce, and the California Department of Fish and Game (collectively the “Wildlife Agencies”) are jointly responsible for overseeing compliance with federal and state statutes and regulations governing the protection endangered wildlife and fish in old growth redwood forests in California. Debtors The Pacific Lumber Company, Scotia Pacific Company LLC, and Salmon Creek LLC currently hold incidental take permits (ITPs or permits) issued by the Government. The permits cover the incidental take of protected species that may result from Debtors’ logging-related activities in California. The terms and conditions of the 50-year permits require the Debtors to implement the Habitat Conservation Plan (HCP) and the associated Implementation Agreement (IA) in California. The HCP and IA include an array of mitigation measures to offset impacts to wildlife and fish species covered under the permits. The HCP is derived from the principles of the 1996 Headwaters Agreement and represents an extraordinary public and private commitment to the preservation of endangered wildlife and fish in old growth redwood forests in California.

Some of the proposed Plans provide for the future transfer of portions of Debtors’ property (“Covered Lands”) which are subject to the ITPs, including the HCP and IA, and subject to covenants, conditions and restrictions (CC&Rs) incorporating the Agreement Relating to Enforcement of AB 1986.

Sections 5.3.1 and 5.5 of the IA require advance approvals by the Wildlife Agencies of each such transfer of Covered Lands. In order to obtain such approvals, the Wildlife Agencies will need to make a determination as to whether any land transfers and contemplated land management activities by third parties would compromise the effectiveness of the HCP. In addition, if any new activity is proposed on lands either transferred or retained under the Plans, the Wildlife Agencies will also need to determine whether the activity can be permitted in accordance with the Federal and State Endangered Species Acts and their implementing regulations, which will require assurances of adequate funding to carry out applicable requirements. The transfers are also subject to the CC&Rs and other applicable federal, state, and local laws and regulations. Whether the Wildlife Agencies will approve any land transfer and/or permit new activities proposed by the Plans cannot be determined at this time.

Some of the proposed Plans propose residential housing or infer that land may be transferred for residential housing on Covered Lands. Residential housing is not a covered activity whose effect on the incidental take of species covered by the state and federal Endangered Species Acts was analyzed as part of the HCP. Housing development can have different and/or additional impacts on the incidental take of covered species that the Wildlife Agencies would need to analyze based on the specifics of proposed uses, including but not limited to: (1) increases in water withdrawal for domestic purposes from watercourses supporting wildlife and fish; (2) increases in road densities and usage that could impact sediment levels in streams which can affect wildlife and fish; (3) the risk of landslide activity that would impact streams, wildlife, and fish; (4) increases in the delivery of nutrients and pesticides to streams that would threaten wildlife and fish; (5) impact on wildlife and fish of increased human activity, including noise, light and domesticated animals; (6) conversion of foraging, nesting and resting habitat for wildlife at building sites; (7) attraction of nuisance species (e.g. corvids) thereby increasing predation on nesting birds (e.g. marbled murrelets); (8) introduction of invasive weed species; (9) conversion of rare plant habitat at building sites; and (10) increased fragmentation of older forest habitats. Whether the Wildlife Agencies would approve particular land transfers for residential housing and/or approve coverage of residential housing under the ITPs cannot be determined at this time.

The Bankruptcy Court has held that “A plan of reorganization cannot restructure the environmental laws and regulations of California and the United States.” Memorandum Opinion and Order at 14 (Docket No. 665)

(April 20, 2007). Accordingly, the Wildlife Agencies believe that the Plans will need to be clarified to provide that advance approval for any land transfers and/or new activities proposed under the Plans will be sought from the Wildlife Agencies and that the Wildlife Agencies' decisions will be subject to review only in accordance with and in any forum provided for by applicable non-bankruptcy law.

### **1.3 Overview of the Headwaters Agreement.**

Certain aspects of the Debtors' current compliance with applicable environmental and other land-use restrictions can best be understood in the context of a 1999 transaction carried out pursuant to the Headwaters Agreement between certain Debtors and the State of California and the United States involving approximately 5,600 acres of old-growth redwood forest. The Headwaters Agreement, among other things, provided for:

- the companies agreed to transfer to the United States and/or the State of California approximately 5,600 acres of the largest remaining old-growth redwood forest in private hands (the "Headwaters Forest");
- the companies to receive from the United States and the State of California property and other consideration (possibly including cash) having an aggregate fair market value of \$300 million and 7,755 acres of adjacent timberlands to be acquired by the United States and California from a third party;
- expedited development, submission and approval by each of the parties, as applicable, of the HCP and SYP;
- the companies to dismiss their takings claims against the state and federal governments; and
- the companies, the United States, and the State of California to cooperate and act in good faith to preserve and defend any challenge to the Headwaters Agreement and the permits and agreements implementing it.

Thereafter, the federal and state governments appropriated the funds for purchasing the old-growth forest, and processed and approved the permits contemplated by the Headwaters Agreement, including the HCP, federal and state ITPs, a streambed-alteration agreement, and the SYP. Extensive discussion, deliberation, and negotiation took place among the parties throughout the process.

The Headwaters Agreement resulted in special enabling and funding legislation that was adopted by both the U.S. Congress (and signed by the President) and the California State Legislature (and signed by the Governor). The State's enabling and appropriation legislation was entitled Assembly Bill 1986. That bill was adopted before the wildlife agencies designated the final form of the HCP. As a result, the State Legislature specified certain minimum restrictions and management measures that it required be included in the HCP and SYP in order for the Debtor companies to receive the state appropriation.

Assembly Bill 1986 includes certain specific additional limitations on land use that the legislature required to be incorporated in the final plan and permit documents. The bill also authorized the purchase of an MMCA known as the Grizzly Creek Complex and an MMCA known as Owl Creek. The State of California did in fact complete the purchase of these MMCAs, which are now held as public preserves and no longer constitute part of the timberlands of the Debtors.

### **1.4 Organizational Structure.**

Palco is a wholly owned subsidiary of MGI, which is wholly owned by MGHI, which is wholly owned by MAXXAM, a publicly traded company.

Scopac, the largest wholly owned subsidiary of Palco, was organized in May 1998 as a special-purpose entity in May 1998 to facilitate the sale of the Prepetition Timber Notes. Palco's other wholly owned subsidiaries are Britt, Scotia Development, Scotia Inn, and Salmon Creek, all of which are Debtors in these cases.

Like Palco, Britt produces and sells lumber products. Salmon Creek was formed as a Delaware corporation in 1993, and in anticipation of the Headwaters Agreement, Palco transferred certain timberlands to it. As a result, Salmon Creek, along with Palco and Scopac, was a party to the Headwaters Agreement. Salmon Creek was converted to a Delaware limited liability company in 1999. Most of Salmon Creek's acreage was transferred under the Headwaters Agreement. Because the approximately 1,300 acres it continues to own are subject to Scopac Timber Rights, Salmon Creek has very limited operations.

The Debtors assert that Scotia Development was formed in 2006 for the purpose of exploring and facilitating development opportunities with respect to commercial, industrial, and residential properties, including raw land, in California and Texas, as well as to assist Palco with the sale of certain assets. The Debtors assert that Scotia Development owns option rights to real property on the Texas Gulf Coast.

Scotia Inn operates a historic inn in Scotia, California in close proximity to Palco's headquarters building. The inn had previously been operated by third parties, but was acquired by Scotia Inn following its closure. The inn reopened in 2007.

## **1.5 Prepetition Debt Structure.**

Before the Petition Date, the Debtors were dependent on borrowings under their revolving credit facilities, collection of receivables generated from operations, and access to customary trade credit to finance seasonal working capital requirements and to supplement operating cash flow.

### **(a) Palco's Long-Term and Revolving Credit Debt.**

On the Petition Date, Palco's indebtedness consisted of a five-year \$85 million secured term loan and a five-year \$60 million secured asset-based revolving credit facility. These facilities were secured by security interests in substantially all of the assets of the Palco Debtors (other than Palco's Equity Interest in Scopac) and the stock of Palco held by MGI.

#### **(1) Palco Revolving Credit Facility.**

Palco and Britt's indebtedness under the Palco Revolving Credit Facility was governed by the Palco Revolving Credit Agreement. The amount available for borrowings under the Palco Revolving Credit Facility was normally the sum of 85% of the borrowers' eligible accounts receivable plus the lesser of (i) 80% of the book value of borrowers' eligible inventory or (ii) 85% of the net orderly liquidation value of such inventory. However, during each period from October 15 through January 15, the amount available for borrowing under the Palco Revolving Credit Facility was the sum of 95% of the borrowers' eligible accounts receivable plus the lesser of (i) 90% of the book value of Borrowers' eligible inventory or (ii) 95% of the net orderly liquidation value of such inventory. The amount available under the Palco Revolving Credit Facility could not exceed \$60 million. The Palco Revolving Credit Facility bore interest at rates of LIBOR plus 2.75% or prime plus 0.75%, at the borrowers' option; however, incremental borrowings made during each October 15 to January 15 utilizing the increased advance rates bore interest at the rate of LIBOR plus 4.50% or prime plus 2.50%, at the borrowers' option.

Prior to commencement of these cases, the Palco Revolving Credit Agreement required the borrowers to comply on a quarterly basis with certain financial covenants, including, among other terms, a minimum level of earnings and a minimum fixed-charge coverage ratio and maximum leverage ratio. As of the Petition Date, Palco and Britt believed that they were in default of certain financial covenants under the Palco Revolving Credit Agreement and the Palco Term Loan Agreement.

As of the Petition Date, approximately \$40 million (including \$14 million in letters of credit) was outstanding under the Palco Revolving Credit Agreement, for which Marathon was the administrative agent for the lending group. LaSalle Business Credit LLC was also a member of the lending group as of the Petition Date. During the course of these cases, Canpartners Investments IV, LLC purchased the position previously held by LaSalle. When the DIP Facility was funded in August 2007, it was used to repay the Palco Revolving Credit Facility.

**(2) Palco Term Loan Agreement.**

Palco and Britt's indebtedness to Marathon under the Palco Term Loan is governed by the Palco Term Loan Agreement. The Palco Term Loan bears interest at the rate of LIBOR plus 8.75%. Borrowings under the Palco Term Loan are secured by a security interest in substantially all of the assets of the Debtors (other than Palco's Equity Interest in Scopac) and the stock of Palco held by MGI.

Before these cases began, the Palco Term Loan Agreement required that the borrowers repay a substantial portion of the outstanding principal of the Palco Term Loan with the net proceeds of various required asset sales, including the real property associated with Palco's former Fortuna and Carlotta mills. The agreement also required 270 Palco-owned homes in Scotia to be sold after certain prerequisites were met. The remaining principal balance of the Palco Term Loan was due on the maturity date, July 18, 2011. In addition, the Palco Term Loan Agreement required the borrowers to comply on a quarterly basis with financial covenants substantially identical to those under the Palco Revolving Credit Agreement.

As of the Petition Date, approximately \$84 million in borrowings were outstanding under the Palco Term Loan Agreement.

**(b) Scopac Indebtedness.**

As of the Petition Date, Scopac's secured debt generally consisted of (i) the Prepetition Timber Notes (\$713.8 million principal outstanding as of December 31, 2006) and (ii) the Scopac Line of Credit, a line of credit with a group of banks pursuant to which Scopac was permitted to borrow to pay up to one-year's interest on the Prepetition Timber Notes (\$36.2 million principal outstanding as of December 31, 2006). As of the Petition Date, annual interest obligations related to Scopac's debt facilities were approximately \$55.4 million. Scopac's obligations under the Prepetition Timber Notes and the Scopac Line of Credit are secured by a jointly held senior Lien on all of Scopac's assets including (i) the Scopac Timberlands, (ii) the Scopac Timber Rights, (iii) the geographical information system that contains information on numerous aspects of the Scopac Timberlands (subject to certain rights of concurrent use by Palco), (iv) the funds held in the SAR Account, (v) certain contracts and other assets, and (vi) the proceeds of the foregoing.

Scopac is the sole obligor on both the Prepetition Timber Notes and the obligations under the Scopac Line of Credit. The Prepetition Timber Notes and the Scopac Line of Credit are not obligations of, and are not guaranteed by, Palco or any other Debtor.

**(1) Prepetition Timber Notes.**

Scopac's senior secured indebtedness under the Prepetition Timber Notes is governed by the Prepetition Indenture. The Prepetition Timber Notes are secured debt securities bearing interest at a rate of 6.55% for the A-1 Timber Notes, 7.11% for the A-2 Timber Notes and 7.71% for the A-3 Timber Notes. As of the Petition Date, approximately \$713.8 million in principal was outstanding on the Prepetition Timber Notes, including: (i) \$7.4 million of A-1 Timber Notes; (ii) \$243.2 million of A-2 Timber Notes; and (iii) \$463.3 million of A-3 Timber Notes.

The Prepetition Indenture contains various covenants that, among other things, limited the ability of Scopac to incur additional indebtedness, encumber assets, make certain asset dispositions, engage in transactions with affiliates, pay dividends, or make investments.

The Prepetition Timber Notes were structured to link, to the extent of cash available, the deemed depletion of Scopac Timber (through the harvest and sale of logs) to the required amortization of the Prepetition Timber Notes. The required amount of amortization on any Prepetition Timber Note payment date was determined by various mathematical formulas set forth in the Prepetition Indenture. The amount of principal Scopac was required to pay (on a cumulative basis and subject to available cash) through any payment date on the Prepetition Timber Notes is referred to as Minimum Principal Amortization. If the Prepetition Timber Notes had been amortized in accordance with Minimum Principal Amortization, the final installment of principal would have been paid on

January 20, 2010, July 20, 2017 and July 20, 2028 for the A-1 Timber Notes, A-2 Timber Notes and A-3 Timber Notes, respectively. Scheduled Amortization is the amount of principal which Scopac was required to pay (on a cumulative basis) through any payment date on the Prepetition Timber Notes in order to avoid prepayment or deficiency premiums. If all payments of principal had been made in accordance with Scheduled Amortization, Scopac would have paid the final installment of principal on January 20, 2014. This final installment would have been a single bullet principal payment of \$463.3 million in respect of the A-3 Timber Notes.

As of the Petition Date, Scopac had remained current under the Prepetition Indenture, making all payments on the Prepetition Timber Notes when due. However, prior to the January 20, 2007, interest payment date, Scopac had insufficient liquidity to make the interest payment, which would have constituted an event of default under the Prepetition Indenture.

(2) **SAR Account.**

In November 1999, Palco contributed \$169.0 million from the sale of the Headwaters Timberlands to Scopac, which Scopac set aside in the SAR Account. Amounts in the SAR Account are part of the Collateral securing the Prepetition Timber Notes and were used to make principal payments to the extent that cash flows from operations were insufficient to pay principal payments on the Prepetition Timber Notes in accordance with Scheduled Amortization. In addition, on or after January 20, 2014, any amounts then remaining in the SAR Account were to be used to amortize the A-3 Timber Notes. As of the Petition Date, the SAR Account held approximately \$42.4 million in Cash and \$2.8 million of A-1 Timber Notes. Certain professional expenses incurred by the Indenture Trustee in these cases are paid from the SAR Account.

(3) **The Scopac Line of Credit.**

Borrowings under the Scopac Line of Credit bore interest at the base rate plus 0.25% or at LIBOR plus 1.0% (the latter rate applying at any time that borrowings had not been continually outstanding for more than six months). The Scopac Line of Credit was available to make interest payments on the Prepetition Timber Notes, with the maximum borrowings being equal to one year's interest on the aggregate outstanding principal balance of the Prepetition Timber Notes.

Bank of America National Trust is the agent for the Scopac Line of Credit. As of the Petition Date, approximately \$36.2 million was outstanding under the Scopac Line of Credit.

**1.6 Factors Leading to the Need for Bankruptcy Relief.**

The Debtors' need to reorganize their businesses under chapter 11 of the Bankruptcy Code was precipitated by the liquidity shortfalls at Palco and Scopac and their resultant inability to make January 2007 interest payments on their respective debt obligations.

On January 18, 2007, it became apparent that Scopac and Palco would not have sufficient liquidity to make the January 2007 interest payment on their debt obligations and, accordingly, the Boards of each of the Debtors elected to file voluntary petitions under chapter 11 of the Bankruptcy Code.

**SECTION 2.  
EVENTS DURING THE BANKRUPTCY CASES**

*This section describes the principal events that have occurred to date during the course of the Debtors' bankruptcy cases. All capitalized terms not defined in this section shall have the meanings ascribed in the Debtors Plan.*

**2.1 Commencement of the Bankruptcy Cases.**

On January 18, 2007, each of the Debtors filed a separate voluntary petition under chapter 11 of the Bankruptcy Code with the Bankruptcy Court. These cases are being jointly administered as *In re Scotia*

*Development LLC, et al.*, Case No. 07-20027. The Debtors continue to manage and operate their respective businesses and properties as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee has been appointed in the case of any Debtor.

## **2.2 Schedules and Statements of Financial Affairs.**

The Debtors have filed their schedules and statements of financial affairs required under section 521 of the Bankruptcy Code and Bankruptcy Rule 1007. Copies of the Debtors' Schedules may be viewed online any time through the Bankruptcy Court's PACER System at [www.tx.uscourts.gov](http://www.tx.uscourts.gov) or at the Debtors' claims agent's website, [www.loganandco.com](http://www.loganandco.com).

## **2.3 Retention of Professionals.**

The Debtors have obtained Bankruptcy Court approval to retain the following professional persons to represent the Debtors in these cases:

<b><u>Name</u></b>	<b><u>Description of Services</u></b>
Baker Botts L.L.P.	General bankruptcy counsel for the Palco Debtors
Cushman & Wakefield of Oregon, Inc.	Appraisers for the Palco Debtors
D.R. Systems Northwest, Inc.	Timber valuation consultants for Scopac
Deloitte & Touche LLP	Independent accountants and auditors for the Debtors
Development Specialists Inc.	Financial consultants for the Debtors
Diamond McCarthy LLP	General bankruptcy counsel for Scopac
Downey Brand	Counsel for the Debtors with respect to California environmental compliance
Environmental Resource Solutions, Inc.	Timber valuation consultants for Scopac
FTI Consulting, Inc.	Valuation consultant and financial advisor for the Debtors
Gibson, Dunn & Crutcher LLP	General bankruptcy counsel for Scopac
Greenfield Advisors LLC	Real estate appraisers for Scopac
Harbinson Tune Kasselik APC	Special counsel for workers compensation matters for the Palco Debtors
Howard Rice Nemerovski Canady Falk & Rabkin	General bankruptcy counsel for the Palco Debtors
Jordan, Hyden, Womble, Culbreth, & Holzer, P.C.	General bankruptcy counsel for the Palco Debtors
Kim Iles & Associates	Timber valuation consultants for Scopac
KPMG LLP	Timber valuation consultants for Scopac
Kramer Levin Naftalis & Frankel LLP	Special counsel for general corporate, securities and employee benefits-related matters for the Palco Debtors
Logan & Company	Claims and noticing agent for the Debtors
Morrison & Foerster LLP	Special counsel for litigation matters and regulatory issues for the Debtors
Pierce Baymiller	Consultant on human resources matters for the Debtors
Porter & Hedges, L.L.P.	General bankruptcy counsel for Scopac
SHN Engineering (and two other engineering firms)	Engineering firms retained in connection with the town project for the Palco Debtors

<u>Name</u>	<u>Description of Services</u>
Blackstone Advisory Services L.P.	Financial advisors for the Debtors
XRoads Solutions Group, LLC	Financial advisors for the Debtors

On July 17, 2007, the Bankruptcy Court entered the Ordinary Course Professionals Order permitting the Debtors to employ professionals in the ordinary course of their business without the necessity of filing individual retention applications for each professional, and to pay such professionals in the ordinary course of business without formal application to the Bankruptcy Court by any such professional; *provided, however*, that such fees and disbursements do not exceed \$20,000 per month, per professional. With respect to those ordinary course professionals who do not exceed the \$20,000 per month limitation, the Debtors were authorized, in their discretion, to pay each of such professionals 100% of its interim fees and disbursements upon the submission to the Debtors of an appropriate invoice setting forth in reasonable detail the nature of the services rendered. In addition to the ordinary course professionals included in the Debtors' original list, the Ordinary Course Professionals Order allows for the filing of supplements to the ordinary course professionals list.

On January 24, 2007, the Bankruptcy Court entered the Interim Compensation Order establishing procedures for interim compensation and reimbursement of expenses of professionals of the Debtors and the Committee. Under the Interim Compensation Order, court-approved professionals may submit a monthly statement to the Debtor they represent, bankruptcy counsel for the specific Debtor they represent, the U.S. Trustee, counsel to that Debtors' secured prepetition lenders and postpetition lenders, if any, and counsel to any official committee in the specific case. If no objection is served within 20 days after receipt of the monthly statement, the order provides for the specific Debtor to pay 80% of the fees and 100% of the out-of-pocket expenses required in the statement. The Interim Compensation Order further provides for the professionals to file with the Bankruptcy Court interim fee applications approximately every four months.

#### **2.4 Official Committee of Unsecured Creditors.**

##### **(a) Committee Formation and Membership.**

On January 25, 2007, the U.S. Trustee appointed an official committee of unsecured creditors for the Debtors. The Committee as initially constituted included the following five members:

Environmental Protection Information Center, Interim Chairman c/o Sharon E. Duggan 370 Grand Avenue Suite 5 Oakland, CA 94610	John Miller, Interim City Manager City of Rio Dell 675 Wildwood Ave. Rio Dell, CA 95562
Pacific Coast Trading, Inc. c/o Miles T. Crail 1690 Green Ash Road Reno, NV 89511	Steve Cave 2332 Wrigley Road Eureka, CA 95503
United Steelworkers c/o David Jury Five Gateway Center, Suite 807 Pittsburgh, PA 15222	

City of Rio Dell resigned from the Committee soon after its appointment and never participated in any Committee meetings or deliberations. The Committee was reconstituted on March 29, 2007, by formally dismissing City of Rio Dell and adding the following members:



Steve Wills Trucking & Logging, LLC c/o Steve Wills P.O. Box 335 Fortuna, CA 95540	Pension Benefit Guaranty Corp. c/o Adi Berger 1200 K Street, NW Washington, DC 20005
SHN Consulting Engineers & Geologists c/o Kenneth "Jeff" Nelson 812 W. Walbash Eureka, CA 95501	

(b) **Committee Professionals.**

The Committee has retained the following professionals:

<b><u>Name</u></b>	<b><u>Description of Services</u></b>
Chanin Capital Partners L.L.C.	Financial advisors
James W. Sewall Company; James L. Able Forestry Consultants, Inc.; Stuntzner Engineering & Forestry LLC; and Mason Bruce & Girard	Valuation advisors
Pachulski Stang Ziehl & Jones LLP	Legal counsel

**2.5 Secured Lenders.**

Pursuant to the various loan and credit agreements described herein, the Debtors are liable for the fees and expenses of the professionals retained by the Secured Lenders. These fees are not subject to supervision of the Bankruptcy Court or the fee procedures described above and have been paid by the Debtors in the ordinary course of business.

The secured lenders have retained the following professionals:

<b><u>Name</u></b>	<b><u>Description of Services</u></b>
Winston & Strawn LLP	Legal counsel to Marathon (Palco)
Haynes and Boone LLP	Legal counsel to Marathon (Palco)
AlixPartners	Financial, operational and valuation advisors to Marathon (Palco & Scopac)
Resource Programming Inc.	Valuation advisors to Marathon (Palco & Scopac)
Philip Tedder Inc.	Valuation advisors to Marathon (Palco & Scopac)
CB Richard Ellis Inc.	Valuation advisors to Marathon (Palco)
Fulbright & Jaworski, LLP	Legal counsel to the Indenture Trustee (Scopac)
Houlihan Lokey Howard & Zukin Capital	Financial advisors to the Indenture Trustee (Scopac)
Thompson & Knight, LLP	Legal counsel to the Indenture Trustee (Scopac)
Jim Fleming & Associates	Valuation advisors to the Indenture Trustee (Scopac)
Western Timber Services	Valuation advisors to the Indenture Trustee (Scopac)
O'Melveny & Myers LLP	Legal counsel to Bank of America (Scopac)

Palco, Britt and the other Palco Debtors are jointly and severally liable for the fees and expenses of the professionals of Marathon, pursuant to the terms of the Palco Revolving Credit Facility and the Palco Term Loan Agreement.

Scopac is liable for the fees and expenses of Fulbright & Jaworski, LLP, Thompson & Knight, LLP, and Houlihan Lokey Howard & Zukin Capital, and several other professionals as legal counsel and/or financial advisors to the Prepetition Indenture Trustee, pursuant to the terms of the Prepetition Indenture. These fees are paid in part from Scopac's cash flow and in part from the SAR Account. Scopac is also liable for the fees and expenses of O'Melveny & Myers LLP, as counsel to Bank of America, pursuant to the terms of the Scopac Line of Credit.

## **2.6 Use of Cash Collateral.**

The Debtors' businesses require the use of working capital to fund payroll and payroll taxes, to pay normal operating expenses, and to pay other business expenses. Certain creditors possess interests in the Palco Debtors' cash collateral pursuant to various prepetition agreements. Under the Palco Revolving Credit Facility and the Palco Term Loan, Marathon and Canpartners Investments IV, LLC—as assignee of LaSalle Bank National Association and LaSalle Business Credit, LLC—possessed security interests in cash collateral held by Palco, Scotia Development, Britt, Salmon Creek, and Scotia Inn. Through a series of stipulated orders approved by the Bankruptcy Court, the Palco Debtors were authorized to use cash collateral to fund their operating expenses from the Petition Date through the closing of the DIP Facility in August 2007.

Similarly, Scopac's use of cash collateral was subject to claims by Bank of America National Trust and Savings Association and The Bank of New York Trust Company, NA, as the Prepetition Indenture Trustee. Scopac's continued use of cash collateral is limited by successive 13-week budgets setting forth Scopac's projected receipts and disbursements and by terms specified in such orders approving the use of cash collateral. Pursuant to stipulations between Scopac, Bank of America, and the Indenture Trustee, Scopac pays limited portions of the monthly expenses of the legal and other professionals retained by its secured creditors. Scopac's most recent cash collateral order approves a supplement budget for use of cash collateral through March 21, 2008.

In connection with Scopac's motion for approval of a 13-week cash collateral budget through August 31, 2008, the Indenture Trustee objected on the ground, among others, that Scopac and Palco had adopted an improper business practice relating to the log purchase agreements in place between the two debtors. The Court overruled these objections and approved the use of cash collateral, but ordered Palco and Scopac to file a more explicit written agreement between them governing the proposed log purchase arrangements. The Indenture Trustee objected to the form of agreement when it was filed. On October 2, 2007, the Indenture Trustee and the Debtors announced a stipulation resolving their disputes over this issue. A written form of the stipulation announced on the record in open court has been drafted and still is under discussion among the parties.

On January 17, 2008, the Bankruptcy Court approved an arrangement under which a MAXXAM non-Debtor affiliate would purchase logs from Palco at a market price subject to a repurchase obligation for the same price, without interest. Later, the Bankruptcy Court approved an arrangement under which Palco would sell lumber to a MAXXAM non-Debtor affiliate at current market prices.

## **2.7 Approval of Debtor-in-Possession Financing.**

The Palco Debtors' projections indicated that their cash flow would not be adequate to continue their ongoing business operations during these cases. Consequently, the Palco Debtors required not only the use of cash collateral but also borrowings under the Palco DIP Facility in order: (a) to pay rent, taxes, utilities, salaries, wages, and employee benefits, (b) to purchase inventory and supplies, (c) to make certain required capital expenditures, and (d) to continue the operation of their businesses without interruption. To meet their working capital needs during the pendency of these cases, the Palco Debtors negotiated the DIP Facility with Marathon.

The Palco DIP Facility provides for a \$75,000,000 revolving line of credit, reduced by certain reserves. This amount includes a sub-limit of \$5,000,000 for letters of credit which could be issued by a separate issuing

bank, with certain lenders guaranteeing the related reimbursement obligations. Proceeds from the Palco DIP Facility must be used: (a) to repay in full all obligations under the Palco Revolving Credit Facility, including accrued and unpaid interest, expenses and fees thereon (including applicable default interest payable from and after the Petition Date), (b) to cash-collateralize all outstanding letters of credit under the Palco Revolving Credit Facility in accordance with its terms, (c) to pay certain fees, costs and expenses relating to the debtor-in-possession financing, (d) to finance working capital needs of the Palco Debtors and for other general corporate purposes, in accordance with budgets to be submitted weekly, or (e) to fund collateralization of letters of credit or other credit support provided by other financial institutions. Loans extended under the Palco DIP Facility constitute superpriority Administrative Expense Claims under section 364(c)(1) of the Bankruptcy Code having priority over all other obligations, liabilities, and indebtedness of the Palco Debtors. DIP Facility Loans are secured by perfected and first priority liens, mortgages, and security interests in respect of substantially all of Palco Debtors' property. The DIP Facility also contains representations and warranties, covenants, and indemnity provisions that are customary for credit facilities of this type. The Palco DIP Facility was approved by the Bankruptcy Court on July 31, 2007, and was funded on August 6, 2007.

On January 17, 2008, the Bankruptcy Court approved Scopac's proposal to pay a \$150,000 work fee to Bank of America to facilitate negotiations toward a potential Scopac DIP Facility in the amount of up to \$51 million on a senior secured basis.

## **2.8 Motion to Transfer Venue of Debtors' Bankruptcy Cases.**

In February 2007, the U.S. Trustee, the Committee, certain noteholders, and certain agencies and governmental entities for the State of California filed motions seeking to transfer these cases from the Southern District of Texas, Corpus Christi Division to the Northern District of California, Oakland Division. LaSalle Business Credit LLC opposed a transfer of venue to California but sought an intradistrict transfer to the Houston Division. The Bankruptcy Court denied the requests to transfer venue. None of the movants appealed the Bankruptcy Court's order.

## **2.9 Motion to Designate Scopac's Bankruptcy Case as a Single Asset Real Estate Case.**

On February 5, 2007, certain of Scopac's Creditors filed a motion for determination that Scopac is a single-asset real estate debtor and for an order requiring Scopac to comply with section 362(d)(3)(A) of the Bankruptcy Code. If Scopac were deemed a single-asset real estate debtor, section 362(d)(3)(A) would require Scopac either (i) to file a plan of reorganization within 90 days of the Petition Date, (ii) to make monthly interest payments on the Prepetition Timber Notes, or (iii) to be subject to an order granting relief from the automatic stay as to the Scopac Timberlands.

The Bankruptcy Court heard the motion and, on April 5, 2007, issued a final order finding that Scopac is not a "single asset real estate debtor" under the Bankruptcy Code. On April 9, 2007, the Bankruptcy Court's order finding that Scopac is not a single asset debtor was appealed. The United States District Court for the Southern District of Texas certified the appeal pursuant to 28 U.S.C. § 158(d)(2), and, on May 14, 2007, the Fifth Circuit Court of Appeals authorized the direct appeal of the Bankruptcy Court's order. The Fifth Circuit Court of Appeals affirmed the Bankruptcy Court's decision by order dated November 13, 2007.

## **2.10 Payment of Prepetition Obligations to Certain Critical Vendors.**

Through two separate requests, the Debtors sought and obtained authority from the Bankruptcy Court to pay prepetition amounts owed to certain critical vendors, conditioned upon their extending credit and supplying materials, equipment, goods, and services to the Debtors in accordance with prepetition practices. The Debtors determined that the continued supply of goods and services from the critical vendors was necessary to avoid severe, and possibly fatal, disruptions to the Debtors' business. The Debtors' critical vendors consist of loggers, haulers and other providers of specialized goods and services in their forest-products operations.

The Bankruptcy Court authorized Scopac to pay its critical vendors an aggregate amount of \$198,000. The Bankruptcy Court similarly authorized the Palco Debtors to pay their critical vendors that are loggers and haulers an

aggregate amount not to exceed \$575,000, absent written consent from its secured lenders and only after providing the Committee with an opportunity to object to such additional payments. Many of the creditors who received payments from the Debtors pursuant to Bankruptcy Court's critical vendor orders previously held prepetition claims appearing on the Debtors' Schedules. In order to ensure that the Debtors' Schedules accurately reflect the Debtors' prepetition debts, and to ensure that only current Holders of Claims receive solicitations to vote on each Plan, the Debtors will file one or more motions with the Bankruptcy Court seeking to deem their Schedules amended by expunging the scheduled Claims of Creditors whose Claims were paid pursuant to the critical vendor orders.

In addition, Palco and Scopac filed a motion seeking Bankruptcy Court approval to make certain payments to each other as critical vendors pursuant certain of the Intercompany Contracts. As discussed in the Netting Motion, on the Petition Date, Palco owed a Netting Claim to Scopac in the amount of \$1.85 million for logs purchased from January 1, 2007, to January 18, 2007, pursuant to the July 20, 1998, New Master Purchase Agreement and in the ordinary course of Palco's pre-petition business. The Bankruptcy Court granted the Netting Motion on August 31, 2007, subject to the parties' reservation of rights concerning the possibility that Palco may establish an offset or recoupment claim against Scopac for the delivery of services during the same prepetition period, from January 1 through 18, 2007, in the approximate amount of \$600,000.

## **2.11 Bar Dates.**

On May 16, 2007, the Bankruptcy Court signed the Bar Date Order setting July 17, 2007 as the general Bar Date and August 17, 2007 as the Bar Date applicable to all Governmental Units. Pursuant to the Bar Date Order, any Person or Entity holding a Claim that arises from the rejection of an executory contract or unexpired lease where the order authorizing such rejection is dated after June 15, 2007, is required to file a Proof of Claim on the later of the Bar Date or thirty days after the effective date of such order authorizing the rejection or forever be barred from doing so.

Additionally, a person or entity (i) whose Claim is listed on the Debtors' Schedules, (ii) whose Claim is not described as "disputed," "contingent," or "unliquidated," and (iii) who does not dispute the amount and manner of classification of the Claim as set forth in the Schedules, is exempted from filing a Proof of Claim. Similarly, a Debtor holding a Claim against one or more of the other Debtors, is exempted from filing a Proof of Claim.

The Bankruptcy Court signed the Supplemental Bar Date Order on July 13, 2007, setting a supplemental Bar Date for creditors of whose identity or claim the Debtors were unaware, and approving the form and manner of broad publication notice intended to reach such creditors. The Supplemental Bar Date Order set September 5, 2007, as the deadline for unknown creditors to file proofs of claim and authorized the Debtors to publish notice of such supplemental Bar Date in certain local newspapers and periodicals.

Pursuant to the Bar Date Order and Supplemental Bar Date Order, Claimants were required to file their Proofs of Claim on or before the applicable Bar Date. Any Claimant who did not file a Proof of Claim by the applicable Bar Date (except as specifically otherwise provided): (a) will not be treated as a Creditor of the Debtors for purposes of notice, voting and distribution under each Plan; and (b) will be forever barred from filing a Proof of Claim with respect to such Claim and asserting such Claims against the Debtors, their Estates, or property.

## **2.12 Resolution of Objections to Disputed Claims**

The Debtors assert that they have begun reviewing all Proofs of Claim filed in their bankruptcy cases and have filed objections to many Proofs of Claim, primarily in the form of omnibus claim objections as permitted under the local bankruptcy rules. In November and December 2007, the Bankruptcy Court granted six separate omnibus objections that resulted in a reduction of claims in the aggregate amount of over \$1.875 billion. In addition, the Debtors filed objections to Qui Tam claims and to 42 claims predicated on alleged damage to residences downstream of the Debtors' timber operations, in the aggregate amount of over \$42 million (the "Disallowed Flood Claims").

On November 26, 2007, the Bankruptcy Court disallowed the Disallowed Flood Claims pursuant to the Debtors' Third Omnibus Objection on the ground of, *inter alia*, duplicativeness. On February 1, 2008, the

Bankruptcy Court approved an agreement between the Debtors and the 60 remaining claimants who sued the Debtors for damages sustained from flooding events that they claim the Debtors caused (the “the Flood Claim Plaintiffs”). Pursuant to the agreement, the claims of the Flood Claim Plaintiffs have been reduced to \$1.00 each, but any rights of such claimants to pursue non-debtor defendants and any available insurance coverage have been preserved.

On July 17, 2007, the Qui Tam Relators filed the Qui Tam Claims, the contents of which mirror the Qui Tam Actions that are described more fully below. The Qui Tam Claims assert damages of over \$1 billion against three of the Debtors for an aggregate of over \$3 billion in claims. The Qui Tam Relators also allege that the damages asserted in the Qui Tam Claims are non-dischargeable pursuant to sections 1141(d)(6) and 523(a)(7) of the Bankruptcy Code. On September 13, 2007, the Debtors filed an objection to the Qui Tam Claims under section 502(b) of the Bankruptcy Code and also filed an alternate motion to estimate the Qui Tam Claims for all purposes under section 502(c) of the Bankruptcy Code on the ground that liquidation of the claims will unduly delay the administration of these cases. On February 28, 2008, the Bankruptcy Court approved a settlement of the Qui Tam Claims, pursuant to which such claims were reduced to \$1.00 each, but any rights of the Qui Tam Relators to pursue non-debtor defendants were preserved.

Although it is anticipated that substantial additional progress will be made in resolving objections to Proofs of Claim prior to the Confirmation Hearing, it is likely that the Proof of Claim objection process will continue beyond the Confirmation Hearing.

## **2.13 Employee Matters.**

### **(a) Payment of Prepetition Wages and Benefits.**

In order to ensure the continued and uninterrupted service of their employees, soon after the Petition Date and on an emergency basis, the Debtors sought authority to pay or honor accrued and unpaid prepetition compensation, benefits and other employee obligations.

Palco, Scotia Inn, and Britt obtained Bankruptcy Court approval (i) to pay prepetition employee bonus and wage claims not exceeding \$10,000 per employee, (ii) to honor workers’ compensation obligations as they came due in the regular course of business, and (iii) to make certain funding contributions to Palco’s defined benefit pension plan. Similarly, Scopac was granted authority (i) to pay accrued but unpaid prepetition wages, salaries and incentive compensation, (ii) to continue those payments in the ordinary course of business on a postpetition basis, (iii) to pay outstanding prepetition benefit plan contributions within the limits set forth under section 507(a)(5) of the Bankruptcy Code, and (iv) to continue to offer and pay existing employee benefits on a postpetition basis.

Prior to the filing of the bankruptcy cases, the Debtors took steps to reduce their work force in response to their increasing financial difficulties. On December 1, 2006, the Debtors instituted a severance program (a reduction in force, or RIF) in an effort to comply with the Worker Adjustment and Retraining Notification Act. Under this severance program, the Debtors promised each terminated employee 60 days’ wages and, for employees with more than five years of service, severance payments tied to the length of their service with the Debtors. The severance payments were to be made 60 days after termination; however, the Debtors filed their chapter 11 bankruptcy petitions before the payments were made. On May 17, 2007, the Debtors filed a motion pursuant to which Scopac sought to pay \$102,996, and the Palco Debtors sought to pay \$843,890, to terminated employees in accordance with the severance program. On September 21, 2007, the Bankruptcy Court denied the Debtors’ motion.

### **(b) Debtors’ Pension Plan.**

The Debtors in this jointly-administered proceeding are contributing sponsors of the Palco Retirement Plan, Employer Identification No./Plan No. 13-3318327/003 (the “Pension Plan”), or members of a contributing sponsor’s controlled group. The Pension Plan is a single-employer defined benefit pension plan covered by Title IV of the Employment Retirement Income Security Act of 1974 (“ERISA”), *as amended*, 29 U.S.C. §§ 1301–1461 (2000 & Supp. V 2005), which created a mandatory pension plan termination insurance program and a wholly-owned United

States Government corporation, the Pension Benefit Guaranty Corporation (“PBGC”), to administer the program. PBGC guarantees the payment of certain benefits upon termination of a pension plan covered by Title IV of ERISA.

PBGC has filed estimated proofs of claim against the Debtors for: (1) unfunded benefit liabilities of the Pension Plan under 29 U.S.C. § 1362(b) in the amount of \$21,700,000; (2) statutorily required minimum funding contributions under 26 U.S.C. § 412(c)(11) and 29 U.S.C. § 1082(c)(11), due to the Pension Plan in the amount of \$1,060,795; and (3) insurance premiums with respect to the Pension Plan under 29 U.S.C. § 1306(a)(3) and (a)(7), in the amount of \$6,836,250 (collectively, the “Pension Claims”).

PBGC asserts that, under ERISA, the contributing sponsor of a pension plan and each member of its “controlled group” are jointly and severally liable for the Pension Claims. PBGC further asserts that, as defined by ERISA, a “controlled group” includes a parent-subsidary and/or a brother-sister group of corporations, trades, or businesses connected through common ownership and control, as defined by Sections 414(b) and (c) of the Internal Revenue Code and regulations promulgated thereunder.

PBGC asserts that Palco, the contributing sponsor of the Pension Plan, is part of a controlled group consisting of various related entities, including, but not necessarily limited to the following Debtors and non-debtor entities:

- Britt Lumber Co., Inc.;
- Salmon Creek LLC;
- Scotia Development LLC;
- Scotia Inn, Inc.;
- Scotia Pacific Company LLC;
- MAXXAM Group, Inc.;
- MAXXAM, Inc.;
- MAXXAM Group Holdings, Inc.;
- MAXXAM Property Company; and
- Sam Houston Race Park, Ltd.

\* The foregoing entities designated with an asterisk are Debtors in these bankruptcy cases.

PBGC asserts that, if the Pension Plan terminates prior to confirmation of a plan of reorganization, Palco and these 10 entities, and any other entity in Palco’s controlled group, will be jointly and severally liable under ERISA for any of Palco’s obligations with respect to the Pension Plan.

PBGC further asserts that, if the Pension Plan does not terminate prior to confirmation of a plan of reorganization, any plans of reorganization should specifically provide that the reorganized Debtors shall assume and continue the Pension Plan, satisfy the minimum funding standards pursuant to 26 U.S.C § 412 and 29 U.S.C. § 1082, and administer the Pension Plan in accordance with its terms and the provisions of ERISA. It is PBGC’s position that nothing in any proposed plans of reorganization shall discharge, release, or relieve Palco or the Debtors, or their reorganized forms, or any entity in Palco’s controlled group, or any other person or entity, in any capacity, from any liability with respect to the Pension Plan under any law, governmental policy, or regulatory provision.

The Pension Plan was frozen as of the December 31, 2005, meaning that while vested benefits are not affected, there is no accrual of any additional or new benefits. Although no new benefits are accrued, Palco continues to have funding requirements.

As of the Petition Date, the Debtors estimate that Palco’s total prepetition liability for contributions and fees with respect to its employees under the Pension Plan was approximately \$20.6 million. Prior to the Petition Date, Palco made quarterly payments in respect of its funding obligations under the Pension Plan, and upon filing its bankruptcy case, Palco sought Bankruptcy Court approval to continue making such quarterly payments. By orders dated April 13, 2007, July 13, 2007, September 18, 2007, October 5, 2007, and December 28, 2007, the Bankruptcy

Court approved one-time payments of \$588,625, \$588,625, \$552,910, \$783,625, and \$588,625, respectively. Palco intends to seek Bankruptcy Court approval for additional quarterly payments as they become due.

**THE MRC/MARATHON PLAN, THE DEBTORS PLAN AND THE PALCO ALTERNATIVE PLAN PROVIDE THAT THE PENSION PLAN SHALL BE ASSUMED.**

**THE INDENTURE TRUSTEE PLAN AND THE SCOPAC ALTERNATIVE PLAN DO NOT CONTEMPLATE THE ASSUMPTION OF THE PENSION PLAN.**

**(c) Approval of Employee Incentive and Retention Plans.**

In mid-2007, Palco, Britt, and Scopac filed motions seeking approval of certain retention and incentive plans applicable to non-officer employees. First, the mill employee incentive plan, which targets production-level employees working in Palco's and Britt's lumber and fencing operations and the power plant, provides for a cash bonus of up to nine percent of the employee's base pay. This bonus is conditioned upon the achievement of specified performance levels in safety, financial and production. Second, the non-officer retention plans, which respectively target employees working in Palco's and Britt's administrative departments and key employees of Scopac (including scientists and members of Scopac's forestry program), provide for a Cash award of up to four months' additional base pay for employees.

Payment under these plans is not due until and unless a Confirmation Order is entered and awards are only payable to employees who remain employed continuously on a full time basis through the Confirmation Date. The Bankruptcy Court approved the Debtors' retention and incentive plans on August 24, 2007.

**(d) Motions Regarding Employment Agreement with Gary C. Clark.**

Mr. Clark has been a Vice-President and the chief financial officer of Palco, Britt and Scopac since 1993 and Scotia Inn since 2005.

On July 25, 2007, Palco filed a motion with the Bankruptcy Court seeking authority to assume Mr. Clark's employment agreement. The Committee and U.S. Trustee objected to Palco's motion on the ground that the employment agreement included payments that are prohibited under BAPCPA. In response to these objections, Palco filed a supplemental motion on August 25, 2007, seeking to reject the prepetition employment agreement and enter into a new employment agreement with Mr. Clark. If approved, the new employment agreement would extend Mr. Clark's employment with the Debtors through April 30, 2008. The agreement also would substantially increase Mr. Clark's monthly salary, partially in exchange for Mr. Clark's agreement to waive certain Claims against the Debtors and further postpone his retirement. The Bankruptcy Court has taken Palco's supplemental motion under advisement.

**2.14 Extension of Time to Assume, Assume and Assign, or Reject Unexpired Leases of Nonresidential Real Property.**

By order dated August 14, 2007, the Bankruptcy Court extended the time by which the Debtors must determine whether to assume or reject certain unexpired leases of nonresidential real property until entry of an order confirming a plan of reorganization with respect to the Debtors' cases. The extension applies to the leases identified in the chart below:

<u>Lessee</u>	<u>Landlord</u>	<u>Lease Description</u>
Palco	Lindy P. Mantova and Jeannie Mantova	Montova Substation Use Agreement: A "Use Agreement" dated January 16, 1996 pertaining to an energy substation in Humboldt County, California
Britt	Steve Sellers	Mad River Industrial Complex: A lease of commercial real property in Arcata, California, used for lumber remanufacturing and storage purposes
Britt	Humboldt Plywood Corporation	Christie Sublease: A lease of a sawmill and manufacturing plant in Humboldt County, California
Palco	Scopac	Master Lease Agreement: A master lease under which Scopac leases various parcels of land to Palco
Scopac	Palco	Scopac Office Lease: A lease of several commercial premises located in Scotia, California

## **2.15 Asset Sales.**

### **(a) Completed Real Property Sales.**

By order dated February 16, 2007, Palco obtained Bankruptcy Court approval authorizing it to sell 39.37 acres of real property located southeast of Fortuna, California to River View Terrace, LLP for a total purchase price of \$1,250,000.

### **(b) De Minimis Sales of Personal Property.**

By motion dated September 25, 2007, the Debtors sought authority to sell *de minimis* personal property without the need for Bankruptcy Court approval upon five Business Days' notice to the U.S. Trustee, counsel for the Committee, and counsel for Marathon. The Debtors intend to use this procedure to sell *de minimis* personal property and avoid the related court costs of filing separate motions for each proposed sale. By order dated October 4, 2007 the Bankruptcy Court approved the Debtors' motion.

### **(c) Sale of Scotia School.**

On January 10, 2008, Palco filed a motion for authority to sell the Scotia school and associated recreational facilities for no less than \$3.3 million. By order dated February 4, 2008, the Bankruptcy Court approved this motion.

## **2.16 Rejection of Contracts.**

On September 28, 2007, Palco filed a motion seeking authority to reject the prepetition Agreement for Purchase and Sale of Aggregate Materials entered into with Granite Construction Company ("Granite"). The parties were able to reach an agreed order, whereby this exclusive materials supply agreement was deemed rejected as of November 1, 2007. On December 10, 2007, Granite filed a proof of claim asserting damages in the amount of approximately \$5.8 million, to which Palco has objected.

On July 17, 2007, Pacific Coast Trading, Inc. ("Pacific Coast"), filed a proof of claim asserting a claim against Palco in the amount of over \$5.3 million, representing damages allegedly arising from Palco's breach of the prepetition Wood Chip Purchase & Sale Agreement between the parties. Shortly thereafter, Palco filed a motion seeking to reject the contract and substantially limit damages. In January 2008, the parties were able to reach an



agreement seeking to allow Pacific Coast's claim as a general unsecured claim against Palco in the amount of \$788,000 and fully disallowing the balance of the claim. On February 11, 2008, the Court entered an Agreed Order Authorizing (I) Rejection of Wood Chip Supply Agreement Pursuant to U.S.C. § 365 and (II) Settlement of Related Claim No. 544 Pursuant to Fed. R. Bankr. P. 9019 (the "Pacific Coast Settlement"). Pursuant to the Pacific Coast Settlement, Pacific Coast's Claim No. 544 was allowed as a general unsecured claim against Palco in the amount of \$788,000.

## **2.17 Reduction in Force and Production Changes.**

On or about August 1, 2007, Palco announced several changes with respect to its operations. In light of the challenges facing the industry as whole, including depressed housing construction trends and reduced demand for lumber products, Palco shut down its Scotia, California sawmill on August 3, 2007, for one month in order to conserve its financial resources. Palco resumed operations in its Scotia mill on September 4, 2007.

As part of its new operational strategy, Palco eliminated its second shift at the Scotia mill (which was approximately 75% Douglas-fir and 25% redwood), and implemented a one-shift strategy that focuses entirely on redwood. This change in strategy also precipitated a reduction in force. The reduction in force covers approximately 100 employees in the aggregate, including those at the Scotia mill and Britt mill. The Britt mill was idled, and those employees have received WARN act notices. The employees at the Scotia mill are not subject to the WARN act given the size of the reduction in force.

## **2.18 Authority to Finance Insurance Premiums.**

By order of the Bankruptcy Court dated July 19, 2007, Palco obtained authority to finance on a secured basis \$1.1 million needed for the payment of certain property insurance premiums. The financing was provided by AICOO, Inc. Palco has financed subsequent insurance premiums consistent with the procedures set forth in the July 19th order.

## **2.19 Extension of Exclusivity.**

Section 1121(b) of the Bankruptcy Code establishes an initial period of 120 days after a bankruptcy court enters an order for relief under chapter 11 of the Bankruptcy Code during which only the debtor may file a plan. If the debtor files a plan within this 120-day period, section 1121(c)(3) of the Bankruptcy Code extends the exclusivity period by an additional sixty days to permit the debtor to seek acceptances of each Plan. While section 1121(d) of the Bankruptcy Code permits the Bankruptcy Court to extend these exclusivity periods "for cause," a recent amendment to the Bankruptcy Code now places a limit on any extensions. In particular, section 1121(d)(2) of the Bankruptcy Code sets a limit of eighteen months after the date of the order for relief on the period during which only the debtor may file a plan and a limit of twenty months after the date of the order for relief on the period during which the debtor may seek acceptances of a plan filed within the initial eighteen months of a chapter 11 case.

Without a further order of the Bankruptcy Court, the Debtors' initial exclusivity period to file a plan would have expired on May 18, 2007. By an order dated May 18, 2007, the Bankruptcy Court extended the Debtors' exclusivity periods through and including September 18, 2007 (to file a plan) and through and including November 19, 2007 (to solicit acceptances).

On August 24, 2007, the Debtors filed a joint motion seeking to extend the exclusivity periods through and including December 17, 2007 (to file a plan) and through and including February 17, 2008 (to solicit acceptances). The Bankruptcy Court extended the exclusivity period to file a plan to and through September 30, 2007. The Debtors filed a plan on September 30, 2007.

On October 23, 2007, the Bankruptcy Court held a hearing on (i) the Debtors' request to extend the exclusive period to February 17, 2008 to allow the Debtors an opportunity to solicit votes on their plan, and (ii) the request by the Indenture Trustee to terminate exclusivity. As described below, the hearing resulted in the parties participating in a mediation process. On December 21, 2007, the Bankruptcy Court approved an agreement by the Debtor and other parties to terminate exclusivity and permit the filing of chapter 11 plans by the Debtors, the

Committee, the Timber Noteholders, and Marathon by January 30, 2008. The Court also scheduled a hearing on this and other Disclosure Statement hearings for February 28, 2008, and the beginning of a hearing on the confirmation of all plans on April 1, 2008.

## **2.20 Mediation.**

Following the October 23, 2007 hearing regarding the Debtors' motion to extend exclusivity, the Bankruptcy Court ordered the Debtors, MAXXAM, and major creditor constituencies (which included the Indenture Trustee, the Committee, Marathon, Bank of America, and various California state agencies) to participate in mediation. By order dated November 16, 2007, the Chief Judge for the Fifth Circuit Court of Appeals assigned Judge Barbara J. Houser (Chief Bankruptcy Judge for the Northern District of Texas), as the mediator.

The parties participated in a series of one-on-one meetings with Judge Houser, followed by three full days of mediation on November 26–28, 2007. A final mediation session was held on December 12, 2007. No settlement was reached. The Bankruptcy Court then set the issue of the extension of exclusivity on for further consideration on December 21, 2007. As noted in Section 2.21 above, at that time the Court authorized the filing of certain competing plans.

## **2.21 Valuation.**

On December 11, 2007, the Debtors filed a motion with the Bankruptcy Court seeking to have the Bankruptcy Court determine the value of the Scopac Timberlands in the context of a valuation hearing pursuant to 11 U.S.C. § 506(a). The Bankruptcy Court has taken the valuation issue under advisement, but has not set the matter for hearing apart from the plan confirmation hearing.

## **2.22 Indenture Trustee's Motion for Appointment of Trustee.**

On January 16, 2008, the Indenture Trustee filed a motion for appointment of a trustee under section 1104 of the Bankruptcy Code, alleging, among other things, that Scopac's management has failed to maintain its independence from Palco, to the detriment of Scopac and its creditors. The motion has been set for hearing concurrent with plan confirmation.

## **2.23 Additional Information.**

Additional information and copies of key documents and notices can be obtained from the Bankruptcy Court at [www.txsb.uscourts.gov](http://www.txsb.uscourts.gov) or the Debtors' claims agent's website, [www.loganandco.com](http://www.loganandco.com).

## **SECTION 3. LITIGATION**

*This section describes the principal pending litigation matters involving the Debtors. All capitalized terms not defined in this section shall have the meanings ascribed in the Debtors Plan.*

### **3.1 Claims Against the Debtors.**

There are various judicial and administrative proceedings pending against the Debtors. While the below-described legal proceedings are, in general, stayed as against the Debtors while the companies are in bankruptcy, such proceedings could be pursued as against the Debtors if the stay is modified by the Bankruptcy Court, if these cases are dismissed, or in certain circumstances, upon the emergence of the Debtors from bankruptcy.

#### **(a) The EPIC-SYP/Permits and USWA Lawsuits.**

In March 1999, an action entitled *Environmental Protection Information Association, Sierra Club v. California Department of Forestry and Fire Protection, California Department of Fish and Game, The Pacific Lumber Company, Scotia Pacific Company LLC, Salmon Creek Corporation, et al.* was filed in Superior Court in

Humboldt County, California (No. CV-990445). This action alleged, among other things, that the issuance of the SYP and California permits violated the California Endangered Species Act and the California Environmental Quality Act. The action sought to invalidate the SYP and the California Permits and sought, among other things, to prevent implementation of THPs approved in reliance upon these documents. This action alleged impropriety by the California Board of Forestry and Fire Protection in conducting Headwaters reviews and granting permits and approvals.

In March 1999, a similar action, entitled *United Steelworkers of America, AFL-CIO, CLC, and Donald Kegley v. California Department of Forestry and Fire Protection, The Pacific Lumber Company, Scotia Pacific Company LLC and Salmon Creek Corporation*, was filed in Humboldt County Superior Court (No. CV-990452) challenging the validity and legality of the SYP. The *EPIC-SYP/Permits* and *USWA* lawsuits were consolidated for trial.

Following the trial, the court in October 2003 entered a judgment invalidating the SYP and the California Permits and in September 2004 granted the plaintiffs' request for reimbursement of an aggregate of \$5.8 million in attorneys' fees and other expenses. Palco, Scopac, Salmon Creek and various state agencies for the State of California appealed both decisions. In December 2005, the appellate court reversed the trial court's decision invalidating the SYP and the California Permits. The plaintiffs have sought review of the appellate court's decision by the California Supreme Court, which has accepted their petition for review. The defendants' appeal of the trial court's award of attorneys' fees and expenses is still pending at the appellate court. Due to the pendency of these cases, both the California Supreme Court and the appellate court entered orders staying the proceedings pending before each court. However, at the request of the parties, the Bankruptcy Court modified the automatic stay by an order dated June 29, 2007 for the limited purpose of allowing the California Supreme Court review to proceed.

**(b) Bear Creek Lawsuit.**

In July 2001, an action entitled *Environmental Protection Information Association et al. v. Pacific Lumber, Scotia Pacific Company LLC* (No. C01-2821) was filed in the U.S. District Court for the Northern District of California, and later amended to add the EPA as a defendant. The lawsuit alleges that harvesting and other forestry operations will result in discharges of pollutants in violation of the Federal Clean Water Act. The plaintiffs assert that the Federal Clean Water Act requires the defendants to obtain a National Pollution Discharge Elimination System permits from the North Coast Regional Water Quality Control Board before beginning timber operations and is seeking to enjoin these activities until such permits have been obtained. The plaintiffs also seek civil penalties of up to \$27,500 per day for the alleged continued violation of the Federal Clean Water Act. In October 2003, the court upheld the validity of an EPA regulation that exempts harvesting and other forestry activities from certain discharge requirements. The case is not yet final as the trial has not yet been held, and there are many unresolved issues involving interpretation of the court's decision and its application to actual operations. On June 30, 2006, the plaintiffs filed a motion for partial summary judgment seeking to establish the liability of Palco, Scopac, and Salmon Creek and Palco, Scopac, and Salmon Creek filed a motion for summary judgment asserting that the plaintiffs lack standing to maintain the lawsuit. After a hearing on these motions was held on October 3, 2006, the court took the matter under submission. On January 8, 2007, the court issued an order denying the motions. Due to the pendency of the Debtors' bankruptcy cases, the court has entered an order staying this matter.

**(c) Watershed Flooding Damages Lawsuits.**

On November 20, 2002, a lawsuit involving two similar actions entitled *Alan Cook, et al. v. Gary Clark, et al.* and lawsuit entitled *Steve Cave, et al. v. Gary Clark, et al.* were filed in Humboldt County Superior Court (Nos. DR020718 and DR020719, respectively), which also name Palco, Scopac, and certain affiliates as defendants. The *Cook action* alleges, among other things, that defendants' logging practices have contributed to an increase in flooding along Freshwater Creek (which runs through the Timberlands), resulting in personal injury and damage to the plaintiffs' properties. Plaintiffs further allege that in order to have THPs approved in the affected areas, the defendants engaged in certain unfair business practices. The plaintiffs seek, among other things, compensatory and exemplary damages, injunctive relief, and appointment of a receiver to ensure that the watershed is restored. The *Cave action* contains similar allegations and requests similar relief with respect to the Elk River watershed a portion of which is contained on the Timberlands. The plaintiffs in the *Cave action* filed a statement of damages of \$3 to \$4 million in property damages and \$2 to \$3 million in special damages for emotional distress and punitive relief.

On October 13, 2005, an action entitled *Edyth Johnson, et.al v. Charles E. Hurwitz, an individual; MAXXAM Inc. et al.* (No. DR040720) was filed in Humboldt County Superior Court and contains allegations similar to the *Cave* and *Cook* actions. Palco does not believe the resolution of these actions should result in a material adverse effect on its consolidated financial condition, results of operations or liquidity. Notices have been filed with the court to stay these matters due to the pendency of the Debtors' bankruptcy cases.

As explained above, the Bankruptcy Court has approved a settlement with the Flood Claim Plaintiffs to settle their claims, totaling approximately \$100 million, for \$1 each, a total of \$120.

**(d) Unfair Business Practices Lawsuit.**

On February 25, 2003, the District Attorney of Humboldt County filed a civil suit entitled *The People of the State of California v. The Pacific Lumber Company, Scotia Pacific Holding Company and Salmon Creek Corporation* in the Humboldt County Superior Court (No. DR030070). The suit was filed under California's unfair competition law and alleges that Palco, Scopac, and Salmon Creek used certain unfair business practices in connection with completion of the Headwaters Agreement, and that this resulted in the harvest of significantly more trees than would have otherwise been the case. The suit seeks a variety of remedies including a civil penalty of \$2,500 for each additional tree that has been or will be harvested due to this alleged increase in harvest, as well as restitution and an injunction in respect of the additional timber harvesting allegedly being conducted. On June 14, 2005, the trial court dismissed this matter in its entirety. On September 19, 2005, the District Attorney appealed this decision.

Due to the pendency of the Debtors' bankruptcy cases, the appellate court initially entered an order staying the appeal. The Debtors and the District Attorney, however, desired to conclude the appeal. Therefore, at the request of the Debtors and the District Attorney, the Bankruptcy Court modified the automatic stay by order dated July 31, 2007 to allow the appeal to proceed. On January 1, 2008, the California Court of Appeal affirmed dismissal of the lawsuit.

**(e) Wrongful Termination.**

Palco is a defendant in an action entitled *Jimmy Dan Cook and Judy Cook v. Robert Manne, The Pacific Lumber Company and Does 1-50* (No. DR060121), which was filed in the Superior Court of Humboldt County, California on March 6, 2006. The lawsuit alleged wrongful termination and related claims for breach of contract and breach of the covenant of good faith and fair dealing based upon the alleged wrongful termination of an employee by Palco and its former President and Chief Executive Officer. The complaint alleges that Mr. Cook was wrongfully discharged because he resisted and questioned certain illegal acts relating to the construction of a sedimentation pond in Scotia, California during the summer of 2004. Ms. Cook dismissed her claim with prejudice on March 27, 2006, but Mr. Cook's claim is still pending. Both parties had filed motions for summary judgment, but on February 27, 2007, the court entered an order directing the clerk to administratively close the case pending the outcome of the Debtors' bankruptcy cases.

**(f) Qui Tam litigation.**

On December 7, 2006, the Qui Tam Relators initiated the two Qui Tam Actions against the Debtors, MAXXAM, and Charles E. Hurwitz, the Chairman of the Board and Chief Executive Officer of MAXXAM. A qui tam action is a lawsuit brought in the name of the government by a private individual called a "relator" against a company or person who the relator alleges has submitted a false claim for the purpose of obtaining payment from the government. Any recovery is for the benefit of the government; however, the relator is allowed to seek a large percentage of any recovery as a "reward." Also, the government is entitled to intervene and take over the action if it wishes to pursue the action itself.

In the Qui Tam Actions the Qui Tam Relators allege that the defendants had obtained money from the United States and California by "fraud" because the SYP approved by the CDF as an agency of the State of California nearly eight years earlier as part of the Headwaters Agreement allegedly relied on improper modeling and computer simulations. The Qui Tam Actions allege that, had the Debtors fully disclosed the manner in which the

SYP had been prepared, the SYP would not have been approved by the CDF, and the United States and California would not have paid the amount of cash and other consideration for the Headwaters Timberlands they acquired. The Qui Tam Actions further allege that the consideration given in exchange for the Headwaters Timberlands and other timberlands exceeded the land's value because of existing regulatory restrictions under the Endangered Species Act. The Qui Tam Relators claim that the difference between the consideration paid and the actual value of the land transferred represents a "false claim" improperly paid by the United States and by California and, therefore, all defendants, including the Debtors, are liable for treble damages totaling approximately \$1 billion.

As required by Federal and State law, the Qui Tam Relators filed the Qui Tam Actions under seal, and the United States and State of California then each had 60 days to review the relevant complaint and decide whether to take over the prosecution of the Qui Tam Actions. After review, both the United States and the State of California declined to pursue the Qui Tam Actions. The Qui Tam Actions were then unsealed and the Debtors then learned of the Qui Tam Actions only after they had filed the Debtors' bankruptcy cases.

Upon the filing of these cases, the automatic stay prevented the further prosecution of the Qui Tam Actions as to the Debtors. However, the Qui Tam Actions proceeded as to non-debtor parties. Since the Debtors may be prejudiced by findings in any judgment entered against the non-debtor parties, on June 25, 2007 the Debtors filed an adversary action before the Bankruptcy Court to extend the automatic stay to non-debtor parties and enjoin the Qui Tam Relators from proceeding against MAXXAM and Hurwitz. (*The Pacific Lumber Company, et. al. v. State of California ex rel. Richard Wilson and Chris Maranto, et. al.*, Adv No. 07-02038). On August 3, 2007, the Bankruptcy Court heard argument on the Debtors' motion for summary judgment and for injunctive relief. The Bankruptcy Court has not yet issued a decision on the Debtors' motion.

On July 17, 2007, the Qui Tam Relators filed the Qui Tam Claims, the contents of which mirror the Qui Tam Actions. The Qui Tam Claims assert damages of over \$1 billion against three of the Debtors for an aggregate of over \$3 billion in claims. The Qui Tam Relators also allege that the damages asserted in the Qui Tam Claims are non-dischargeable pursuant to sections 1141(d)(6) and 523(a)(7) of the Bankruptcy Code.

On September 13, 2007, the Debtors filed an objection to the Qui Tam Claims in these bankruptcy cases under section 502(b) of the Bankruptcy Code and also filed an alternate motion to estimate the Qui Tam Claims for all purposes under section 502(c) of the Bankruptcy Code on the ground that liquidation of the claims will unduly delay the administration of the bankruptcy cases. As addressed above, the Bankruptcy Court has approved a settlement of the Qui Tam Claims for \$1.00 each.

### **3.2 Claims by the Debtors.**

#### **(a) Headwaters Breach of Contract Claim.**

In December 2005, Palco and Scopac filed a claim with the California Victim Compensation and Government Claims Board against the North Coast Water Board, the State Water Board and the State of California (Claim No. G558159). The claim alleges that the defendants have substantially impaired the contractual and legal rights of Palco and Scopac under the Headwaters Agreement and the related permits, authorizations and approvals. The claim also alleges that the actions of the defendants have caused the companies substantial damages, but does not specify an amount. The Claims Board did not approve or deny the claim by the statutory deadline. As a result, the claim is by operation of law treated as having been denied, and Palco became entitled to file a suit for damages in California state court. Palco and Scopac filed such a suit on December 20, 2006 in Superior Court in Fresno, California (No. CECG 0422). In the complaint, Scopac and Palco seek to recover substantial damages and compensation for harm that they allege was inflicted by the breach of the Headwaters Agreement by the State of California. The defendants in the action contest the Debtors' allegations and contend that the Debtors are entitled to no recovery.

#### **(b) Bad Faith Coverage-Denial Claim.**

On January 12, 2006, Palco and various of its affiliates filed an action entitled *The Pacific Lumber Company, Scotia Pacific Company LLC, MAXXAM Inc., MAXXAM Group Inc., MAXXAM Group Holdings Inc.*,

*Charles E. Hurwitz, Gary Clark, John Campbell and Robert Manne vs. General Star Indemnity Company, and Transportation Insurance Company* in the United States District Court for the Northern District of California, San Francisco Division (No. 06-0212 (EDL)). Palco and its affiliates allege that their current and prior insurers used bad faith in denying coverage for the flooding damages in the Elk River and Freshwater creek, as described above in the *Cave, Cook and Johnson* actions. The three cases making up this action are complicated by the several policies involving a number of different insurers of various parties in varying risks at different points in time.

## **SECTION 4. GENERAL PROVISIONS REGARDING THE COMPETING PLANS**

### **4.1 General.**

Before voting on any of the Plans, persons who have claims are referred to, and encouraged to review carefully, the relevant provisions of each of the Plans, the other Plan Documents, and the Bankruptcy Code since their rights could be affected. They also are encouraged to review the Plans, and this Joint Disclosure Statement with their counsel or other advisors. Note that this Joint Disclosure Statement merely summarizes the principal provisions of the Plans and is not a substitute for careful review of the provisions of the Plans themselves.

### **4.2 Overview of Chapter 11.**

Chapter 11 is the principal business reorganization chapter of the Bankruptcy Code. Under chapter 11, a debtor can reorganize its business for the benefit of itself, its creditors, and interest holders. Chapter 11 also strives to promote equality of treatment for similarly situated creditors and similarly situated interest holders with respect to the distribution of a debtor's assets.

The commencement of a chapter 11 case creates an estate that is comprised of all of the legal and equitable interests of a debtor as of the filing date. The Bankruptcy Code provides that the debtor may continue to operate its business and remain in possession of its property as a "debtor-in-possession."

The consummation of a plan of reorganization is the principal objective of a chapter 11 case. A plan of reorganization sets forth the means for satisfying claims against, and interests in, a debtor. Confirmation of a plan of reorganization makes the plan binding upon the debtor, any issuer of securities under the plan, any person or entity acquiring property under the plan, and any creditor of or equity interest holder in the debtor, whether or not such creditor or equity holder is impaired under or has accepted the plan, or receives or retains any property under the plan. Subject to certain limited exceptions, and except as otherwise provided in the plan or the confirmation order itself, a confirmation order discharges the debtor from any debt that arose prior to the date of confirmation of the plan and substitutes for those debts the obligations specified under the confirmed plan.

A chapter 11 plan may specify that the legal, contractual, and equitable rights of the holders of claims or interests in certain classes are to remain unaltered by the reorganization effectuated by the plan. Such classes are referred to as "unimpaired" and, because of such favorable treatment, are deemed to accept the plan. Accordingly, a debtor need not solicit votes from the holders of claims or equity interests in such unimpaired classes. A chapter 11 plan also may specify that certain classes will not receive any distribution of property or retain any claim against a debtor. Such classes are deemed to reject the plan and, therefore, need not be solicited to vote to accept or reject the plan. Any classes that are receiving a distribution of property under the plan but are not "unimpaired" will be solicited to vote to accept or reject the plan.

Section 1123 of the Bankruptcy Code provides that a plan of reorganization must classify the claims of a debtor's creditors and equity interest holders. A debtor is also required, as discussed above, under section 1122 of the Bankruptcy Code, to classify claims and interests into classes that contain claims and interests that are substantially similar to the other claims and interests in such classes.

The Plan Proponents believe that each of their respective proposed Plans classify all claims and interests in compliance with sections 1122 and 1123 of the Bankruptcy Code, but it is possible that a Plan Proponent of a competing Plan or the holder of a claim or interest may challenge the classification of claims and interests in one of

more of the Plans and that the Bankruptcy Court may find that a different classification is required for such Plan(s) to be confirmed. In such event, each of the Plan Proponents intends, to the extent permitted by the Bankruptcy Court and their respective Plans, to make such modifications of the classifications under the applicable Plan(s) to permit confirmation and to use the Plan acceptances received in this solicitation for the purpose of obtaining the approval of the reconstituted class or classes of which the accepting holder is ultimately deemed to be a member. Any such reclassification could adversely affect the Class in which such holder was initially a member, or any other class under any Plan, by changing the composition of such class and the vote required of that class for approval of such Plan(s).

## **SECTION 5. SUMMARY OF MATERIAL TERMS OF THE COMPETING PLANS**

Sections 6, 7 and 8 below summarize certain material provisions of each of the proposed Plans. By necessity, the summary is incomplete and is qualified in its entirety by reference to the more detailed information appearing elsewhere in this Joint Disclosure Statement, the attached exhibits, the proposed Plans, and the exhibits thereto, as amended from time to time. Please read the entire Joint Disclosure Statement carefully before deciding how to vote because your rights may be affected by implementation of any of the Plans.

Only one Plan can be confirmed. If more than one Plan meets the requisites for confirmation, the Bankruptcy Court shall consider the preferences of creditors and equity security holders in determining which Plan to confirm. Once confirmed, the Plan will implement a reorganization that will address the liabilities of some or all of the Debtors in a comprehensive and complete manner. The Plan Proponents believe that each of their respective Plans provides for the maximum recoveries to, and expeditious and equitable treatment of, the holders of claims and interests.

SECTIONS 6, 7 AND 8 BELOW SUMMARIZE THE STRUCTURE AND MEANS FOR IMPLEMENTATION OF THE COMPETING PLANS AND THE CLASSIFICATION AND TREATMENT OF CLAIMS AND INTERESTS THEREUNDER, AND THESE SECTIONS ARE QUALIFIED IN THEIR ENTIRETY BY REFERENCE TO THE PLANS, THE PLAN SUPPLEMENTS, AND THE EXHIBITS AND DEFINITIONS CONTAINED IN EACH DOCUMENT. THE STATEMENTS CONTAINED IN THIS JOINT DISCLOSURE STATEMENT INCLUDE SUMMARIES OF THE PROVISIONS CONTAINED IN THE PLANS AND THE DOCUMENTS REFERRED TO THEREIN.

THE STATEMENTS CONTAINED IN THIS JOINT DISCLOSURE STATEMENT DO NOT PURPORT TO BE PRECISE OR COMPLETE STATEMENTS OF ALL THE TERMS AND PROVISIONS OF THE PLANS OR DOCUMENTS REFERRED TO THEREIN, AND REFERENCE IS MADE TO SUCH DOCUMENTS FOR THE FULL AND COMPLETE STATEMENT OF SUCH TERMS AND PROVISIONS.

THE PLANS THEMSELVES AND THE DOCUMENTS CONTAINED THEREIN CONTROL THE ACTUAL TREATMENT OF CLAIMS AND INTERESTS THEREUNDER AND WILL, UPON THE OCCURRENCE OF THE EFFECTIVE DATE, BE BINDING UPON, AMONG OTHER ENTITIES, ALL HOLDERS OF CLAIMS AND INTERESTS, REORGANIZED DEBTORS, ALL ENTITIES RECEIVING PROPERTY UNDER A CONFIRMED PLAN, AND OTHER PARTIES IN INTEREST. IN THE EVENT OF ANY CONFLICT BETWEEN THIS JOINT DISCLOSURE STATEMENT AND ANY PLAN OR ANY OTHER OPERATIVE DOCUMENT, THE TERMS OF THE PLAN AND SUCH OTHER OPERATIVE DOCUMENT SHALL CONTROL.

Finally, please note that each of the Plans is subject to various state and federal regulatory obligations, as addressed above. For instance, the California State Agencies assert as follows:

- Transfers of land are subject to prior approval of the federal and state wildlife agencies under the Incidental Take Permits (“ITPs”), including the Habitat Conservation Plan (“HCP”) and Implementation Agreement for the Habitat Conservation Plan (“IA”) and subject to prior approval of signatory state agencies under the Agreement Relating to Enforcement of AB 1986.

- Additional uses of timberlands (e.g., development) are subject to prior approval of the federal and state wildlife agencies under the ITPs, in accordance with the HCP and IA, applicable provisions of the State and federal Endangered Species Acts and associated regulations, and other applicable law, which may or may not be met by the proposed plans.
- Assignment or transfer of the ITP is subject to written consent of the California Department of Fish & Game.
- With respect to obligations under Waste Discharge Requirements (“WDR”) and Watershed Wide Waste Discharge Requirements (“WWDR”), there is no “transfer” provision for general WDR and WWDR enrollments of approved timber harvest plans. Thus, any transferee would need to reapply for any required WDRs and WWDRs. In addition, any transferee may be responsible for clean up and abatement requirements.
- There is no guaranty that all required approvals will be forthcoming. Even if one assumes the approvals can be granted, the process is complex and lengthy. The time and cost required may affect feasibility.

## **SECTION 6. THE MRC/MARATHON PLAN**

*The text of this section of the Joint Disclosure Statement has been prepared by MRC and Marathon with reference to the MRC/Marathon Plan. All statements and representations herein are the sole responsibility of MRC and Marathon. The other Plan Proponents do not necessarily agree or disagree with any of the statements or representations herein, and expressly reserve all rights to contest any such statements or representations, if appropriate.*

*The defined terms used in this section have the meanings set forth in the MRC/Marathon Plan.*

### **6.1 Overview of MRC/Marathon Plan.**

MRC and Marathon propose to reorganize the Debtors by integrating the commercial timberland and sawmill operations and managing them in a responsible and sustainable manner pursuant to a business plan developed by MRC. MRC’s business plan is set forth below. MRC and its affiliates are experienced and environmentally responsible operators of an integrated commercial redwood timberland, sawmill and lumber distribution operation located in nearby Mendocino County. MRC and Marathon also propose to restructure the town of Scotia and allow residents to purchase their homes. In addition, the MRC/Marathon Plan will substantially reduce the amount of debt owed by the Debtors to a level that is serviceable from operating profits, provides substantial recoveries to all creditors and preserves jobs, pensions, business operations, and going-concern value.

The principal elements of the MRC/Marathon Plan are as follows:

1. MRC will contribute \$200 million of Cash, and Marathon will contribute \$25 million of Cash to Newco. Marathon will also convert approximately \$135 million of senior secured prepetition and postpetition debt into equity.
2. MRC and Marathon will bring in a new experienced management team from MRC with a proven track record of success in the redwood forest and lumber business. The commercial timberland and sawmill operations will be integrated and managed by MRC, and lumber distribution activities will be added to the sawmill operations.
3. Newco will benefit from approximately \$10 million annually of savings from synergies that will be realized as a result of MRC sharing its management, relationships and infrastructure with Newco.



4. MRC will immediately seek Forest Stewardship Council certification of the Debtors' timberlands, and will implement the same forestry practices on the Debtors' timberlands that have been successfully employed on MRC's 230,000 acres in Mendocino County over the last almost ten years (see [www.fscus.org](http://www.fscus.org) and [www.mrc.com](http://www.mrc.com)).
5. Newco will be run in an environmentally responsible manner and the MRC/Marathon Plan assumes all environmental obligations, without any modification, of the Debtors, including the HCP resulting from the Headwaters Agreement.
6. The debt obligations of the Debtors will be reduced by a total of approximately \$625 million, and, as a result, Newco and Townco will be able to responsibly service their debt obligations going forward.
7. Trade creditors will be paid cash in the amount of approximately 75-90% of their claims and will be eligible for further distributions.
8. The Holders of Scopac Timber Notes will, subject to certain adjustments, receive \$175 million cash, plus new Timber Notes issued in the principal amount of \$325 million secured by the Debtors' Timberlands and be eligible for further distributions.
9. Newco will assume responsibility for the Debtors' Pension Plan.
10. The town of Scotia will be reorganized and residents will be offered the opportunity to purchase their homes.
11. Bank of America's claim against Scopac for approximately \$37.6 million will be paid in full, with default interest being paid over time in monthly installments.
12. All Allowed administrative and administrative priority Claims of all Debtors will be paid in full.
13. Certain of the Debtors' litigation assets will be pursued by a Litigation Trustee for the benefit of all unsecured creditors.

Most importantly, the MRC/Marathon Plan can be fully implemented following confirmation. The \$225 million of new capital provided by MRC and Marathon, and MRC's experienced management team and business plan are committed and ready to be put into operation and assume management positions at Newco. Moreover, there is no financing or due diligence contingency in the MRC/Marathon Plan.

**(a) The Proponents of the MRC/Marathon Plan.**

MRC, owned by the Fisher family from San Francisco California, is considered to be a successful manager of its integrated commercial redwood timberlands, having developed good and positive working relationships with the regulatory, environmental and residential communities. In addition, MRC has demonstrated measurable ecological progress in the management of its forestry operations. MRC's affiliate, Mendocino Forest Products Company, LLC ("MFP"), operates a successful redwood lumber sawmill and related distribution business in Ukiah, California. Moreover, MFP has been a significant customer of Palco for close to ten years, and thus is familiar with many of the operational problems that have plagued the company.

Marathon is the Administrative Agent and a lender to the Palco Debtors. Marathon has provided a total of \$160 million in prepetition and postpetition "DIP" financing to the Palco Debtors. Marathon has determined to convert much of its debt into equity in the Reorganized Entities, and, along with MRC, provide \$225 million of new equity capital to enable the reorganization of the Debtors. In addition, Marathon will use its expertise in real estate and real estate financing to restructure the town of Scotia, with the eventual goal of allowing Scotia's residents to purchase their homes.

**(b) The Debtors' Assets and Operations.**

The Debtors' primary assets consist of (i) commercial timberland operations, (ii) sawmill operations, and (iii) the Town of Scotia, California. The timberlands consist of two components. The first is approximately 210,000 acres of commercially operated timberlands that historically have generated the bulk of the Debtors' cash flows. The second component consists of six groves of ancient redwood trees totaling approximately 6,600 acres. These groves contain primarily old-growth redwood timber and a habitat used by marbled murrelet, a coastal seabird, and these groves have been designated as "marbled murrelet conservation areas" or "MMCA's." The MMCA's are not part of the Debtors' forestry operations and are subject to various environmental restrictions that prevent commercial harvesting.

The Scotia Mill consists of a sawmill located in Scotia and lumber marketing and distribution operations. The Debtors once operated five sawmills, but have since consolidated them into the one sawmill that was constructed in 2006.

The town of Scotia consists of primarily 270 homes, a co-generation plant and various commercial properties. Many of the Debtors' employees live in the town and pay rent to the Debtors. The town includes a sawmill in Arcata, California that is being shut down, and its equipment is being liquidated.

**(c) The Debtors' Bankruptcies.**

The Debtors' commercial timberland and mill operations have declined for some time. The causes for the Debtors' decline and eventual filing of these chapter 11 cases are numerous. Since 1986, the Debtors have borrowed heavily and, despite significant reductions in their standing inventory of conifer timber and a sale of lands for more than \$300 million in conjunction with the Headwaters Agreement in 1999, the Debtors have over \$200 million more debt today than when they were formed more than twenty years ago. The Debtors are currently unable to service their payment obligations to secured creditors.

Other factors that have contributed to the Debtors' deterioration include inefficient operations, poor customer service, competition from other products, a decline in housing construction and hostility and litigation with regulators, the local community and non-governmental environmental organizations.

The Debtors contend that their bankruptcies are the result of the debt they incurred and their inability to harvest at a level necessary to service their debt due to a "snarl of litigation" with regulators and the environmental community. However, MRC and Marathon believe the Debtors' problems are larger, and include a need for a new capital structure, a new long term strategic objective, a different approach with regulators and the community and a change in management to address issues with respect to the Debtors' operations. Accordingly, MRC and Marathon submit that the optimal plan of reorganization for the Debtors must address each of these issues.

**(d) The Reorganized Entities will Perform all Environmental Obligations.**

MRC has a proven track record of operating an environmentally responsible forestry business. In addition, MRC has operated in an open and transparent fashion with regulators, the environmental community and local residents. Moreover, several environmental organizations have indicated that they view MRC's proposed involvement in the Debtors' reorganization efforts in a positive manner.

MRC has obtained certification from the Forest Stewardship Council on its forestry operations, and MRC intends to immediately seek the same certification for Newco. Forest Stewardship Council certification is an independent third party standard of exemplary forest management supported by leading environmental groups, such as World Wildlife Fund, Natural Resources Defense Council and Greenpeace.<sup>1</sup>

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<sup>1</sup> See [www.fscus.org/membership](http://www.fscus.org/membership) for a complete list of current NGO members of the Forest Stewardship Council in the United States.

The MRC/Marathon Plan requires the Reorganized Entities to satisfy, complete, perform, and comply with all Environmental Obligations. Thus, the reorganization will ensure that all environmental regulations are complied with.

The Debtors' track record with environmental regulators has been the subject of much controversy and litigation. In contrast, MRC's management team that will operate Newco has positive relationships with various environmental regulators.

(e) **The MRC/Marathon Plan.**

MRC and Marathon submit that their Plan is based on what is realistically achievable and is supported by a seasoned management team and by the contribution of more than \$225 million of cash equity. The MRC/Marathon Plan maximizes value from the Debtors' existing assets. Most creditors would not receive a full recovery, but *will* receive a substantial recovery. Moreover, Newco and Townco will be positioned for success for the long term going forward, benefiting those creditors who will continue to do business with the reorganized companies.

MRC and Marathon believe they have compiled all the elements of a successful reorganization for all Debtors: an experienced management team, a realistic business plan that maximizes value for all creditors, and the commitment of significant cash.

*The position of MRC and Marathon with respect to the competing plans of reorganization proposed by the Debtors and the Indenture Trustee is set forth in the attached Exhibit A-3.*

**6.2 Summary Description of Classes and Distributions Under MRC/Marathon Plan.**

The MRC/Marathon Plan consolidates certain Classes with one another for voting and distribution purposes. If the Bankruptcy Court authorizes consolidation of such Classes for voting and distribution purposes, each of those Classes of Claims and Interests against certain Debtors will be treated as a Claim or Interest in or against a single consolidated Estate, without regard to the separate identification of the Debtors.

If the Bankruptcy Court authorizes the Debtors to consolidate for voting and distribution purposes fewer than all of the Classes of Claims sought to be consolidated for these purposes, MRC and Marathon may, among other options, proceed with separate classifications for any such non-consolidated Classes. If MRC and Marathon elect to proceed with separate classifications for any such non-consolidated Classes of Claims and Interests, such Classes of Claims and Interests will be treated as against each individual non-consolidated Debtor for voting and distribution purposes. In such event, the MRC/Marathon Plan would divide each Class of Claims and Interests into, subclasses; one for each of the Debtors, as set forth below.

PL - The Pacific Lumber Company  
BL - Britt Lumber Co., Inc.  
SC - Salmon Creek LLC  
SD - Scotia Development LLC  
SI - Scotia Inn Inc.  
SP - Scotia Pacific Company LLC

For example, Class 1 – “Other Priority Claims -- can be divided into six sub-classes for voting purposes: Class 1-PL, Class 1-BL ... through Class 1-SP. Class 1-PL relates to Other Priority Claims asserted against Palco, Class 1-BL relates to Other Priority Claims asserted against Britt, and so on. In some situations a particular Debtor may not have any claims asserted against it in a particular Class.

The classification of Claims and Interests, the estimated aggregate amount of Claims in each Class and the amount and nature of distributions to Holders of Claims or Interests in each Class are summarized in the table below. **Please refer to the MRC/Marathon Plan for the details relevant to classification of, and distributions to, Holders of Claims and Interests.**

No representation can be made that the information below is without inaccuracy. Moreover, such information is subject to the uncertainties of litigation with respect to many of the Claims and other factors that may not be resolved in the Debtors' favor. Therefore, no assurance can be given that the estimated Claims are exact or that the estimated recoveries will be achieved.

**(a) Unclassified Claims Under the MRC/Marathon Plan.**

In accordance with section 1123(a)(1) of the Bankruptcy Code, Administrative Expense Claims and Priority Tax Claims have not been classified under the MRC/Marathon Plan.

Description and Estimate of Claims	Description of Distributions or Treatment Under MRC/Marathon Plan	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Administrative Expense Claims	<p>Allowed Professional Compensation Claims for Professionals employed pursuant to the Bankruptcy Code will be paid pursuant to applicable orders of the Bankruptcy Court.</p> <p>Allowed Administrative Expense Claims resulting from (a) post-petition liabilities incurred in the ordinary course of business by a Debtor or (b) post-petition contractual liabilities arising as a result of loans and advances (whether or not incurred in the ordinary course) will be paid in accordance with the terms and conditions of the particular transactions relating to such liabilities and any agreements relating thereto.</p> <p>All other Allowed Administrative Expense Claims will be paid in Cash on the later of (a) the Effective Date, or (b) the date on which each such Administrative Expense Claim is Allowed, unless the Holder agrees to other, lesser treatment.</p>	<p>PL-\$7.3 million            BL-\$0            SC-\$0            SD-\$0            SI-\$0            SP-\$10 million  <b>Total: \$17.3 million</b></p>	100%
Priority Tax Claims	<p>Holders of Allowed Priority Tax Claims will receive at the sole option of the Reorganized Entities, as applicable,</p> <p>(a) payment of Cash in full, or</p> <p>(b) payment of Cash in full over five (5) years, together with interest at the applicable rate under non-bankruptcy law.</p>	<p>PL-\$25,000            BL-\$1,000            SC-\$0            SD-\$0            SI-\$6,000            SP-\$507,000  <b>Total: \$539,000</b></p>	100%

**(b) Classified Claims and Interests Under the MRC/Marathon Plan.**

The following Claims and Interests have been classified under the MRC/Marathon Plan:

Description and Estimate of Claims	Description of Distributions or Treatment Under MRC/Marathon Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Class 1: Other Priority Claims	<p> Holders of Allowed Other Priority Claims will receive:</p> <ul style="list-style-type: none"> <li>i. payment of Cash in full, plus Post-petition Interest; or</li> <li>ii. such other, lesser treatment as the Reorganized Entities and the Holder may agree to in writing.</li> </ul>	<p><b>Unimpaired</b></p> <p>Deemed to Accept the MRC/Marathon Plan</p> <p>Not Entitled to Vote</p>	<p>PL-\$884,000</p> <p>BL-\$4,000</p> <p>SC-\$0</p> <p>SD-\$0</p> <p>SI-\$0</p> <p>SP-\$96,000</p> <p><b>Total: \$984,000 to \$1,106,000</b></p>	100%
Class 2: Secured Tax Claims and Other Secured Claims	<p>Except to the extent that the Plan Proponents or the Reorganized Entities and a Holder of an Allowed Secured Tax Claim and Allowed Other Secured Claim, as applicable, agree to a different treatment, in each case at the sole option of the Reorganized Entities</p> <p>1. Holders of Allowed Secured Tax Claims will receive from the Reorganized Entities, as applicable,</p> <ul style="list-style-type: none"> <li>(i) payment of Cash in full plus Post-petition Interest, or</li> <li>(ii) payment of Cash in full over five (5) years, together with interest at the applicable rate under non-bankruptcy law.</li> </ul> <p>2. Allowed Other Secured Claims:</p> <ul style="list-style-type: none"> <li>(i) Each such Claim shall be reinstated and rendered unimpaired pursuant to section 1124(2) of the Bankruptcy Code,</li> <li>(ii) Holders of such Claims shall receive payment of Cash in full, including any interest on such Allowed Other Secured Claims required to be paid pursuant to section 506(b) of the Bankruptcy Code, or</li> <li>(iii) Holders of such Claims shall receive the collateral securing such Claims and any interest required pursuant to section 506(b) of the Bankruptcy Code.</li> </ul>	<p><b>Unimpaired</b></p> <p>Deemed to Accept the MRC/Marathon Plan</p> <p>Not Entitled to Vote</p>	<p>PL-\$0</p> <p>BL-\$0</p> <p>SC-\$0</p> <p>SD-\$0</p> <p>SI-\$0</p> <p>SP-\$0</p> <p><b>Total: \$0<sup>2</sup></b></p>	100%

<sup>2</sup> The County of Humboldt, California asserts a Secured Tax Claim in the approximate amount of \$1,287,120. If Allowed, such Claim shall receive the treatment provided for Holders of Allowed Secured Tax Claims under the MRC/Marathon Plan.

Description and Estimate of Claims	Description of Distributions or Treatment Under MRC/Marathon Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Class 3: Palco DIP Loan Claim	The Holder of an Allowed Class 3 Palco DIP Loan Claim and Allowed Class 4 Palco Term Loan Claim shall receive (1) 100% equity ownership interest of Townco, (2) 15% equity ownership interest in Newco (subject to adjustment), and (3) a note from Newco in the aggregate principal amount equal to the amount of the Mill Working Capital and secured solely by Liens on the Mill Working Capital.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the MRC/Marathon Plan	PL-\$75.3 million BL--\$75.3 million SC--\$75.3 million SD--\$75.3 million SI--\$75.3 million  <b>Total: \$75.3 million</b>	Not applicable
Class 4: Palco Term Loan Claim	The Holder of an Allowed Class 3 Palco DIP Loan Claim and Allowed Class 4 Palco Term Loan Claim shall receive (1) 100% equity ownership interest of Townco, (2) 15% equity ownership interest in Newco (subject to adjustment), and (3) a note from Newco in the aggregate principal amount equal to the amount of the Mill Working Capital and secured solely by Liens on the Mill Working Capital.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the MRC/Marathon Plan	PL-\$87.1 million BL-\$87.1 million SC-\$87.1 million SD-\$87.1 million SI-\$87.1 million  <b>Total: \$87.1 million</b>	Not applicable

Description and Estimate of Claims	Description of Distributions or Treatment Under MRC/Marathon Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Class 5: Scopac Loan Claim	<p>On the Distribution Date, Bank of America, as Holder of the Allowed Scopac Loan Claim, shall receive:</p> <ul style="list-style-type: none"> <li>i. payment of Cash in full, plus unpaid accrued interest at non default rate plus unpaid default interest to be paid in twelve monthly installments; or</li> <li>ii. such other, lesser treatment as the Reorganized Entities and the Holder may agree to in writing.</li> </ul>	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the MRC/Marathon Plan</p>	\$37.6 million	100%
Class 6: Scopac Timber Note Secured Claims	<p>Each Holder of an Allowed Scopac Timber Note Secured Claim shall receive its Pro Rata share of \$175 million in Cash plus its Pro Rata share of New Timber Notes in the principal amount of \$325 million (subject to the New Timber Note Adjustment) accruing interest at 5.5% per annum and secured by the Timberlands as more fully set forth in the MRC/Marathon Plan; or, to the extent that this Class 6 makes an election pursuant to section 1111(b)(1)(A)(i) of the Bankruptcy Code prior to the agreed deadline of March 2, 2008 at 5:00 p.m. Central time, each Holder of an Allowed Scopac Timber Note Secured Claim shall receive the treatment described in the MRC/Marathon Plan.</p>	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the MRC/Marathon Plan</p>	\$800 million	62.5%

Description and Estimate of Claims	Description of Distributions or Treatment Under MRC/Marathon Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Class 7: Palco Trade Claims and Palco General Unsecured Claims	Each Holder of an Allowed Palco Trade Claim and Allowed Palco General Unsecured Claim shall receive its Pro Rata share of \$10.1 million plus, together with Holders of Allowed Scopac Trade Claims and Allowed Scopac General Unsecured Claims, its applicable Litigation Trust Participation for any remaining amount owed.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the MRC/Marathon Plan	PL-\$10.1 million  BL-\$164,000  SC-\$0  SD-\$180,000  SI-\$0  <b>Total: \$10.4 million (plus litigation claims and rejection damages)<sup>3</sup></b>	75-90%
Class 8: Scopac Trade Claims	Each Holder of an Allowed Scopac Trade Claim shall receive its Pro Rata share of \$500,000 plus, together with Holders of Allowed Palco Trade Claims and Allowed Palco General Unsecured Claims and Allowed Scopac General Unsecured Claims, its applicable Litigation Trust Participation for any remaining amount owed.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the MRC/Marathon Plan	\$362,000 <b>(plus litigation claims and rejection damages)<sup>4</sup></b>	75-90%
Class 9: Scopac General Unsecured Claims	Each Holder of an Allowed Scopac General Unsecured Claim shall receive, together with Holders of Allowed Palco Trade Claims and Allowed Palco General Unsecured Claims and Allowed Scopac Trade Claims, its applicable Litigation Trust Participation.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the MRC/Marathon Plan	Approximately \$300 million (including deficiency claim of Timber Noteholders)	Unknown

<sup>3</sup> There are millions of dollars of disputed litigation claims asserted against the Debtors that could substantially dilute the recovery by general unsecured creditors under the MRC/Marathon Plan, if such claims were allowed. MRC and Marathon also anticipate that additional claims arising from the rejection of executory contracts and unexpired leases could be filed. If Allowed, these claims could substantially dilute the recovery by general unsecured creditors under the MRC/Marathon Plan.

<sup>4</sup> There are millions of dollars of disputed litigation claims asserted against the Debtors that could substantially dilute the recovery by general unsecured creditors under the MRC/Marathon Plan, if such claims were allowed. MRC and Marathon also anticipate that additional claims arising from the rejection of executory contracts and unexpired leases could be filed. If Allowed, these claims could substantially dilute the recovery by general unsecured creditors under the MRC/Marathon Plan.



<b>Description and Estimate of Claims</b>	<b>Description of Distributions or Treatment Under MRC/Marathon Plan</b>	<b>Status/ Entitled to Vote</b>	<b>Estimated Aggregate Amount of Claims</b>	<b>Estimated Percentage Recovery</b>
Class 10: Inter-Debtor Claims	Inter-Debtor Claims shall be discharged and the Holders of Inter-Debtor Claims are not entitled to Distributions	<b>Impaired</b> Deemed to Reject the MRC/Marathon Plan Not Entitled to Vote	Not applicable	0%
Class 11: Non-Debtor Affiliate Claims	Non-Debtor Affiliate Claims shall be discharged and Holders of Non-Debtor Affiliate Claims are not entitled to Distributions	<b>Impaired</b> Deemed to Reject the MRC/Marathon Plan Not Entitled to Vote	Not applicable.	0%
Class 12: Interests in the Debtors	Interests in the Debtors shall be discharged and Holders of Interests in the Debtors are not entitled to Distributions	<b>Impaired</b> Deemed to Reject the MRC/Marathon Plan Not Entitled to Vote	Not applicable.	0%

### **6.3 Means of Implementation of the MRC/Marathon Plan.**

*The means of implementation of the MRC/Marathon Plan are outlined in detail in Article VII of the MRC/Marathon Plan, and are incorporated herein by reference. All parties are urged to carefully review the MRC/Marathon Plan in detail before making a decision on how to vote. The following is a summary of the principal means of implementation of the MRC/Marathon Plan.*

On or prior to the Effective Date, MRC and Marathon shall contribute \$225 million in Cash to Newco. Also on the Effective Date, the Debtors shall be reorganized into two newly formed reorganized entities, Newco and Townco, and, except as otherwise set forth herein, all of the Debtors' Assets shall be transferred to these reorganized entities free and clear of all Claims, Liens, charges, other encumbrances and Interests. On and after the Effective Date, the reorganized entities may operate their businesses, may use, acquire and dispose of property, may retain, compensate and pay any professionals or advisors, and compromise or settle any causes of action, claims or interests without supervision of or approval by the Bankruptcy Court and free and clear of any restrictions of the Bankruptcy Code or the Bankruptcy Rules other than restrictions expressly imposed by the MRC/Marathon Plan and the Confirmation Order.

Newco is the reorganized entity that will include the assets of the Mill and the Timberlands, together with any and all Assets of the Debtors currently associated with or anticipated to be associated with Mill and the Timberlands on and after the Effective Date.

Newco will be managed and run by MRC pursuant to a business plan that is more fully discussed below.

*All parties are urged to carefully review the MRC/Marathon Plan in detail with respect to the means of implantation of the MRC/Marathon Plan.*

(a) **MRC's Background.**

MRC was formed on June 30, 1998 with capital supplied largely by the Fisher family from San Francisco, California. Doris and Don Fisher founded the Gap in 1969, and as a family continue to be significant shareholders in Gap Inc. The Fisher family has supported a number of environmental causes over time. In addition, Bob Fisher has served on the board of the Natural Resources Defense Council (NRDC) for more than 15 years and is currently the Vice Chairman of the board of NRDC. Bob Fisher has also served on the board of Conservation International (CI) for the last 8 years, and is currently the Chairman of the Executive Committee of CI.

MRC was created with 230,000 acres of timberlands previously owned by Louisiana Pacific ("LP") for a period of 25 years. Through related affiliates, MRC also bought two sawmills, a distribution business, and associated operations. LP managed the lands, now owned by MRC, with a traditional industrial approach. Prior to MRC's acquisition, LP relied on significant clear cutting, harvesting in excess of the forest's growth rate. Accordingly, LP's relations with the community at the time of acquisition could be characterized by anger, mistrust and skepticism.

MRC started with a publicly declared purpose: "to demonstrate it is possible to manage productive forestlands with a high standard of environmental stewardship, and also operate a successful business." There are numerous examples of what it means to be a successful business; but, far fewer of good stewardship. In an effort to address stewardship objectives, MRC early on made specific forest policy changes. MRC's new policies included:

- Eliminating traditional clear cutting,
- Implementing an old growth policy down to level of tree,
- Reducing the level of harvest,
- Pursuit and attainment of Forest Stewardship Council (FSC) certification.<sup>5</sup>

**See [www.mrc.com](http://www.mrc.com) for significant additional information about the history, policies, and 10 year progress of MRC and its 230,000 acres of forestlands in Mendocino County.**

Now, almost ten years later, there is measurable ecological progress in MRC's forest. In particular:

- standing conifer (redwood and Douglas-fir) timber inventory has increased by more than 25% (approximately 600 million board feet);
- 40,000 acres, once rich in redwood and Douglas-fir (conifers), that had become overgrown with tan oak as a result of legacy forest practices dating as far back as the 1850's, have been treated so that a robust conifer forest will again emerge in the next 30 to 40 years; and
- investment of \$11 million in sediment and erosion control that has withheld almost 700,000 cubic yards of sediment (the equivalent of almost 70,000 dump trucks) from fouling streams and rivers running through the MRC forest.

MRC has purposefully operated in an open and transparent fashion with members of the community, environmental organizations, regulators, and other stakeholders.

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<sup>5</sup> Forest Stewardship Council certification is an independent third party standard of exemplary forest management supported by leading environmental groups, such as World Wildlife Fund, Natural Resources Defense Council and Greenpeace. See [www.fscus.org/membership](http://www.fscus.org/membership) for a complete list of current NGO members of the Forest Stewardship Council in the United States.

Since 2003, MRC's annual harvest has averaged 33.4 million board feet of conifer (redwood and Douglas-fir) logs. EBITDA attributable solely to MRC's harvest and its fiber-based share of related mill and distribution business, net of capital spending, has averaged \$4.7 million per year. While some might consider this level of cash earnings modest for the size of MRC's forest, meeting the high standards of FSC management requires higher costs than a traditional industrial approach. And, these cash returns are supplemented by growth in timber volume that is not harvested. In MRC's case, the extra timber grown but not harvested has averaged roughly 60 million board feet per year since MRC's inception in 1998.

**(b) MRC Has Many Similarities with the Debtors.**

The operations of MRC and the Debtors have many similar characteristics. MRC and the Debtors both operate just over 200,000 acres of redwood timberlands, and also each (in the case of MRC through an affiliate) operates a single sawmill. MRC and the Debtors operations are each contained almost entirely in two adjacent counties. See tables below for comparisons:

County Statistics – Mendocino and Humboldt County

	Mendocino	Humboldt
<b>Population</b> <sup>1</sup>		
2000 Census	86,265	126,518
2005 <sup>7</sup>	88,276	128,359
<b>Annual Population Growth</b> <sup>1</sup>		
April 2000 - July 2006	0.35%	0.24%
<b>Median Household Income (MHI)</b> <sup>1</sup>		
2004	\$36,624	\$33,281
<b>Per Capita Income (PCI)</b> <sup>7</sup>		
2005	\$29,117	\$27,932
<b>Per Capita Income as a % of State Average (2005)</b> <sup>7</sup>		
California	78.83%	75.62%
<b>Size of County (in acres)</b> <sup>3</sup>	2,000,000	2,300,000
<b>Size of County (in square miles)</b> <sup>3</sup>	3,509	3,573
<b>Miles from San Francisco (southern border)</b> <sup>4</sup>	84.70	191.50
<b>Miles from San Francisco (northern border)</b> <sup>4</sup>	191.50	328.60
<b>Population Density (people per square mile)</b> <sup>1</sup>	24.6	35.4
<b>New Homes built in last year (single family dwellings)</b> <sup>3</sup>		
2007 County - Unincorporated	196	223
<b>New homes built in last 5 years (single family dwellings)</b> <sup>3</sup>		
2003-2007 County - Unincorporated	1,396	1,350
<b>Value of Average Home</b>		
Nov 2007 Median Prices -Houses Sold <sup>2</sup>	\$385,000	\$299,000
<b>Unemployment</b> <sup>5</sup>		
2006	5.20%	5.60%
<b>Total Harvest</b> <sup>6</sup>		
2006	114 mmbf	401 mmbf
2005	125 mmbf	460 mmbf
2004	119 mmbf	484 mmbf

MRC's existing timberlands and the Debtors' Timberlands are also similar in scale and composition:

**TIMBERLANDS – MRC VS PALCO**

<u><i>Timberlands</i></u>	<u><i>MRC</i></u>	<u><i>Palco</i></u>
Acres Of Forest Land	218,231	209,960
Miles Of Roads On Lands <sup>1</sup>	2,400	1,679
Miles Of Streams (class I & II) <sup>1</sup>	1,034	1,017
Standing Inventory Of Merchantable Conifers (net MBF) <sup>2</sup>	2,676,405	3,943,170
Unrestricted Standing Inventory Of Merchantable Conifer (net MBF) <sup>3</sup>	1,542,085	2,628,314
Average Harvest Last Five Years (2003 to 2007) MBF net	33,106	126,200
Average Expected Harvest next 5 years (net MBF)	38,000	55,000
Average Annual All Forestry Costs Other Than Log And Haul And Road expenditures (projected next 5 years) <sup>4</sup>	\$9,600,000	\$15,200,000
Average Annual Road Expenditures (projected next 5 years) <sup>5</sup>	\$3,100,000	\$7,850,000
Forest Related Employees ( <i>Road Dept. not included</i> )	60	83

<sup>1</sup> *Palco HCP/MRC GIS*

<sup>2</sup> *Palco Intralink Data 4.1.21 (includes OGR)*

<sup>3</sup> *MRC vol. 1/07 MRC State of Inventory/Palco Intralink Data 4.4.18. Newco vol. per MRC*

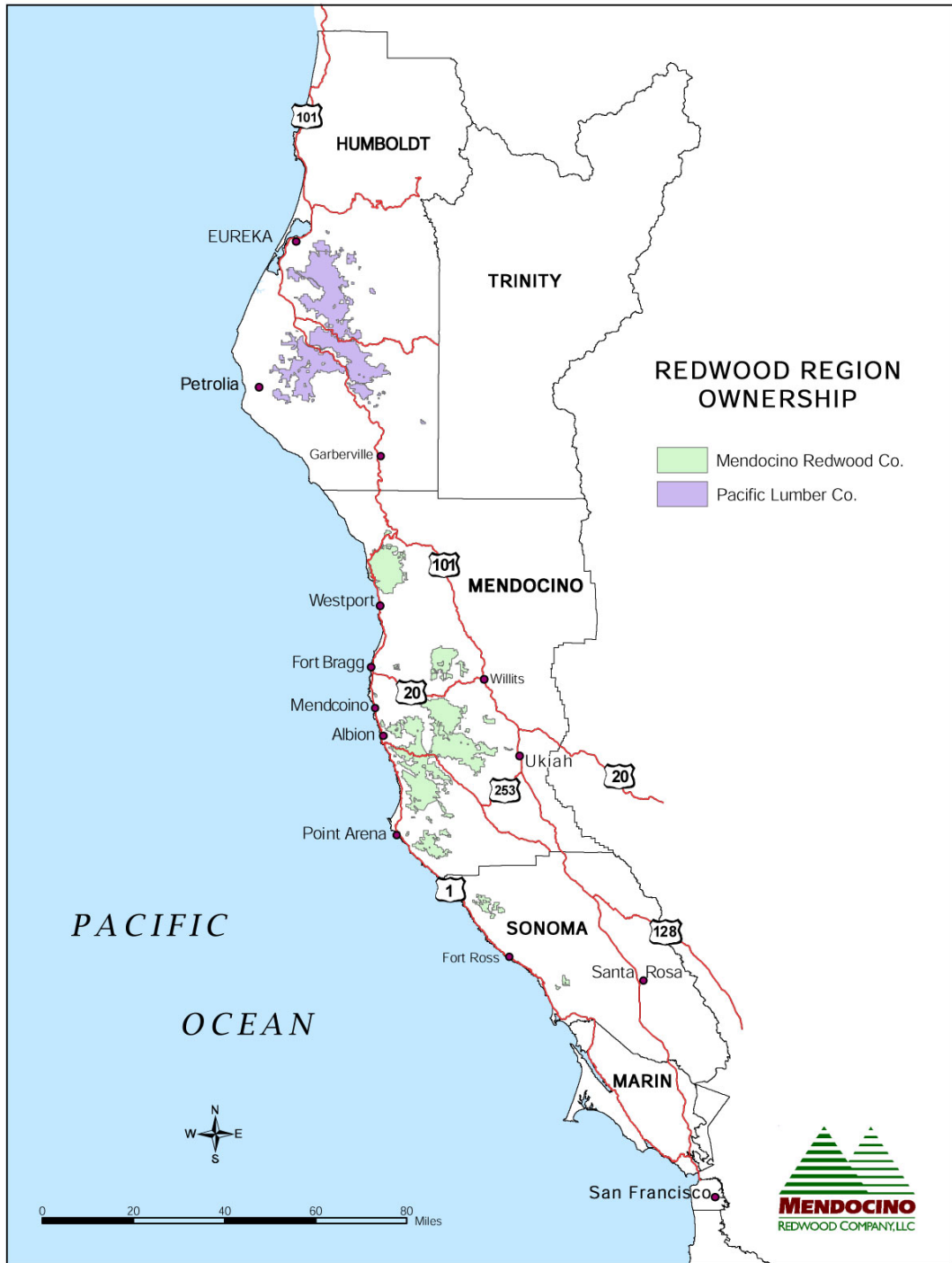
*Note: Volumes are net harvestable as they include volume on acres with BA residual limitations*

<sup>4</sup> *Proposed budget*

<sup>5</sup> *MRC & Scopac budgets \*5, plus 3% per Newco 5 year budget*

<sup>6</sup> *Based on initial estimate of annual harvest.*

The following map illustrates the relative location of MRC's existing timberlands to the Debtors' Timberlands:



(c) **Background of Mendocino Forest Products Company, LLC (“MFP”).**

MRC’s affiliate, MFP, successfully operates a sawmill and related distribution business in Ukiah, California. In recent years, MFP has primarily served Home Depot. In the course of their relationship, Home Depot has named MFP its Environmental Partner of the Year, and more recently Home Depot’s Lumber Department’s Vendor of the Year (Home Depot purchases about \$6 billion in lumber from suppliers every year). MFP’s Ukiah sawmill produced approximately 55 million board feet of redwood lumber in 2007, operating one shift of production. MFP’s distribution business sells approximately 190 million board feet of redwood lumber and complementary forest products.

In addition, MFP recently acquired a new affiliate that sells an additional 190 million board feet of forest products to a well diversified group of 650 customers, including one national “big box” customer. Many of these 650 customers fit the profile of traditional retailers of redwood lumber.

MFP has been successful over time, despite the fact that it operates a modest sized sawmill on only one shift, in conjunction with a related distribution business. MFP’s operations are coordinated with MRC’s timberlands to allow MFP to produce lumber based on market demand and with a sawmill that is matched to the harvest capacity of logs from MRC lands and logs easily available for purchase from other forest landowners in the region. The success of MFP has been a function of

- matching sawmill capacity to log harvest,
- producing and maintaining lumber inventory in anticipation of market demand, and
- providing just in time delivery service with a high degree of accuracy and dependability for wholesalers and retailers of redwood lumber.

In addition, MFP has achieved better service for its customers and strengthened its overall business by distributing additional lumber products that complement its redwood product line. MFP revenues of non-redwood products are roughly equal to its revenues of redwood products. MFP believes that redwood lumber’s future success will require distribution capabilities that extend to complementary products, creating an attractive, diverse product offering to shore up redwood’s declining market share among the breadth of competing products.

MFP’s mill operations and the Debtors’ Mill have many similarities:

**SAWMILL – MENDOCINO FOREST PRODUCTS UKIAH MILL VS PACIFIC LUMBER COMPANY’S SCOTIA MILL**

<b><u>Mill</u></b>	<b><u>MFP</u></b>	<b><u>Palco</u></b>
Mill Average Production Rate	30 mbf/hr	43 mbf/hr <sup>1</sup>
Average Fully Loaded Mill Conversion Costs	\$115/mbf	\$210/mbf <sup>1</sup>
Fence Line Average Production Rate	12 mbf/hr	7.8 mbf/hr <sup>3</sup>
Average Fence Line Conversion Costs (direct)	\$54.07	\$177.00 <sup>2</sup>
Average Log Length	13.15ft	16.7ft <sup>3</sup>
Average Mill Uptime	90.00%	90.00% <sup>3</sup>

<sup>1</sup> *Intralink Section 5.0; Debtors 004246 5.2.4.04 Operating Metrics-September YTD-Unstamped*

<sup>2</sup> *Intralink 0.1.09 Debtors 008754-55 Sawmill Data*

*Note: Conversion costs shown in \$ per gross mbf and December 2007 costs are forecasted*

<sup>3</sup> *Estimates by MFP*

(d) **Background on Redwood Forestry and Log Market.**

Redwood is a species that holds a special place in the heart of many Californians. Historically, before Europeans came to California, it is believed redwoods could be found on roughly 2 million acres of land from the Big Sur Coast North to Del Norte County, roughly 450 miles along a thin, fog- influenced strip of coastal California. More recently, for the last several decades, there have been four major redwood landowners:

- Pacific Lumber Company; 210,000 acres
- Green Diamond (formerly Simpson); 440,000 acres
- Mendocino Redwood Company (formerly Louisiana Pacific): 230,000 acres
- Hawthorne Timber Co (formerly Georgia Pacific); 113,000 acres

Commercial and private ownership of redwood forestlands is estimated today at 1.3 million acres. Another 350,000 acres is owned by federal, state and local governments and conservation groups, including 86,000 acres (approximately 125 square miles) of old growth forest that have been preserved permanently.

Forestry in California is a highly regulated activity. Regulation has evolved as a result of California environmental laws that have, over a long period of time, required increased public disclosure of forestry related activities as compared to other states. The California mandated disclosure has lead to greater application of federal environmental laws in California as compared to other states on privately held forest lands. Greater application of federal environmental laws has in turn often led to additional state environmental laws, and the disclosure process has created a cycle of ever increasing forestry regulation over time.

The following Federal, State and local regulatory agencies all have regulatory authority over the Debtors and forestry operations in general: (emphasis added.)

- Federal
  - US Fish and Wildlife Service
  - National Marines Fisheries Service (NOAA)
  - Army Corp of Engineers
  - Federal Environmental Protection Agency
- State of California
  - Cal Fire (formerly California Department of Fire and Forestry Protection)
  - California State and Regional Water Quality Control Boards
  - California State and Regional Air Quality Control Boards
  - State Environmental Protection Agency
  - Cal Trans (Department of Transportation)
  - California Dept of Fish and Game
  - California Dept of Mines and Geology

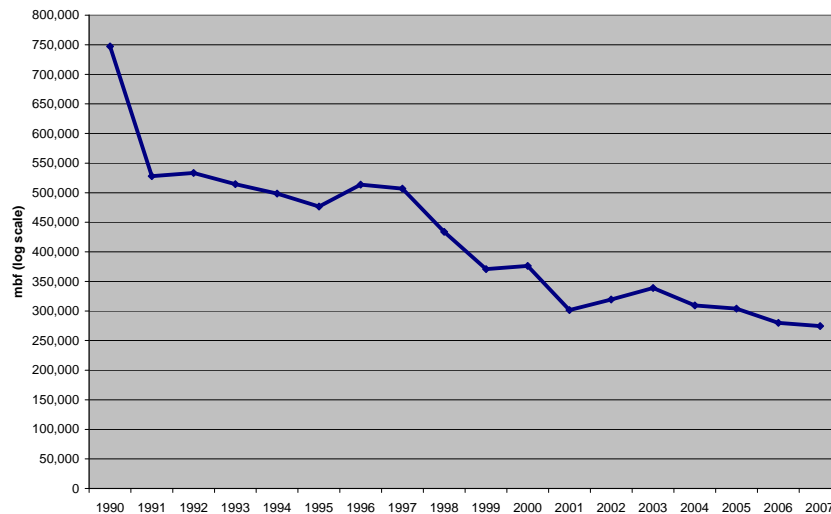
- California Board of Forestry
- County (in Counties with commercial timberlands)
  - County Planning Departments
  - County Transportation Departments
  - County Ag Commissioner's Office

The regulatory system for California forestry is considered challenging, as these varied federal, state and county agencies all regulate independently. However, most of these agencies predominately coordinate their actions through two agencies, Cal Fire (whose decisions can be appealed to the California Board of Forestry) and the California State and Regional Quality Control Boards (whose decisions cannot easily be appealed under California law).

The Debtors, along with other operators, have experienced increased operational costs as a result of increasing environmental regulations as. In addition, the Debtors have a generally poor relationship with their regulators and with the environmental community in general. Indeed, the Debtors have engendered continual litigation over their forest operations and, as a result, face unique regulatory challenges to their operations.

Redwood timber harvesting has been declining for an extended period of time. Since 1990, annual redwood harvest has declined by 63% (See Figure 1).

Figure 1: Redwood Harvest Volumes, 1990 - 2007



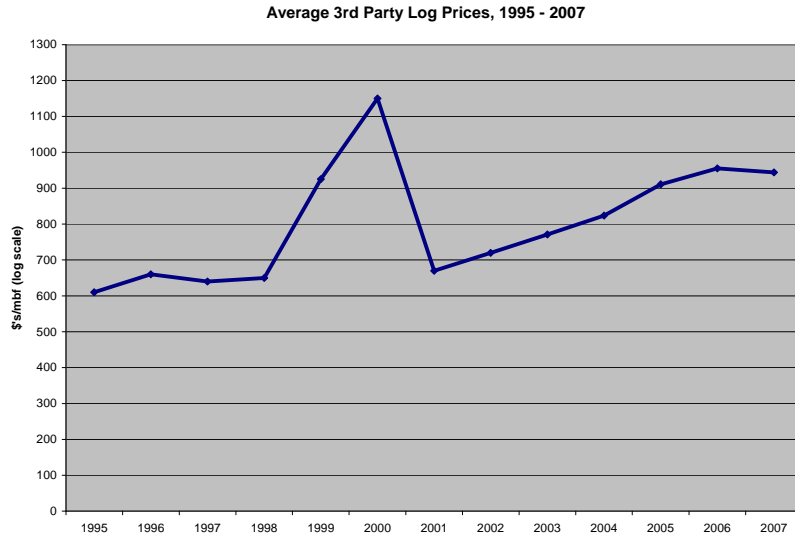
Source: Historical reports by the California Board of Equalization and(2007 Projection by MRC

This redwood log harvest decline is caused largely by historic harvesting at rates in excess of the growth in standing inventory of the forest, and to a lesser degree, due to increasing regulatory restrictions over time. MRC believes that, barring any unforeseen significant conversion of redwood timberlands for either development or parks, or further reductions caused by regulatory considerations, declines in redwood timber harvesting have ended, and over time harvest rates will gradually increase creating greater supplies of redwood lumber in the future.

Most harvestable redwood acreage is owned in an integrated format whereby the landowner also owns associated sawmill infrastructure. About 25% of all redwood logs harvested, however, are sold in third-party sales to unrelated lumber mills.



In the short-term, pricing for third party log sales is a function of log and lumber inventories at saw mills. In the long-term, log prices are tied to lumber prices. The log price run up of 2000 was in response to mill concerns that no logs would be available due to disruptions in harvest associated with the Headwaters Agreement. Mills quickly learned that consumers would not pay for lumber based on log prices inflated by supply concerns of that period. Following the price decline of redwood logs in 2001 (see graph below), redwood log prices have risen gradually until the recent slump in housing construction in mid 2007.



Source: Pacific Rim Wood Markets Report (Atterbury Consultants for data prior to 1999)

Separate and apart from the overall redwood log and lumber markets, it appears that log prices in Humboldt County were inflated in 2004, 2005 and 2006 and the first half of 2007 due to the demands of the Scotia Mill operating on 2 shifts, which exceeded the natural supply of logs from the economic wood basket. This can be seen on the following table:

	Estimated Small Log Prices at the mill <sup>1</sup> by County (\$/s/mbf, log scale)			Estimated Small Log Prices net to landowner (stumpage) <sup>2</sup> by County (\$/s/mbf, log scale)		
	Humboldt	Mendocino	Humboldt Premium <sup>3</sup>	Humboldt	Mendocino	Humboldt Premium <sup>3</sup>
	Jan-98	730	710	20	570	540
Jul-98	741	750	(9)	580	570	10
Jan-99	740	750	(10)	580	570	10
Jul-99	860	850	10	700	670	30
Jan-00	1,025	1,070	(45)	870	900	(30)
Jul-00	1,355	1,435	(80)	1,200	1,200	-
Jan-01	1,175	1,226	(51)	1,000	1,000	-
Jul-01	781	875	(94)	600	650	(50)
Jan-02	692	718	(26)	500	500	-
Jul-02	627	680	(54)	420	460	(40)
Jan-03	671	702	(31)	450	480	(30)
Jul-03	765	792	(27)	550	570	(20)
Jan-04	831	811	20	620	570	50
Jul-04	846	816	30	630	580	50
Jan-05	932	887	45	720	640	80
Jul-05	970	938	32	750	680	70
Jan-06	1,012	967	45	790	690	100
Jul-06	1,013	958	55	780	680	100
Jan-07	1,038	991	47	790	700	90
Jul-07	969	932	37	720	650	70
Jan-08	1,014	978	36	750	660	90
	<b>Average, Jan-04 to Jan-08</b>		<b>39</b>			<b>78</b>

**Notes:**

<sup>1</sup> "Small" logs are 15" or less in diameter. Prices shown at the mill are based upon "stumpage" prices reported by California Board of Equalization, plus estimated average costs to "log & haul" the timber.

<sup>2</sup> "Stumpage" is the log price paid, net of the costs to harvest ("log") and deliver ("haul") the logs to a mill.

<sup>3</sup> "Premium" refers to the difference between Humboldt prices and Mendocino prices.

Source: California State Board of Equalization -- The above data was taken from the California State Board of Equalization records which are recorded by county in conjunction with the collection of yield tax (due on all commercially harvested timber in California).

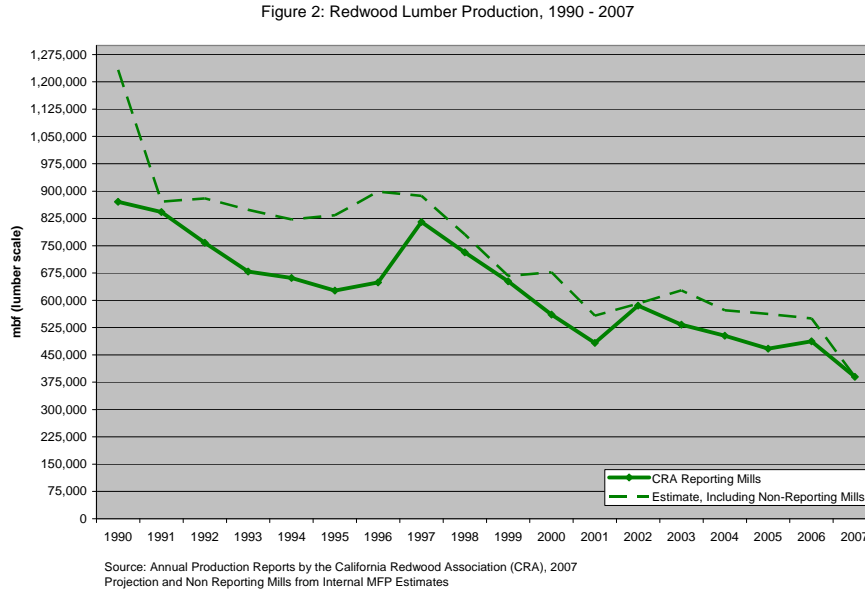
The Scotia Mill opened in 2004 with a large appetite for small redwood logs (by far the largest volume class of log). The table presents timber prices on a stumpage basis (net proceeds received by the landowner after the cost of log and haul), and on a delivered basis (the actual prices paid by the mill, where mills normally bear directly or indirectly the cost of log and haul).

The table indicates that landowners in Humboldt County received on average \$78 per thousand board feet more for small redwood logs than their counterparts in Mendocino County from July 2004 through July 2007. The table also indicates that sawmills in Humboldt County paid \$39 per thousand board feet more than sawmills in Mendocino County for the same period.

Based on Scopac total redwood harvest rates of just under 250 million board feet for the period July 2004 through June 2007, it would appear that the Scotia Mill paid to Scopac roughly \$10 million more in aggregate dollars for small redwood logs than was paid by comparable mills in Mendocino County for the same logs. Similarly, Scopac appears to have received roughly \$20 million more in aggregate dollars for its logs relative to what Mendocino County landowners were receiving for the same logs during the same period.

(e) **Background – Redwood and Related Lumber Markets.**

Redwood region sawmill production of redwood lumber has declined along with the decline in redwood log harvests:



Almost 90% of all redwood lumber produced is consumed in the construction of residential decks and fences. The demand for deck and fence construction is driven by 3 key factors, in order of their impact: (i) repair/replacement of existing decks and fences as they age; (ii) remodeling additions to existing residences; and (iii) new housing starts. The recent decline in new housing construction and the contraction of real estate credit can be expected to have a negative effect on the demand drivers for decks and fences for at least the next two years.

Other uses of redwood are for specialty consumer products such as garden treatments, play sets, outdoor furniture, and decorative trim. Ultra high grade redwood, representing less than 5% of potential yield, has application as a premium interior finishing material in significant architectural projects as exposed beams, timbers, paneling, and siding.

Nationwide, the 2005 market value for decking surface materials is estimated to be over \$5 billion. However, on a national basis, redwood now accounts for less than 5% of the market for decking and fencing materials.

(1) **Competition.**

Lumber is generally sold in highly competitive markets. Competition generally is based on a combination of price, service, product availability, product quality and competition with other products. Consumers enjoy a greater selection of materials to use in creating their decks and fences than ever before.

The principal materials competing with redwood are: pressure treated lumber, wood/plastic composites (e.g. Trex), plastics, Western red cedar and tropical hardwoods (including ipe, cumaru, mahogany and teak).

Pressure treated lumber, typically southern yellow pine, is the most popular decking material outside of California. This material garnered 72.4% of the national decking market in 2006. What pressure treated lumber lacks in beauty and appearance seems to be offset by its low cost, availability, and ease of use in the minds of consumers. Retailers almost always position treated lumber as their “economy” or “good” offering among decking options.

Wood/Plastic Composites (“WPC”), such as Trex, the fastest growing competitive WPC, is an engineered material manufactured from a mixture of wood flour waste, purchased from furniture makers, and recycled polyethylene from plastic milk jugs and garbage bags. From the inception of this technology in the mid-1990’s, WPC market share has risen to 11.8% (2006 estimate) of the National decking marketing. Manufacturers of WPC have historically spent tens of millions each year on brand building and promotion; far in excess of the entire promotional budget of the California Redwood Association (only \$150,000 in 2006). Consumers favor WPC’s perceived low maintenance and long life. Most retailers position WPC as the premium or “best” category of decking.

Plastics decking material, such as eOn, began to emerge in the marketplace in response to the success of WPCs. Plastic decking is usually fabricated from virgin or recycled polyvinylchloride (PVC). At 2006, industry analysts estimated that plastic decking had captured 2.7% of the national market. Plastic decking is usually positioned as the “better” or “best” choice in retail assortments.

Western red cedar is primarily fueled by Canadian imports. Consumers perceive this material as comparable to redwood but more readily available due to its wider growing region. Positioned by most retailers as a “better” category of decking material, western red cedar enjoys a national market share of approximately 6.4%.

Tropical hardwoods comprise 2.1% of the national marketing owing to their limited availability. These materials are also very difficult to fabricate into decks, often requiring pre-drilling and special saw blades in the construction process. Retailers tend to position these materials as “exotic” or “luxury” and price them at a significant premium.

The level of demand for the Debtors’ products is dependent on such broad factors as overall economic conditions, interest rates, and demographic trends. In addition, competitive considerations, such as total industry production and competitors’ pricing, as well as the price of other construction products, affect the sales prices for their lumber products. Competition in the common-grade redwood and Douglas-fir lumber market is intense, with numerous large and small lumber producers. Palco and Britt primarily compete with the northern California mills of Simpson, Redwood Empire, Sierra Pacific, and Canadian cedar lumber producers, as well as other imports and non-wood alternatives.

## **(2) Customer Concentration.**

As harvest volumes declined over the years, the distribution network for redwood lumber has naturally contracted in scope. The former nationwide network has become regionalized into the western US. In 2006, 83% of all redwood lumber was sold within the state of California. The next largest redwood consuming state was Colorado which accounted for 3.6% of redwood sales volume.

Traditionally, redwood lumber was sold by the producing mills to stocking distributors who, in turn, sold the lumber at wholesale prices to retail lumber yards, including small regional retail chains. Since 1996, “big box” retailers, such as the Home Depot and Lowes, began to purchase redwood directly from mill operators. The industry’s on-going transition from the traditional “three step” distribution network to the big box “two step” network requires new technology and skills. Today’s large retailers demand rapid response capabilities, warehouse management systems, logistics systems, and a depth of customer service and merchandizing support not available at traditional redwood mill operations.

As the distribution channel for redwood continues to evolve and consolidate, the surviving stocking distributors and big box retailers also look for advantages from consolidated shipments to service their locations. Single product (redwood only) line suppliers such as the Debtors are poorly positioned to capitalize on this trend.

**(3) Price Fluctuations and Seasonality.**

First-quarter lumber sales historically have been lower due largely to the general decline in construction related activity during the winter months. The demand for lumber is also being affected negatively by the lower level of new construction, remodeling and renovation activity. These activities are, in turn, subject to fluctuations due to, among other factors:

- changes in domestic and international economic conditions;
- interest rates or the availability of financing;
- population growth and changing demographics; and
- seasonal weather cycles (e.g., dry summers, wet winters) and other weather-driven events.

Decreases in the level of residential construction activity or repair and remodeling activity generally reduce demand for logs and wood products. In addition, timber owners generally increase production volumes for logs and products during favorable price environments. Such increased production could, when coupled with declines in demand for these products in general, lead to oversupply and lower prices.

**(4) Current Market Conditions.**

The current housing slow-down and overall unfavorable economic trends have and will continue to negatively affect the Debtors. According to the California Redwood Association, redwood lumber sales in 2007 were down 20% compared to 2006

However, MRC expects the California Board of Equalization to report that 2007 redwood log harvest levels declined by only a modest 2% from 2006 levels. It is estimated that total redwood log inventories have increased by 22% in 2007 when compared to 2006. On a short term basis, significant declines in lumber sales without corresponding declines in log harvest will lead to large increases in log and lumber inventories. Large increases in log and lumber inventory combined with weak end-consumer demand have lead to declines in log and lumber prices.

**(f) MRC Business Strategy for Newco.**

As part of the reorganization of the Debtors, MRC has developed a business strategy for Newco based on its expertise and its experience in managing MRC's integrated commercial redwood timberland, sawmill and lumber distribution operations in nearby Mendocino County.

**(1) Change the Forest Practices.**

First and foremost, MRC will, as soon as practicable, institute new forestry practices of for Newco, including

- bring all of the applicable forest practices, policies and procedures that MRC has used in the last 10 years to the Palco Timberlands;
- immediately seek Forest Stewardship Council certification;
- honor all aspects of the HCP entered into in conjunction with the Headwaters Agreement (to the extent regulators and non-governmental organizations wish to seek to improve the implementation of the HCP in the future, MRC would work with stakeholders to do that);

- set the harvest rate initially at 55 million board feet based on a detailed review of all acres available for harvest for the next 15 years combined with MRC's forest practices;<sup>6</sup> and
- inventory the forest and develop a long term spatially specific long-term harvest plan through an 18 to 24 month public process. Increases in conifer inventory, increases in endangered species habitat, and smoothed changes in harvest (to avoid economic shocks) will be objectives in the long term harvest plan. MRC does not expect the long term harvest plan would result in significant increases in harvest above 55 million board feet in the first 10 years of management.

**(2) Integrate the Timberlands and Mill to Maximize Value.**

Successful operators of redwood timberlands must operate related processing and distribution businesses to maximize the long term value of their lands. Of the four major redwood timberland owners, only one is not integrated and this non-integrated redwood landowner has relied heavily on land sales in the last 5 years to achieve acceptable financial returns. A successfully integrated redwood landowner can avoid the need for land sales to achieve acceptable financial returns through integration. An integrated operation also maintains more local employment and tax revenue.

The Debtors' experience with having separated the Mill from the Timberlands has been destructive of value. For Newco, MRC would incorporate substantial lumber distribution activities as a final step in the operation of the Mill to obtain maximum value for the redwood lumber derived from the Timberlands.

Integration of the Mill and Timberlands, combined with the addition of lumber distribution activities, will allow Newco to benefit from better manufacturing and marketing of redwood lumber. By incorporating MFP's lumber distribution experience, service to lumber retailers will be substantially improved. The best way to maximize the value of the Timberlands is to have consumers value the end-finished lumber products that are derived from the Timberlands. Redwood lumber is the major product of opportunity for this increase in value.

Historically, redwood landowners have been unable or unwilling to support marketing of redwood lumber or service for redwood lumber distribution. However, MRC and MFP have successfully worked together to better market redwood lumber and to provide better service to redwood lumber customers.

To maximize value from the integration of the Mill and Timberlands, MRC and MFP will take the following actions:

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<sup>6</sup> MRC has carefully reviewed all available information to estimate realistic and attainable harvest rates for the foreseeable future. For the short term, MRC has estimated harvest by assessing all harvestable acres for the next 15 years, growing stand inventories until time of harvest, and harvesting all available acres for harvest between now and year 15 utilizing harvest practices consistent with MRC's operations in Mendocino County. Acres available for harvest was determined by reviewing all acres on Pacific Lumber Company lands and eliminating from harvest consideration:

1. any "restricted acres" due to watercourses, habitat conservation plan commitments, or other identified regulatory constraints;
2. any acres with less than 10,000 board feet per acre;
3. any acres harvested in the last ten years with remaining stocking of less than 20,000 board feet; and
4. any acres that are in too small of a stand to be economically harvested (typically a 10 acre stand is required to be economic).

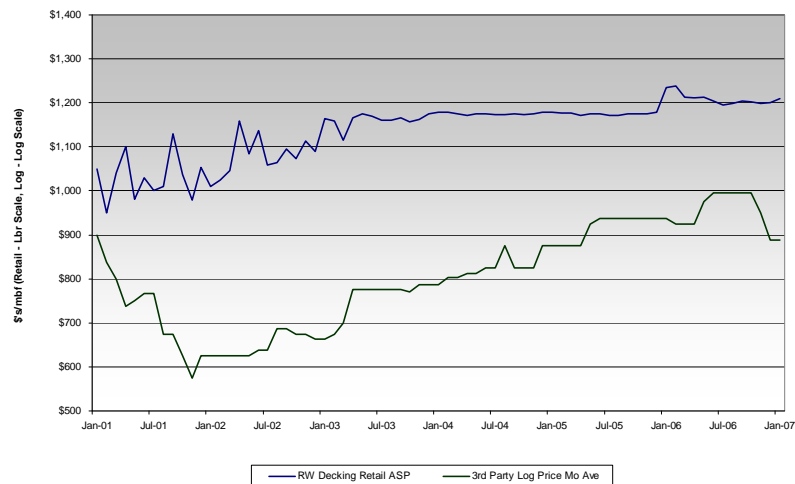
Harvest was further constrained by estimates of water quality restrictions in the Freshwater and Elk watersheds in particular, as well as the permanent elimination of traditional clear cutting from Pacific Lumber Company lands.

- orient Mill and distribution of redwood to what the customers want, as opposed to what the Mill wants to produce;
- market the attributes of redwood that customers value to increase the desirability of redwood to consumers for the long term;
- provide outstanding service to distribution customers; and
- sell additional products to redwood customers to create more efficiency for providing outstanding service.

Integration of the Mill and Timberlands will allow Newco to capture greater “return to the log” in periods of weak lumber demand. Lumber is a cyclical product, and will have periods of declining demand due to end use in construction as is the case today. As lumber inventory stacks up, sawmills drop log prices to slow fiber supply into the sawmill. Decreasing lumber prices will not stimulate demand in a period of weak lumber demand. Lower log prices appear to reduce harvesting particularly amongst non industrial landowners.

A well-managed and integrated sawmill will help insulate a landowner from declining log values to the extent lumber prices decline less than log prices. In the case of redwood, log prices have been much more volatile than lumber prices, as illustrated in the following chart:

Figure 5: 3rd Party Log Prices Compared to Retail Decking & Fencing Prices



MRC plans to take the following specific steps to be taken to maximize value from the Mill and Timberlands:

- invest \$7.5 million in new capital in the Mill to make the Mill flexible enough to handle the logs produced by the Timberlands and reduce costs of processing to the level achieved by MFP’s Ukiah sawmill;
- match production of the Mill to the harvest rate and size of the logs being harvested from the Timberlands;
- change the strategy of the Mill to produce what the market wants to buy, as opposed to what can be produced in high volume or low cost;

- work to rebuild customer relationships that have been frayed over the past 10 years due to poor customer service by the Debtors which were caused by, among other things, the Debtors' cyclical operations and the Debtors' corporate parent; and
- develop redwood lumber distribution capabilities, and /or utilize existing distribution infrastructure of MFP and its affiliates to better market redwood lumber and to better serve customers with redwood lumber and complementary forest products.

**(3) Enable Newco to Achieve Significant Synergies With MRC and MFP.**

MRC and MFP's existing management, operations, and experience will provide substantial synergies to Newco. The ability to realize these benefits are unique to MRC and MFP due to the similarity of MRC and MFP's business to Newco, as well as MFP and related affiliates already distributing almost 400 million board feet of redwood lumber and complementary forest products. Synergies that will be realized and benefit Newco will include:

- eliminate duplicative senior management positions (estimated annual savings of \$1.5 million);
- consolidate redundant information system costs (estimated annual savings of \$0.5 million);
- eliminate duplicative sales, sawmill administration, and accounting administration positions (estimated annual savings of \$0.25 million);
- unify forestry science, inventory and GIS departments (estimated annual savings of \$0.5 million); and
- utilize existing distribution facilities, capabilities, and relationships at MFP and its Affiliate to sell redwood lumber and related products to existing customers and retain the resulting economic benefits for Newco (estimated avoided cost of \$6 million annually).

In addition, MRC will combine MRC and Newco Douglas-fir harvests to establish an FSC Certified Douglas-fir Lumber program on behalf of a "big box" retailer. This program will assure an ability to move Douglas-fir lumber in down markets such as the one that exists today.

**(g) Benefits of MRC's Strategy**

Operational benefits to be realized from MRC's plan for Newco include:

- committed capital, new management, and operational plans that are all available to be utilized by Newco today;
- realization of significant synergies through the management, operations and experience delivered by MRC and MFP;
- bring the successful forestry practices of MRC to Newco, and immediately seek Forest Stewardship Council certification of exemplary practices;
- integration of the Timberlands and Mill, thereby avoiding the need to pursue land sales as an ordinary course measure for achieving acceptable financial returns;



- MRC and MFP management dedicated to investing in the Scotia Mill for its long term success, thereby maximize long term employment in Humboldt County and preserving the identity of Scotia as a successful lumber mill town;
- better marketing of redwood products, and better service for redwood lumber retailers, maximizing the value of redwood products to the end consumer for the long term and thereby creating the most resources to be available to invest in the health of the forest for the future in a fashion similar to what has been achieved at MRC;
- a higher standard of management not subject to the constraints imposed by the current corporate parent working to achieve more productive and efficient relationships with all the regulatory agencies overseeing the Timberlands; and
- creditors to receive substantial recoveries based on the infusion of \$225 million of new cash equity.

**(h) Implementation of Strategy.**

**Management** – See below for biographies. With the benefit of an intact management team and not subject to the constraints imposed by the current corporate parent, the Debtors can cease their practice of relying on a parade of strategy consultants, operation consultants, financial consultants and forestry experts from other areas of the country, all of whom have brought different ideas to the Debtors without any principal downside if their ideas fail to be successful. Relying on operational and financial goals that have been formulated by MRC and its tenured management team from the redwood region will allow Newco to meet its commitments going forward.

**Coordination with MRC and MFP** - Newco will also closely coordinate its operations with MRC and MFP. While operating as separate companies and they will share best practices for producing high quality products for the lowest cost possible.

**Start-up** - A \$5 million operations expense reserve will be established to cover inefficiencies at Newco during the early transition months. Providing a sufficient number of Newco mill employees volunteer and sufficient log supply is available, MFP is prepared and willing to staff a second shift at the Ukiah mill to offset any Newco mill downtime during the initial period of capital redesign and retooling. An appropriate per diem would be provided to cover meals, lodging and weekly travel for each volunteer. In addition, a process to enable employees to transfer across affiliate companies will be explored.

**Employment** - Over time, Newco and MRC will try to standardize, where possible, providing fair and competitive wages, benefits and incentives. This will provide expanded training, development and professional growth to all employees. A process to enable employees to transfer across Newco and MRC will be explored.

**(1) Management of Newco.**

MRC and MFP have worked with a stable and experienced group of individuals to develop a strong cohesive and effective management team. MRC and MFP would utilize their entire existing management team to address the changes that need to be implemented at Newco. Members of the management team for Newco will include:

**Richard Higgenbottom** is Chief Executive Officer for MRC and MFP. His biography is included below for Newco's Board of Directors.

**Michael E. Jani** is President and Chief Forester of Timberland Operations for MRC. Mr. Jani joined the company in May of 1999 as Chief Forester. He successfully led MRC's initiative to demonstrate that it is possible to manage a large block of forestland utilizing high standards of environmental stewardship and at

the same time operate a successful business. These efforts were recognized in November 2000 when MRC achieved FSC certification by the Forest Stewardship Council through their rigorous certification process. Mr. Jani has 34 years experience in the redwood business. Prior to joining the company, he worked for Big Creek Lumber Company in Santa Cruz County, California for 24 years, where he held a number of positions, including Chief Forester. Big Creek was the first company in California's redwood region to be certified under the Forest Stewardship Council's program. Mr. Jani also received FSC certification as a Professional Resource Manager. He is a member of the Society of American Foresters, the Forest Stewards Guild, and the Forest Stewardship Council and has been an active participant with The Society of American Foresters and the Farm Bureau. More recently, he has participated in the development of the FSC Pacific Coast standards; he sits on the Board of Directors for the FSC-US and the State Forestry Advisory Committee and is a member of Cal Poly's and Berkeley's Forestry School's Curriculum Advisory Council. Mr. Jani is a valued and respected resource on forestland stewardship issues at the local, state and national levels. Mr. Jani graduated from the University of California, Berkeley, with a B.S. in Forestry, is a state Registered Professional Forester and has attained national certification as a Specialist in Sediment and Erosion Control.

**John L. Russell** is President of Sawmill and Distribution operations for MFP. Mr. Russell has been with the company for almost ten years, having joined the company in 1998 as part of the original acquisition from Louisiana Pacific, and has 20 years experience in the redwood business. Mr. Russell has held a number of positions throughout the years, including Western Division Sales Manager, Director of Distribution and most recently Senior Vice President of Sales and Marketing. Prior to joining Louisiana Pacific, Mr. Russell began his career at Wisconsin-California Forest Products. He currently serves as Vice Chairman of the Board for the California Redwood Association, and is a member of the Lumber Association of California and Nevada, and the Home Depot Foundation Advisory Committee. He holds a B.A. from the University of California, Santa Barbara, and studied Forestry at Humboldt State University.

**Martin R. Olhiser** is Senior Vice President for MFP. Mr. Olhiser joined the company in 1998 as part of the original acquisition from Louisiana Pacific, and he has 38 years experience in the redwood business. Prior to his current role, he was the Executive Vice President, Manufacturing and Sawmill Sales, Treating and Distribution. While at Louisiana Pacific, Mr. Olhiser was the Business Manager for the Wholesale, Treated Wood, and Distribution businesses, as well as having been Sales & Marketing Manager. His previous experience includes managing the startup and operation of two distribution businesses. Mr. Olhiser currently serves as a Board member for TrueGuard, LLC, the California Redwood Association, and the Timber Advisory Committee to the California State Board of Equalization representing large timber owners. Previously, Mr. Olhiser was the Chairman of the Board for the California Redwood Association. Marty holds an AA degree in Business Administration from Santa Rosa Junior College.

**James Pelkey** is Chief Financial Officer for MRC and MFP. He joined the company in 2004, and has over 16 years experience in finance and accounting. Mr. Pelkey began his career in public accounting, spending 4 years with both Arthur Andersen & Company and Price Waterhouse & Company in Boston, MA and San Francisco, respectively. Upon leaving Price Waterhouse, Mr. Pelkey spent 7 years in various management positions in the financial services and consumer products industries. In 5 years with Dartford Partnership, he participated in several acquisitions, procuring acquisition financings for several transactions in the consumer products industry. Additionally, he participated in several initial public offerings while with Dartford. Mr. Pelkey has a B.S. degree in Business Administration from Northeastern University, and an M.S. degree in Accounting from Bentley College, and is a Certified Public Accountant.

**Thomas Schultz** is Asset Manager for MRC and has over 30 years experience in the redwood business. Tom transitioned to MRC as the Timberlands Manager as part of the original acquisition from Louisiana Pacific in 1998. He is a Registered Professional Forester, and holds a B.S. degree from Humboldt State University in Forestry. Mr. Schultz is the current Chairman of the Mendocino County Cooperative Aerial Fire Patrol, Associate Director/Nominated Director of the Mendocino County Resource Conservation District, and a board member of the Noyo River Watershed Alliance. Mr. Schultz has been Past President of the Salmon Restoration Association, Past Director of the California Licensed Foresters Association, and a past member of Mendocino County General Plan Citizens Advisory Committee and the Garcia River Watershed Advisory Committee.

**Adam Steinbuck** is Timberlands Manager for MRC. He has been in the redwood business for over 13 years, 9.5 with MRC. Previous positions with Mendocino Redwood Company include Asset Manager, Forest Science Manager, and Stewardship Director. Prior to joining the company, he worked for Louisiana Pacific as a Forester and Logging Supervisor. Mr. Steinbuck is the Chairman of the Leadership Mendocino Steering Committee, is a member of the California Licensed Foresters Association and is on the Advisory Committee for the Redwood Valley Outdoor Education Program. He was also Past President/Director for the Redwood Region Logging Conference. Mr. Steinbuck is a Registered Professional Forester, and holds a B.S. in Forestry from Humboldt State University.

**Sarah Billig** is Stewardship Director for MRC, having joined the company in 2001. In addition to her current position, she has held a variety of Biologist positions with MRC. She is a current member of the Western Section of the Wildlife Society, the Society for Conservation Biology, and on the Leadership Mendocino Steering Committee. Ms. Billig holds a B.S. degree from the University of Michigan in Natural Resources.

**John Arlich** is Quality Assurance Analyst for MFP, having been with the company since the original acquisition from Louisiana Pacific in 1998, and brings over 30 years experience in the redwood business. Prior to transitioning to MFP, John held a variety of positions with Louisiana Pacific including Quality Control Supervisor, Plant Manager – LP de Mexico, and Regional Quality Control Manager. Mr. Arlich is the Chairman for the Redwood Inspection Service Quality Standards Committee. He is a certified Lumber Grader by the Redwood Inspection Service, West Coast Lumber Inspection Bureau, & Western Wood Products Association, and has recently received certification as a Six Sigma Green Belt.

**Doug McIsaac** is the Sawmill Production Supervisor for MFP. Mr. McIsaac has over 28 years experience in the redwood business, having been with the company for 9.5 years since the original acquisition from Louisiana Pacific in 1998.

**James Russell** is In-House Counsel and Director, Administration for MFP. He joined the company in 2005 as Director, Materials and Logistics/Distribution, and has over 10 years experience in the redwood business. Prior to MFP, he was General Manager for Siskiyou Lumber Products. He holds a B.S. from the University of California at Davis, and a J.D. from the University of Pacific, McGeorge School of Law. Mr. Russell is a current member of the California State Bar Association.

(2) **Directors for Newco.**

Newco will be governed by a five member Board of Directors. The Board will have substantial overlap with the existing MRC and MFP Boards. Marathon will have an investment in Newco but will not have an investment in MRC and MFP, and thus Marathon will be the arbiter of any items that could be a conflict between the two businesses. Objective procedures have been agreed to in advance to deal with any conflicts that could arise in the ordinary course of business (such as splitting cost of human resources who might spend time on both businesses or for the transfer of logs or lumber from one business to the next). Directors will include:

**Sandy Dean** has served as the Chairman of the Board for MRC, MFP and TrueGuard, LLC since these boards were formed in 2000, and he will serve as the Chairman of Newco. He has spent 9 ½ years with MRC and MFP, including the first two years as President of both companies. He was involved on a day-to-day basis as part of the original acquisition from Louisiana Pacific in 1998. He is a co-founder of Sansome Partners, LP in 1997, and remains a partner in the firm which is dedicated to making direct investments on behalf of the Fisher family. Prior to founding Sansome, Mr. Dean was a Partner with Blum Capital Partners, L.P. At Blum, he worked on sourcing, structuring, and managing both private and public equity investments. Prior to joining Blum, Mr. Dean worked in the leveraged buyout group of Brentwood Associates in Los Angeles and also as a financial analyst at Goldman, Sachs & Co. in New York. He has been involved in an oversight capacity with a number of private businesses, and has served on several not-for-profit boards. Sandy has a B.S.E from Duke University and an M.B.A. from the Graduate School of Business at Stanford University.

**John Fisher** has been a Director since the formation of MRC and MFP Boards in 2000. John is a co-founder of Sansome Partners, LP and he currently is the President of Pisces, Inc., a company started in 1992 as a family investment and management office for the Fisher family. Prior to starting Pisces, Mr. Fisher was a project manager at Carpenter & Company, a Boston-based real estate development firm. He currently serves on the Advisory Board of the Hotel Equities Fund and has served on the boards of a number of private companies. He has a B.A. from Princeton University and an M.B.A. from the Graduate School of Business at Stanford University.

**Richard Higgenbottom** is Chief Executive Officer for MRC and MFP. Mr. Higgenbottom joined the companies in 2000, bringing executive experience in manufacturing, distribution, and marketing. Under his guidance, MFP has expanded its partnership with its customer by increasing distribution markets and product lines through innovative approaches to distribution, supply chain management, operational efficiency, marketing, merchandising and customer service. He has been instrumental in providing leadership supporting the company's initiatives of high environmental stewardship standards, and FSC Certification. Prior to joining the company, Richard has held progressively responsible positions in engineering, product development, profit and loss accountability, and supplying products to Original Equipment Manufacturers, wholesalers and retail markets. He currently serves as Treasurer of the California Forestry Association, an organization committed to keeping its members and the public informed of issues surrounding efforts to keep California forests healthy, sustainable and well-managed for water, wildlife, and the economy and protected against disease and wildfire. He has a B.S. in Industrial Technology, College of Engineering, Tennessee Technological University.

**Thomas Paper** has been a Director since the formation of MRC and MFP Boards in 2000. He was the former Chief Financial Officer of MRC and MFP from 1999 through 2002. Mr. Paper received a BA in Economics from Williams College and an M.B.A. from the Graduate School of Business at Stanford University. He is currently the Managing Partner of Webster Pacific LLC, a strategic and financial consulting firm, formed in 2003. Mr. Paper is also a Director of Lewis Bolt & Nut Company and a Board Member to the Gateway High School in San Francisco, the St. Francis Memorial Hospital and the Turnaround Management Association of San Francisco.

**Richard K. Ronzetti** is the Executive Managing Director and Global Head of Investment Management at Marathon. As a member of Marathon's Executive and Investment Committees, Mr. Ronzetti is responsible for coordinating Marathon's private equity activities with the Investment Committee. Mr. Ronzetti also oversees restructurings, distressed investments, investment research and credit analysis for Marathon, including private finance investments. Prior to joining Marathon, Mr. Ronzetti worked at Morgan Stanley & Co. and Drexel Burnham Lambert as an investment banker in the corporate finance and financial institutions departments and at Agnelli Group's U.S. private equity arm where he was a Senior Investment Analyst responsible for the analysis of private equity investments in Latin America and several private equity investments and restructurings in the United States. Mr. Ronzetti also has experience serving as a Managing Director and Head of Emerging Markets and International High Yield research, among other roles in research and corporate finance, at several Wall Street firms including Paine Webber, Inc. and Smith Barney. Mr. Ronzetti holds a Bachelor of Arts degree, cum laude, in Government and Economics from Harvard College and a Master of Business Administration degree from the Harvard University Graduate School of Business Administration.

#### **6.4 Reorganized Entities' Financial Projections.**

Exhibit A-4 to this Joint Disclosure Statement includes financial projections prepared by MRC and Marathon which represent their present judgment of the projected business operations of Reorganized Palco and Reorganized Scopac. The projections are estimates by MRC and Marathon based on what are currently believed to be reasonable assumptions regarding the future earnings of the Reorganized Entities and are subject to the limitations and conditions stated in the notes to the projections. Unanticipated events and circumstances occurring subsequent to the preparation of the financial projections may affect the actual financial results of the Reorganized Entities. While MRC and Marathon believe that the financial projections are reasonable, as they are based upon the assumptions set forth in connection with such projections, some or all of the estimates will vary. Variations between the actual financial results and those projected, moreover, may be material and adverse.

The financial projections are based upon numerous assumptions regarding the following: (a) the tax consequences of the MRC/Marathon Plan; (b) the anticipated future performance of the Reorganized Entities; (c) the Confirmation and consummation of the MRC/Marathon Plan in accordance with its terms; (d) general business and economic conditions; and (e) certain other matters, many of which are beyond the control of Marathon, MRC and the Reorganized Entities. There can be no assurance that such assumptions will prove to be valid, and the effect of any variance from the projections may be material and adverse.

Although lands and mill will be closely integrated, it is appropriate and possible to model them separately financially. Given the chronic inability of the Debtors to meet financial projections, the MRC/Marathon Plan has been developed with projections that rely heavily on the experience of MRC and MFP for financial assumptions.

### **Forestland Income Statement**

<u>Harvest rate</u> –	Set at 55 mm bf based on a detailed review of all acres available for harvest for the next 15 years along with an application of MRC’s forest practices to the available acres for harvest. Year one is a partial year and assumed to be 50 million board feet. <sup>7</sup>
<u>Species mix</u> –	Assumed to match the inventory of the watersheds harvested over time, resulting in redwood harvest of roughly 74% for the foreseeable future.
<u>Log Prices</u> –	Based on long term regression analysis of redwood log prices, adjusted for cyclical pressure on logs currently due to weak lumber markets and with slightly reduced future growth rates due to competing products.
<u>Log and Haul</u> –	Based on Palco actual experience, with adjustments made to reflect MRC’s forest practices.
<u>Non Log and Haul</u> –	Based to a limited degree on a review of Palco’s actual costs, and more heavily based on MRC’s actual experience adjusted for differences in volumes per acre, HCP compliance and additional road requirements. Non Log and Haul costs typically come down more slowly than reductions in harvest. MRC has also used its knowledge of another large operator of redwood’s Non Log and Haul costs to benchmark appropriate costs for a reorganized Palco. Non Log and Haul typically runs much higher for California lands as compared to other states due to much higher level of regulation as compared to conifer forests in other states.

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<sup>7</sup> MRC has carefully reviewed all available information to estimate realistic and attainable harvest rates for the foreseeable future. For the short term, MRC has estimated harvest by assessing all harvestable acres for the next 15 years, growing stand inventories until time of harvest, and harvesting all available acres for harvest between now and year 15 utilizing harvest practices consistent with MRC’s operations in Mendocino County. Acres available for harvest was determined by reviewing all acres on Pacific Lumber Company lands and eliminating from harvest consideration:

1. any “restricted acres” due to watercourses, habitat conservation plan commitments, or other identified regulatory constraints;
2. any acres with less than 10,000 board feet per acre;
3. any acres harvested in the last ten years with remaining stocking of less than 20,000 board feet; and
4. any acres that are in too small of a stand to be economically harvested (typically a 10 acre stand is required to be economic).

Harvest was further constrained by estimates of water quality restrictions in the Freshwater and Elk watershed in particular, as well as the permanent elimination of traditional clear cutting from Pacific Lumber Company lands.

Road Costs – Palco road expenditures (capitalized and expensed) run abnormally high due to HCP related obligations and the company’s failure to keep up with THP related road obligations in recent years. The plan assumes \$8 million of deferred road obligations, and ongoing road expenditures of \$6.5 million to support ongoing harvest.

Other Capitalized – Equipment (pick ups and road maintenance equipment).

	Year 1 <sup>(1)</sup>	Year 2	Year 3	Year 4	Year 5
Harvest Rate (mmbf)	50,000	55,000	55,000	55,000	55,000
Species Mix					
Redwood	74%	74%	74%	74%	74%
Douglas Fir	21%	21%	21%	21%	21%
Hem Fir	5%	5%	5%	5%	5%
Log Prices (\$ per mbf)					
Redwood	\$ 850	\$ 890	\$ 930	\$ 969	\$ 998
Douglas Fir	\$ 400	\$ 460	\$ 512	\$ 519	\$ 526
Hem Fir	\$ 285	\$ 320	\$ 340	\$ 340	\$ 340
Cash Flow (\$ thousands)					
Revenue	\$ 36,411	\$ 42,416	\$ 44,700	\$ 46,368	47,629
Log and Haul Cost	11,700	12,870	13,256	13,654	14,063
Non Log and Haul	6,297	8,048	8,188	8,331	8,477
Road Costs	9,270	9,270	6,778	6,913	7,052
Other Capital Costs	550	650	663	676	690
Cash Flow	\$ 8,594	\$ 11,578	\$ 15,815	\$ 16,794	\$ 17,347

<sup>(1)</sup> partial year

### Mill and Distribution Income Statement

Log Volumes to Mill – Based upon a timber harvest split of 74% Redwood, 21% Douglas-fir and 5% Hem Fir. All Redwood and Douglas-fir volume for forest goes to the mill. Hem Fir logs sold by timber company. Mill does not purchase logs from third parties.

Lumber Sales – Sales calculated using prices to retail customers of MFP and MFP’s recently acquired affiliate, based upon current conditions and ten plus years of experience in the market. All intercompany sales have been eliminated (i.e. sales do not include sales from mill to distribution).

Mill Conversion Costs – Newco expects to lower conversion costs to levels equal to or better than the conversion costs that MFP consistently achieves at its mill in Ukiah. Achievement of these lower conversion costs will require: a) approximately \$8 million of capital investments; and b) a 3 to 4 month shutdown, which would be expected to use a portion of a \$5 million Transition Reserve (see below).

Distribution – Newco expects to utilize the existing MFP distribution infrastructure, as well as the distribution infrastructure of MFP’s recently acquired affiliate, to sell the output of the mill.

Financial Model – The projection of the results for the mill and distribution is based upon a robust

Excel model that predicts earnings, based upon inputs of logs from the timber company, specific cuts for each specie and size of log, the resultant outputs of lumber, as well as conversion costs, distribution costs, mill sales prices and distribution sales prices.

Transition Reserve – Transition reserve reflects projected costs of inefficiency at the mill until the capital program can be completed, as well as costs associated with downtime at the sawmill and costs associated with time to rebalance the mill once the capital project is completed.

Pension – Pension costs reflect required funding to satisfy forecasted funding requirements of pension liability, based on actuarial projections. MRC is awaiting final analysis based upon current market values of the pension fund.

Capital Costs – Capital costs reflective of costs to a) open up the DLI infeed to allow a larger log to be run, which will increase production, b) also on the DLI side, remove the current horizontal resaw and replace with line bar resaw to allow greater flexibility and increased production, c) on the headrig side of the mill, remove the sash gang and install a horizontal twin resaw to allow greater flexibility and increased production, d) for the entire mill, add a green chain and stacker system to the end of the sawmill to improve production by eliminating bottlenecks in the current sorting system, e) invest in additional asphalt and, in particular, pave the log yard to reduce damage to logs and rolling stock, and f) invest in additional rolling stock (i.e. log loaders and forklifts) to reduce downtime and maintenance costs.

	Year 1	Year 2	Year 3	Year 4	Year 5
<b>Log Volumes to Mill</b> (mbf log scale)					
<b>Redwood</b>	37,000	40,700	40,700	40,700	40,700
<b>Douglas Fir</b>	10,500	11,550	11,550	11,550	11,550
<b>Hem Fir</b>	-	-	-	-	-
<b>Cash Flow</b> (\$ thousands)					
<b>Lumber sales</b>	\$ 67,760	\$ 78,022	\$ 81,024	\$ 83,776	\$ 86,066
<b>Fiber, Conversion, Distribution, Freight, Admin</b>	57,509	65,227	67,597	\$ 69,414	\$ 70,831
<b>Recurring EBITDA</b>	10,251	12,795	13,427	14,362	15,235
<b>Transition Reserve</b>	5,000	-	-	-	-
<b>Pension Cost</b>	1,920	1,066	700	400	-
<b>Capex</b>	5,000	3,000	500	500	500
<b>EBITDA less Non-Recurring Items</b>	\$ (1,669)	\$ 8,729	\$ 12,227	\$ 13,462	\$ 14,735

**WHILE MRC AND MARATHON BELIEVE THAT THE FINANCIAL PROJECTIONS ARE REASONABLE IN LIGHT OF CURRENT FACTS AND CIRCUMSTANCES KNOWN TO MRC AND MARATHON, THE PROJECTIONS ARE BASED ON A NUMBER OF ASSUMPTIONS AND ARE SUBJECT TO SIGNIFICANT UNCERTAINTIES WHICH ARE BEYOND THE CONTROL OF MRC, MARATHON AND THE REORGANIZED ENTITIES. THEREFORE, THERE CAN BE NO ASSURANCE THAT THESE PROJECTIONS WILL BE REALIZED. THE ACTUAL OPERATING RESULTS MAY BE MATERIALLY HIGHER OR LOWER THAN THE PRESENT FORECAST.**

(a) **Executory Contracts and Unexpired Leases.**

Except as otherwise provided herein or pursuant to the Confirmation Order, as of the Effective Date, all executory contracts and unexpired leases between the Debtors and any Person, including, but not limited to, all

Intercompany Contracts, shall be rejected pursuant to section 365(a) of the Bankruptcy Code except for (a) any such contract or lease that has been assumed or rejected or renegotiated and either assumed or rejected on renegotiated terms, pursuant to an order of the Bankruptcy Court entered prior to the Effective Date, or (b) any such contract or lease that is specifically treated otherwise in the MRC/Marathon Plan. Entry of the Confirmation Order shall constitute approval, pursuant to section 365(a) of the Bankruptcy Code, of the rejection and assumption of executory contracts and unexpired leases provided for herein; *provided, however*, that any Environmental Obligation shall be treated as indicated in Section 2.5 of the MRC/Marathon Plan and any order entered in connection with Confirmation of the MRC/Marathon Plan shall not constitute a finding that any Environmental Obligation is an executory contract.

Notwithstanding anything to the contrary contained in the MRC/Marathon Plan, including Section 6.1 of the MRC/Marathon Plan, a list of Assumed Contracts which shall be deemed assumed pursuant to section 365(a) of the Bankruptcy Code as of the Effective Date shall be provided in the Plan Supplement, together with an estimate of the cure costs that would result from such assumption; *provided, however*, that any Environmental Obligation shall be treated as indicated in Section 2.5 of the MRC/Marathon Plan and any order entered in connection with Confirmation of the MRC/Marathon Plan shall not constitute a finding that any Environmental Obligation is an executory contract; *provided, further, however*, Marathon, MRC and the Reorganized Entities reserve the right, at any time prior to the Effective Date, to amend the Plan Supplement to: (a) delete any Assumed Contract listed therein, thus providing for its rejection pursuant to the MRC/Marathon Plan; or (b) add any executory contract or unexpired lease thereto, thus providing for its treatment as an Assumed Contract pursuant to the MRC/Marathon Plan.

**(b) Assumption of Debtors' Pension Plan.**

As of the Effective Date, the Reorganized Entities shall be deemed to have assumed the Debtors' Pension Plan pursuant to section 365(a) of the Bankruptcy Code. Upon the Effective Date, the Reorganized Entities shall continue to pay the obligations under the Debtors' Pension Plan in accordance with applicable law with respect to continued funding of such plans. Nothing in the MRC/Marathon Plan shall be deemed to discharge, release or relieve any Person or Entity from any current or future liability under applicable law with respect to the Debtors' Pension Plan. Any and all obligations to participants under the Debtors' Pension Plan shall be paid in accordance with applicable law.

**(c) Workers' Compensation Programs.**

Upon Confirmation and consummation of the MRC/Marathon Plan, the Reorganized Entities shall continue any pre-petition workers' compensation programs in accordance with applicable law, and the obligations of the Reorganized Entities under applicable law with respect to continued funding of such programs shall remain unaltered. Nothing in the MRC/Marathon Plan shall be deemed to discharge, release or relieve the Debtors or the Reorganized Entities, of or from any current or future liability for their workers' compensation programs under applicable law. Any and all obligations under the pre-petition workers' compensation programs shall be paid in accordance with applicable law. The Debtors (and the Reorganized Entities, as applicable, upon the Effective Date of the MRC/Marathon Plan) shall be responsible for all valid claims for benefits and liabilities under the workers' compensation programs regardless of when the actual injuries occurred.

**(d) Compensation and Benefit Programs.**

Except as otherwise set forth in Sections 6.5 and 6.6 of the MRC/Marathon Plan, to the extent provided herein or in the Plan Supplement, all employment and severance agreements and policies, and all compensation and benefit plans, policies, and programs of the Debtors applicable to their employees, officers and directors including, without limitation, all savings plans, retirement plans, health care plans, disability plans, severance benefit agreements and plans, incentive plans, deferred compensation plans and life, accidental death and dismemberment insurance plans, shall be treated as executory contracts under the MRC/Marathon Plan, and on the Effective Date shall be deemed rejected pursuant to the provisions of sections 365 and 1123 of the Bankruptcy Code, except for executory contracts or employee benefit plans specifically assumed pursuant to the MRC/Marathon Plan or the Plan Supplement.



(e) **Summary of Reorganization of the Debtors.**

On or prior to the Effective Date, (a) as set forth in Section 4.6.2.1(a)(i) of the MRC/Marathon Plan, to the extent that Class 6 does not make the election pursuant to section 1111(b)(1)(A)(i) of the Bankruptcy Code prior to the agreed deadline of March 2, 2008 at 5:00 p.m. Central time, MRC and Marathon shall contribute \$225 million in Cash to Newco, or (b) as set forth in Section 4.6.2.2(a)(i) of the MRC/Marathon Plan, to the extent that Class 6 makes the election pursuant to section 1111(b)(1)(A)(i) of the Bankruptcy Code prior to the agreed deadline of March 2, 2008 at 5:00 p.m. Central time, on the Distribution Date, in full satisfaction, release and discharge of and in exchange for such Claims, MRC and Marathon shall contribute \$75 million in Cash to Newco. Also on the Effective Date, the Debtors shall be reorganized into two newly formed Reorganized Entities, Newco and Townco, and, except as otherwise set forth herein, all of the Debtors' Assets shall be transferred to these Reorganized Entities free and clear of all Claims, Liens, charges, other encumbrances and Interests. On and after the Effective Date, the Reorganized Entities may operate their businesses, may use, acquire and dispose of property, may retain, compensate and pay any professionals or advisors, and compromise or settle any causes of action, claims or interests without supervision of or approval by the Bankruptcy Court and free and clear of any restrictions of the Bankruptcy Code or the Bankruptcy Rules other than restrictions expressly imposed by the MRC/Marathon Plan and the Confirmation Order.

(f) **Creation of Litigation Trust.**

On the Effective Date, the Reorganized Entities shall take any and all such actions as may be necessary or appropriate to establish the Litigation Trust, including the execution and delivery of the Litigation Trust Agreement, in substantially the form provided in the Plan Supplement; *provided, however*, for avoidance of doubt, Litigation Trust Assets shall not include rights to setoff under section 553 of the Bankruptcy Code; *provided, further, however*, Litigation Trust Assets shall not include the following: (i) Causes of Action against any Debtor, Plan Proponent (in any capacity, including without limitation, Marathon, as lender to the Palco Debtors), Reorganized Entity and the Holder of the Class 5 Scopac Loan Claim; (ii) Avoidance Actions under section 547(b)(4)(a) of the Bankruptcy Code (i.e., ninety (90) day preference actions), with respect to trade creditors that (x) supply the Reorganized Entities in the ordinary course of their business with goods and services, and (y) are identified in writing by the Reorganized Entities to the Litigation Trustee within ten (10) Business Days after the Litigation Trustee submits a written list of potential defendants to the Reorganized Entities; (iii) Causes of Action with respect to accounts receivables, tax refunds, tax rebates and any other amounts owed to the Debtors or Reorganized Entities by account debtors; (iv) Causes of Action for recovery of amounts paid by the Debtors or Reorganized Entities in respect of Tax Claims that result in a New Timber Note Adjustment, provided that any net recovery by the Reorganized Entities on account of the Causes of Action in this sub-paragraph (iv) would cause an upward readjustment of the New Timber Note Adjustment; (v) the Headwaters Litigation; and (vi) Causes of Action with respect to Environmental Obligations.

On the Effective Date, as set forth in the MRC/Marathon Plan, (i) all Litigation Trust Assets of the Debtors shall be transferred by the Debtors to the Litigation Trust free and clear of all Claims, Liens, charges, other encumbrances and Interests and (ii) Newco shall transfer to the Litigation Trust that certain \$10.6 million, which amount shall be used by the Litigation Trustee first for payment to Holders of Allowed claims classified in Classes 7 and 8, second to repay the Funding Amount and finally, any remaining amounts returned to the Reorganized Entities.

The Litigation Trust shall be established for the purposes liquidating and Distributing the Litigation Trust Assets of the Litigation Trust to the Holders of Allowed Claims in Classes 7, 8 and 9 and paying Statutory Fees as set forth in the MRC/Marathon Plan. The Funding Amount shall not be considered an asset of the Litigation Trust for Distribution to Holders of Allowed Claims for Classes 7, 8 and 9. The Litigation Trustee shall be responsible for prosecuting, settling, resolving or abandoning all Litigation Trust Assets. Other rights and duties of the Litigation Trustee and the beneficiaries shall be as set forth in the Litigation Trust Agreement. The Reorganized Entities shall provide the Litigation Trustee with reasonable access to their books, records, documents and personnel for investigation and prosecution of the Litigation Trust Assets and for the making of Distributions, at the expense of the Litigation Trust.

The Debtors may have potential claims and causes of action not released pursuant to the releases described herein and set forth in the MRC/Marathon Plan, including but not limited to causes of action against the Debtors' parent companies, including MAXXAM, MGHI and MGI, and the Debtors' directors and officers. A list of potential claims and causes of action and the identities of potential defendants will be filed in the Plan Supplement. Avoidance Actions that are preserved may be pursued by the Litigation Trust.

**(g) Authorized Share Capital and Corporate Structure.**

On or as soon as reasonably practicable after the Effective Date, as set forth in Article IX of the MRC/Marathon Plan, (i) 100% of the Newco equity interests shall, without the need for any further corporate act or other action under any applicable law, regulation, order or rule, be issued and distributed by Newco to MRC and Marathon, 85% to MRC, and 15% to Marathon (subject to adjustment), and (ii) 100% of the Townco equity interests shall, without the need for any further corporate act or other action under any applicable law, regulation, order or rule, be issued and distributed by Townco to Marathon.

**(h) Transfer of Assets.**

Except as otherwise set forth in the MRC/Marathon Plan, on the Effective Date, the Debtors shall transfer all Assets of the Estates and Interests in the Estates, to the fullest extent of sections 541 and 1123(a)(5)(B) of the Bankruptcy Code (including any stock of subsidiaries), and any and all other rights and Assets of the Debtors of every kind and nature to the Reorganized Entities and the Litigation Trust, as applicable, free and clear of all Liens, Claims and Interests other than (i) those Liens, Claims and Interests retained or created pursuant to the MRC/Marathon Plan or any document entered into in connection with the transactions described in the MRC/Marathon Plan, and (ii) Liens that have arisen subsequent to the Petition Date on account of taxes that arose subsequent to the Petition Date. The transfer and assignment of any Assets of the Debtors shall be, to the fullest extent permitted by law, exempt from all stamp taxes and similar taxes within the meaning of section 1146(c) of the Bankruptcy Code. Specifically,

(1) any and all of the Assets of the Mill and Scopac, and any and all Assets of the Debtors currently associated with or anticipated to be associated with the Mill and Scopac, and any other Assets of the Debtors, other than those being transferred to Townco or transferred to the Litigation Trust, shall be transferred by the Debtors to Newco;

(2) any and all of the Assets of the Debtors currently associated with or anticipated to be associated with the Scotia, including, without limitation, the power plant and the Britt mill in Arcata, California, shall be transferred by the Debtors to Townco;

(3) any Litigation Trust Assets of the Debtors shall be transferred by the Debtors to the Litigation Trust; and

(4) cash in an amount equal to the unpaid principal amount of the Allowed Class 5 Scopac Loan Claim plus accrued but unpaid interest, fees and other expenses, at the applicable non-default rate of interest under the Scopac Loan, shall be transferred from the SAR Account by the Debtors to the Holder of the Allowed Class 5 Scopac Loan Claim. Any remaining amount held in the SAR Account shall be transferred by the Debtors to Newco. Any remaining amount owed in respect of the Allowed Class 5 Scopac Loan Claim shall be paid by Newco.

**(i) Exit Financing.**

On the Effective Date, without the requirement of further action, the Reorganized Entities shall be authorized to execute and deliver those documents necessary or appropriate to obtain the Exit Financing, including without limitation, any documents required in connection with the creation or perfection of the Liens on the collateral for the Exit Financing, if any. The maximum amount of Exit Financing with respect to Newco shall be \$50 million or as otherwise permitted under the Pre-petition Indenture for the Timber Notes, secured by the Timberland Assets of Newco. The form of any such documents shall be included in the Plan Supplement.

Confirmation of the MRC/Marathon Plan shall constitute an approval of the transactions contemplated hereby and all the actions to be taken, undertakings to be made and obligation to be incurred by the Reorganized Entities, as the case may be, in connection therewith, including the issuance by Newco to Marathon (and the retention by Marathon) of a promissory note in the aggregate principal amount equal to the amount of the Mill Working Capital and secured solely by Liens on the Mill Working Capital. The Exit Financing and or the Reorganized Entities' Cash balances and operations, may be used for any purpose permitted by the Exit Financing, including the funding of obligations under the MRC/Marathon Plan, such as the payment of Administrative Expense Claims and the satisfaction of ongoing working capital requirements.

**(j) Compliance with Environmental Laws.**

Under the MRC/Marathon Plan, the Debtors, Marathon, MRC and the Reorganized Entities, as the case may be, shall comply, complete, perform, satisfy and/or provide for satisfaction or completion of any current, ongoing, executory, and future regulatory or statutory obligations which arise or result from, or may arise or result from, the Environmental Obligations.

The MRC/Marathon Plan is specifically conceived and shall be implemented in a manner which complies with the California state and federal ITPs and consistency determinations under CESA, including the associated HCP and IA, as well as AB 1986, including the Agreement Relating to Enforcement of AB 1986 and the associated, recorded CC&Rs.

**(k) Effect of Confirmation of MRC/Marathon Plan.**

**(1) Discharge of Claims Against the Debtors and the Reorganized Entities.**

*Except as otherwise expressly provided in the MRC/Marathon Plan (i.e. Section 2.5) or the Confirmation Order, the Confirmation of the MRC/Marathon Plan shall as of the Effective Date: (i) discharge the Debtors, the Reorganized Entities and any of their Assets from all Claims demands, liabilities, other debts and Interests that arose on or before the Effective Date, including, without limitation, all debts of the kind specified in sections 502(g), 502(h), or 502(i) of the Bankruptcy Code, whether or not (A) a Proof of Claim based on such debt is filed or deemed filed pursuant to section 501 of the Bankruptcy Code, (B) a Claim based on such debt is Allowed pursuant to section 502 of the Bankruptcy Code, or (C) the Holder of a Claim based on such debt has accepted the MRC/Marathon Plan; and (ii) preclude all Persons from asserting against the Debtors, the Reorganized Entities or any of their Assets any other or further Claims or Interests based upon any act or omission, transaction or other activity of any kind or nature that occurred prior to the Effective Date, all pursuant to sections 524 and 1141 of the Bankruptcy Code. The discharge provided in this provision shall void any judgment obtained against any of the Debtors at any time, to the extent that such judgment relates to a discharged Claim or cancelled Interest.*

**(2) Injunction Related to the Discharge.**

*Except as otherwise provided in the MRC/Marathon Plan (i.e. Section 2.5) or the Confirmation Order, all entities that have held, currently hold or may hold Claims or other debts or liabilities against the Debtors or an Interest or other right of an equity security Holder in any or all of the Debtors that are discharged pursuant to the terms of the MRC/Marathon Plan are permanently enjoined, on and after the Effective Date, from taking any of the following actions on account of any such Claims, debts, liabilities or Interests or rights: (i) commencing or continuing in any manner any action or other proceeding of any kind with respect to any such Claim debt, liability, Interest or right other than to enforce any right to a Distribution pursuant to the MRC/Marathon Plan; (ii) enforcing, attaching, collecting or recovering in any manner any judgment, award decree or order against the Debtors, the Reorganized Entities or any of their Assets on account of any such Claim debt, liability, Interest or right; (iii) creating, perfecting or enforcing any Lien or encumbrance against the Debtors, the Reorganized Entities or any of their Assets on account of any such Claim debt liability, Interest or right; (iv) asserting any right of setoff subrogation or recoupment of any kind against any debt, liability or obligation due to the Debtors, the Reorganized Entities or any of their Assets on account of any such Claim debt, liability, Interest or right; and (v) commencing or continuing any action in any manner, in any place that does not comply with or is inconsistent with the provisions of the MRC/Marathon Plan or the Confirmation Order. Such injunction shall extend to any successor of the Debtors, the Reorganized Entities and any of their Assets. Any entity injured by a willful violation of such injunction shall*

recover actual damages, including costs and attorneys' and experts' fees and disbursements, and, in appropriate circumstances, may recover punitive damages from the willful violator.

**(3) Releases.**

*As of the Effective Date, for good and valuable consideration the adequacy of which is hereby confirmed, the Debtors in their individual capacity and as debtors-in-possession shall be deemed to release and forever waive and discharge all Claims obligations, suits, judgments, damage demands, debts, rights, Causes of Action and liabilities whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown foreseen or unforeseen, then existing or thereafter arising, in law, equity or otherwise that are based in whole or part on any act, omission, transaction event or other occurrence taking place on or prior to the Effective Date (including prior to the Petition Date) in any way relating to the Debtors, the Reorganization Cases, the MRC/Marathon Plan or the Disclosure Statement and that could have been asserted by or on behalf of the Debtors or their Estates at any time up to immediately prior to the Effective Date against the Released Parties.*

*Although MRC and Marathon do not believe that California law is applicable to the MRC/Marathon Plan, nevertheless, in an abundance of caution, each Debtor shall waive the effect of Section 1542 of the California Civil Code to the extent that such section is applicable to the Debtors. Section 1542 of the California Civil Code provides:*

§1542. A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.

*EACH DEBTOR AGREES TO ASSUME THE RISK OF ANY AND ALL UNKNOWN UNANTICIPATED OR MISUNDERSTOOD DEFENSES, CLAIMS, CAUSES OF ACTION, CONTRACTS, LIABILITIES, INDEBTEDNESS AND OBLIGATIONS WHICH ARE RELEASED BY THE MRC/MARATHON PLAN AND EACH DEBTOR HEREBY WAIVES AND RELEASES ALL RIGHTS AND BENEFITS WHICH IT MIGHT OTHERWISE HAVE UNDER THE AFOREMENTIONED SECTION 1542 OF THE CALIFORNIA CIVIL CODE WITH REGARD TO THE RELEASE OF SUCH UNKNOWN UNANTICIPATED OR MISUNDERSTOOD DEFENSES, CLAIMS, CAUSES OF ACTION, CONTRACTS, LIABILITIES, INDEBTEDNESS AND OBLIGATIONS. TO THE EXTENT (IF ANY) ANY OTHER LAWS SIMILAR TO SECTION 1542 OF THE CALIFORNIA CIVIL CODE MAY BE APPLICABLE EACH DEBTOR WAIVES AND RELEASES ANY BENEFIT RIGHT OR DEFENSE WHICH IT MIGHT OTHERWISE HAVE UNDER ANY SUCH LAW WITH REGARD TO THE RELEASE OF UNKNOWN UNANTICIPATED OR MISUNDERSTOOD DEFENSES, CLAIMS, CAUSES OF ACTION, CONTRACTS, LIABILITIES, INDEBTEDNESS AND OBLIGATIONS.*

**(4) Preservation of Rights of Action by the Debtors and the Reorganized Entities.**

*Except as provided in the MRC/Marathon Plan or in any contract, instrument, release or other agreement entered into or delivered in connection with the MRC/Marathon Plan, in accordance with section 1123(b) of the Bankruptcy Code and to the fullest extent possible under applicable law, the Reorganized Entities and the Litigation Trustee, as the case may be, shall retain and may enforce, and shall have the sole right to enforce, any claims, demands, rights and Causes of Action that any Debtor or Estate may hold against any Entity. The Reorganized Entities, the Litigation Trustee or their successors, as the case may be, and may pursue such retained claims, demands, rights or Causes of Action, as appropriate, in accordance with the best interests of the Reorganized Entities, the Litigation Trust, or their successors, as the case may be, holding such claims, demands, rights or Causes of Action. Further, the Reorganized Entities, as the case may be, retain their rights to file and pursue, and shall have the sole right to file and pursue any adversary proceedings against any account debtor related to debit balances or deposits owed to any Debtor.*

**(5) Injunction Related to Releases.**

To the fullest extent Allowed by law, and except as otherwise provided in the MRC/Marathon Plan (i.e. Section 2.5) or the Confirmation Order, all Entities that have held currently hold or may hold claims, obligations, suits, judgments, damages, demands, debts, rights, Causes of Action and liabilities that are released pursuant to Section 10.2.1 of the MRC/Marathon Plan are permanently enjoined, on and after the Effective Date from taking any of the following actions on account of any such claims, obligations, suits, judgments, damages, demands, debts, rights, Causes of Action, and liabilities: (i) commencing or continuing in any manner any action or other proceeding of any kind against a Released Party with respect to any such claims, obligations, suits, judgments, damages, demands, debts, rights, Causes of Action, and liabilities; (ii) enforcing, attaching, collecting or recovering in any manner any judgment, award, decree or order against any Released Party or any of its or their Assets on account of any such claims, obligations, suits, judgments, damages, demands, debts, rights, Causes of Action, and liabilities; (iii) creating, perfecting or enforcing any Lien or encumbrance against any Released Party or any of its or their Assets on account of any such claims, obligations, suits, judgments, damages, demands, debts, rights, Causes of Action, and liabilities; (iv) asserting any right of setoff, subrogation or recoupment of any kind against any debt liability or obligation due to any Released Party or any of its or their Assets on account of any such claims, obligations, suits, judgments, damages, demands, debts, rights, Causes of Action, and liabilities; and (v) commencing or continuing any action, in any manner, in any place that does not comply with or is inconsistent with the provisions of the MRC/Marathon Plan or the Confirmation Order. Such injunction shall extend to any successor of any Released Party or any of its or their Assets. Any Entity injured by any willful violation of such injunction shall recover actual damages, including costs and attorneys' and experts' fees and disbursements, and, in appropriate circumstances, may recover punitive damages from the willful violator.

**(6) Exculpation.**

The Exculpated Parties shall not be liable, other than for gross negligence or willful misconduct, to any Holder of a Claim or Interest or any other Entity with respect to any action omission, forbearance from action, decision, or exercise of discretion taken at any time prior to the Effective Date in connection with:

- the management or operation of the Debtors or the discharge of their duties under the Bankruptcy Code;
- the implementation of any of the transactions provided for, or contemplated in, the MRC/Marathon Plan or the other Plan Documents;
- any action taken in connection with either the enforcement of the rights of any Debtor against any Entities or the defense of Claims asserted against any such Debtor with regard to the Reorganization Cases;
- any action taken in the negotiation, formulation, development, proposal, solicitation, disclosure, Confirmation, or implementation of the MRC/Marathon Plan or the other Plan Documents; or
- the administration of the MRC/Marathon Plan or the assets and property to be distributed pursuant to the MRC/Marathon Plan.

In connection with this provision, the Exculpated Parties are entitled to reasonably rely upon the opinions of their respective counsel, accountants, and other experts or professionals and such reliance, if reasonable, shall conclusively establish the absence of gross negligence or willful misconduct; provided, however, that a determination that such reliance is unreasonable shall not, by itself, constitute a determination regarding the existence of willful misconduct or gross negligence.

If the Holder of a Claim or Interest or other Entity brings an action, suit or proceeding covered by the relevant Article of the MRC/Marathon Plan and does not prevail, such Holder or other Entity must pay the reasonable attorneys' fees and costs to the Exculpated Party. Moreover, as a condition to going forward with such

*action, suit, or proceeding, the Holder of a Claim or Interest or other Entity must, at the outset, provide appropriate proof and assurances of its capacity to pay the Exculpated Party's reasonable attorneys' fees and costs in the event the Holder or other Entity fails to prevail. The Exculpated Party shall have no obligation to pay, or provide appropriate proof and financial assurance of its capacity to pay, reasonable attorneys' fees and costs in the event that the Holder of a Claim or Interest or other Entity prevails in an such action suit or proceeding against such Exculpated Party.*

*The MRC/Marathon Plan does not protect the Exculpated Parties from liability for any conduct in violation of the Environmental Obligations. Any such liability shall be determined under non-bankruptcy law in an appropriate forum.*

**(7) No Liability for Solicitation or Participation.**

None of MRC, Marathon, the Reorganized Entities, the Administrative Agent and the lenders under the Term Loan Agreement, dated as of July 18, 2006, the Administrative Agent and the lenders under the Revolving Credit Agreement, dated as of July 18, 2006, and the Administrative Agent and lenders under the Debtor-In-Possession Revolving Credit Agreement dated as of August 6, 2007, nor any of their respective current members, partners, officers, directors, employees, affiliates, agents and advisors (including any attorneys, financial advisors, investment bankers, accountants and other professionals retained by such Persons) shall have or incur any liability to any Holder of any Claim or Interest for any act or omission in connection with, or arising out of the MRC/Marathon Plan, the Reorganization Cases, the Disclosure Statement, the Palco DIP Loan, the Exit Financing, any agreements relating to the foregoing or with respect to the transactions contemplated hereunder or thereunder, the solicitation of votes for and the pursuit of the MRC/Marathon Plan, the consummation of the MRC/Marathon Plan or the administration of the MRC/Marathon Plan or the property to be distributed under the MRC/Marathon Plan, including, without limitation, all documents ancillary thereto, all decisions, actions, inactions and alleged negligence or misconduct relating thereto and all pre-petition activities leading to the promulgation and Confirmation of the MRC/Marathon Plan, except willful misconduct or gross negligence as determined by a Final Order of the Bankruptcy Court. The foregoing parties shall be entitled to rely upon the advice of counsel with respect to their duties and responsibilities under the MRC/Marathon Plan.

**6.5 Recommendation of MRC and Marathon.**

MRC and Marathon recommend that all Holders of Claims in Classes 3, 4, 5, 6, 7, 8 and 9 under the MRC/Marathon Plan vote to accept the MRC/Marathon Plan and return their Ballots in the enclosed envelope to the Balloting Agent *so that they will be received*, on or before **4:00 p.m.**, prevailing Central Time, on **March 25, 2008**.

In the view of MRC and Marathon, the MRC/Marathon Plan provides the best available alternative for providing equitable and expeditious distributions to Holders of Claims out of the Debtors' Estates. Your support of the MRC/Marathon Plan will enable it to be implemented and help ensure its success.

**SECTION 7.  
THE INDENTURE TRUSTEE PLAN**

*The text of this section of the Joint Disclosure Statement has been prepared by the Indenture Trustee with reference to the Indenture Trustee Plan. All statements and representations herein are the sole responsibility of the Indenture Trustee. The other Plan Proponents do not necessarily agree or disagree with any of the statements or representations herein, and expressly reserve all rights to contest any such statements or representations, if appropriate.*

*The defined terms used in this section have the meanings set forth in the Indenture Trustee Plan.*

## **7.1 Overview of the Indenture Trustee Plan.**

The Indenture Trustee has proposed the Indenture Trustee Plan, summarized herein, solely for Scopac. The Indenture Trustee Plan devotes Scopac's assets to pay its creditors and interestholders pursuant to the absolute priority rule and provides any qualified interested party the right to bid for Scopac's assets. The Indenture Trustee Plan will be implemented through (1) an orderly sale of Scopac's assets, (2) the recovery of funds through Avoidance Actions and (3) settlement or prosecution to judgment of all of Scopac's existing and potential litigation. The Indenture Trustee Plan provides for the appointment of a Plan Agent on the Confirmation Date, who will take over management and control of the Post-Confirmation Debtor and implement the Indenture Trustee Plan. The Plan Agent will engage Houlihan Lokey Howard & Zukin ("Houlihan Lokey") to act as sales agent for the Post-Confirmation Debtor.

Scopac's assets will be sold in an auction implemented through bidding and sale procedures approved by the Court, and effectuated through final auction(s). Far from being a "fire sale" or "foreclosure" of Scopac's assets, the Indenture Trustee Plan anticipates conducting a commercially reasonable sale of Scopac's assets as a going concern.

The Indenture Trustee believes there are highly qualified third party purchasers with significant interest in acquiring, owning and operating Scopac's assets who are ready and able to make significant cash bids for Scopac's assets in a competitive auction process supervised by the Bankruptcy Court, and with any sale or sales being finally approved by the Bankruptcy Court. While it is unknown precisely how much value such a commercially reasonable sale will generate, based on the opinions of its retained experts, the Indenture Trustee believes that the value of the assets to be sold is in excess of \$600 million.

Regardless of the final sales price, the Indenture Trustee Plan provides that the Indenture Trustee will voluntarily carve out from the proceeds of the sale, cash of up to \$1.45 million to ensure that holders of Allowed Unsecured Claims against Scopac will receive a distribution anticipated to be 100% of the amount of the Allowed General Unsecured Claims. If the proceeds from the sales of the assets are sufficient to pay all claims of creditors in full, with interest, the Indenture Trustee Plan provides that any remaining proceeds will inure to the benefit of existing equity.

The Indenture Trustee believes the Indenture Trustee Plan is superior to other plans for Scopac because it (1) recognizes and maintains the bargained-for separateness of Scopac, (2) uses the market-determined value of Scopac's assets to pay Scopac's creditors and (3) affords any party, including MAXXAM, the opportunity to bid as much as it thinks Scopac's assets are worth.

***The position of the Indenture Trustee with respect to the competing plans of reorganization proposed by the Debtors and MRC/Marathon is set forth in the attached Exhibit B-2.***

## **7.2 Summary Description of Classes and Distributions Under the Indenture Trustee Plan (Scopac Only).**

The classification of Claims and Interests, the estimated aggregate amount of Claims in each Class and the amount and nature of distributions to Holders of Claims or Interests in each Class under the Indenture Trustee Plan are summarized in the table below. *The Indenture Trustee Plan deals with Claims and Interests against Scopac only. Please refer to the Indenture Trustee Plan for the details relevant to classification of, and distributions to, holders of Claims and Interests.*

No representation can be made that the information below is without inaccuracy. Moreover, such information is subject to the uncertainties of litigation with respect to many of the Claims and other factors. Therefore, no assurance can be given that the estimated Claims are exact or that the estimated recoveries will be achieved.

Description and Amount of Claims or Interests (Scopac Only)	Treatment
<b>Nonclassified Claims</b>	
<p><b>Administrative Claims (unimpaired):</b> Costs and expenses of administration allowed under sections 503(b), 507(b) or 1114(e)(2) of the Bankruptcy Code.</p> <p>Estimated Aggregate Class Amount: <u>\$10,000,000</u></p>	<p>Unless otherwise agreed, each holder of an Allowed Administrative Claim will be paid out of the Administrative Expense Reserve on the later of (a) the Effective Date or (b) within ten (10) days after the Allowance Date.</p> <p>Estimated Percentage of Recovery: <u>100%</u>.</p>
<p><b>Priority Unsecured Tax Claims (unimpaired):</b> Priority Tax Claims allowed under section 507(a)(8) of the Bankruptcy Code.</p> <p>Estimated Aggregate Class Amount: <u>\$507,000</u></p>	<p>Unless otherwise agreed, each holder of an Allowed Priority Unsecured Tax Claim will receive, in full satisfaction of its Priority Tax Claim, Cash in an amount equal to such Allowed Priority Unsecured Tax Claim on the later of (a) the Effective Date or (b) within ten (10) days after the Allowance Date.</p> <p>Estimated Percentage of Recovery: <u>100%</u></p>
<b>Classified Claims</b>	
<p><b>Class 1 Allowed Priority Unsecured Non-Tax Claims (unimpaired):</b> Claims that are entitled to priority under section 507(a)(3), (a)(4) and (a)(6) of the Bankruptcy Code.</p> <p>Estimated Aggregate Class Amount: <u>\$96,000</u></p>	<p>Unless otherwise agreed, on the later of (a) the Initial Distribution Date or (b) when such claim becomes an Allowed Claim in the ordinary course of business, each holder of such a Claim will receive, in full satisfaction of such Allowed Claim, Cash equal to the amount of the Allowed Claim.</p> <p>Estimated Percentage of Recovery: <u>100%</u></p>
<p><b>Class 2(a) Secured Claims of Liquidity Providers under the Scopac Line of Credit (unimpaired)</b></p> <p>Class 2(a)(1) Secured Claim of Bank of America under the Scopac Line of Credit (unimpaired):</p> <p>Estimated Class Amount:       <u>\$14,923,805.05</u></p> <p>Class 2(a)(2) Secured Claim of US Bank under the Scopac Line of Credit (unimpaired):</p> <p>Estimated Claim Amount:       <u>\$7,124,151.86</u></p> <p>Class 2(a)(3) Secured Claim of Key Bank under the Scopac Line of Credit (unimpaired):</p> <p>Estimated Claim Amount:       <u>\$7,163,471.97</u></p> <p>Class 2(a)(4) Secured Claim of Bank of Nova Scotia under the Scopac Line of Credit (unimpaired):</p> <p>Estimated Claim Amount:       <u>\$7,163,471.97</u></p>	<p>The Claims of the Class 2(a) Secured Creditors constitute Allowed Secured Claims, and shall be treated as follows:</p> <p>In full satisfaction of Class 2(a) Allowed Secured Claims, on the Effective Date, the Class 2(a) Allowed Claims shall be paid in full in cash from (i) the funds on deposit in the SAR Account; and (ii) proceeds of sale of the Indenture Trustee's Collateral in payment of their Allowed Secured Claims in recognition of the payment priorities set forth in the Indenture, Deed of Trust and the Bankruptcy Code and, in the event of a successful credit bid by the Indenture Trustee, additional funds obtained by the Plan Agent through a first priority, senior secured loan for any shortfall in the SAR Account; or (iii) shall receive such other treatment as may be agreed to in writing by the Class 2(a) Claimants and the Plan Agent. Notwithstanding any language to the contrary in the Indenture Trustee Plan, Class 2(a) Claimants shall retain their liens and security interests against the Collateral subsequent to the Confirmation of the Indenture Trustee Plan and the conveyance of Estate Property to the Post-Confirmation Debtor, the Litigation</p>



<p>For purposes of distributions, the Claims in Class 2(a)(1), 2(a)(2), 2(a)(3) and 2(a)(4) shall be treated as one class and the distribution shall be made to the Bank of America as Agent for the Liquidity Providers under the Scopac Line of Credit without regard to the subclass.</p>	<p>Trust or the Scotia Pacific Liquidating Trust.</p> <p>Estimated Percentage of Recovery: <u>100%</u></p>
<p><b>Class 2(b) Secured Claims of the Indenture Trustee on behalf of holders of Timber Notes (impaired):</b></p> <p>Class 2(b)(1) – Secured Claim of the Indenture Trustee on behalf of holders of the 6.55% Class A-1 Notes.</p> <p>Class 2(b)(2) – Secured Claim of the Indenture Trustee on behalf of holders of the 7.11% Class A-2 Timber Notes.</p> <p>Class 2(b)(3) – Secured Claim of the Indenture Trustee on behalf of holders of the 7.71% Class A-3 Timber Notes.</p> <p>For purposes of distributions, the Claims in Class 2(b)(1), 2(b)(2), and 2(b)(3) shall be treated as one class and the distribution shall be made to the Indenture Trustee without regard to the subclass.</p> <p>Estimated Aggregate Class Amount: <u>\$900,000,000</u></p>	<p>The Indenture Trustee’s Secured Claim constitutes an Allowed Secured Claim, and shall be treated as follows:</p> <p>In satisfaction of the Indenture Trustee’s Allowed Secured Claim, the Indenture Trustee shall receive: (i) the proceeds of the sale of the Collateral on or within two (2) business days after the closing of any sale of Collateral as contemplated in Article 7 of the Indenture Trustee Plan; and (ii) such other treatment as may be agreed to in writing by the Indenture Trustee and the Plan Agent. To the extent the Collateral, including the proceeds of the sales thereof, are insufficient to pay the Claims in Class 2(b) in full, the Indenture Trustee shall have a Class 3 Allowed General Unsecured Claim for the deficiency. Notwithstanding any language to the contrary in the Indenture Trustee Plan, Class 2(b) Claimants shall retain their liens and security interests against the Collateral subsequent to the Confirmation of the Indenture Trustee Plan and the conveyance of Estate Property to the Post-Confirmation Debtor, the Litigation Trust or the Scotia Pacific Liquidating Trust.</p> <p>The Indenture Trustee shall retain its right to credit bid under 11 U.S.C. § 363(k) regarding any sale of Timber Note Collateral.</p> <p>Estimated Percentage of Recovery: <u>unknown</u></p>
<p><b>Class 2(c) Secured Claim of Caterpillar arising from lease or purchase of equipment (impaired):</b></p> <p>Estimated Aggregate Class Amount: <u>\$1,453,498.34</u></p>	<p>To the extent it is determined that Caterpillar’s Secured Claim constitutes an Allowed Secured Claim, then it shall be treated as follows:</p> <p>In satisfaction of any Allowed Secured Claim of Caterpillar, Caterpillar shall receive on the Effective Date either: (i) the return of its collateral in full satisfaction of its claim unless Caterpillar elects to have its collateral sold pursuant to the Indenture Trustee Plan; (ii) the proceeds of the sales of any collateral that Caterpillar elects to have sold pursuant to Article 7 of the Indenture Trustee Plan; or (iii) such other treatment as may be agreed to in writing by Caterpillar and the Plan Agent. Notwithstanding any language to the contrary in the Indenture Trustee Plan, Class 2(c) Claimants shall retain their liens and security interests</p>

	<p>against the Collateral subsequent to the Confirmation of the Indenture Trustee Plan and the conveyance of Estate Property to the Post-Confirmation Debtor, the Litigation Trust or the Scotia Pacific Liquidating Trust. To the extent Caterpillar's collateral is sold and the proceeds of the sales thereof are insufficient to pay the Claim in Class 2(c) in full, Caterpillar shall have a Class 3 Allowed General Unsecured Claim for the deficiency.</p> <p>Estimated Percentage of Recovery: <u>unknown</u></p>
<p><b>Class 2(d) Secured Tax Claims (unimpaired):</b></p> <p>Estimated Aggregate Class Amount: <u>\$28,000</u><sup>8</sup></p>	<p>On the Effective Date, each holder of an Allowed Secured Tax Claim shall receive payment in full in cash or such other treatment as may be agreed to in writing by the holder of such claim and the Plan Agent. Notwithstanding any language to the contrary in the Indenture Trustee Plan, Class 2(d) Claimants shall retain their liens against the Estate Property subsequent to the Confirmation of the Indenture Trustee Plan and the conveyance of Estate Property to the Post-Confirmation Debtor, the Litigation Trust or the Scotia Pacific Liquidating Trust.</p> <p>Estimated Percentage of Recovery: <u>100%</u></p>
<p><b>Class 3 Allowed General Unsecured Claims (impaired):</b> Claims that are not secured by a lien on the property of the Debtor.</p> <p>Estimated Aggregate Class Amount: <u>\$700,000</u></p>	<p>Unless the Claim is a Disputed Claim, each holder of an Allowed Class 3 General Unsecured Claim shall receive: (a) their Pro Rata share of the Unsecured Claim Distribution Account up to 100% of their Allowed Claim, (b) their Pro Rata share of the proceeds of Avoidance Actions recovered for the benefit of Claimants of the Scopac Estate, (c) their Pro Rata share of any proceeds that are placed in the Distribution Account from the sale of the Estate Property after satisfaction of any Lien secured by such proceeds (plus interest and Allowed fees and expenses), (d) distributions from the Litigation Trust pursuant to the terms of the Litigation Trust Agreement, and (e) distributions from the Scotia Pacific Liquidating Trust pursuant to the terms of the Liquidating Trust Agreement.</p> <p>Estimated Percentage of Recovery: <u>100%</u></p>

<sup>8</sup> The County of Humboldt, California asserts a Secured Tax Claim in the approximate amount of \$1,287,120. If Allowed, such Claim shall receive the treatment provided for Holders of Allowed Secured Tax Claims under the Indenture Trustee Plan.

<p><b>Class 4 Allowed Contingent Unsecured Claims (impaired):</b></p> <p>Estimated Aggregate Class Amount: <u>unknown</u></p>	<p>If, on or before the Confirmation Date, a Class 4 Contingent Unsecured Claim is determined by the Bankruptcy Court to be no longer contingent, then the claim will be treated as Class 3 Allowed General Unsecured Claims. Unless the Claim is a Disputed Claim, each holder of an Allowed Class 4 Contingent Unsecured Claim that is later determined to be no longer contingent shall receive (a) their Pro Rata share of the proceeds of Avoidance Actions recovered for the benefit of Claimants of the Scopac Estate, (b) their Pro Rata share of any proceeds that are placed in the Distribution Account from the sale of the Estate Property after satisfaction of any Lien secured by such proceeds (plus interest and Allowed fees and expenses), (c) distributions from the Litigation Trust pursuant to the terms of the Litigation Trust Agreement, and (d) distributions from the Scotia Pacific Liquidating Trust pursuant to the terms of the Liquidating Trust Agreement.</p> <p>Estimated Percentage of Recovery: <u>unknown</u></p>
<p><b>Class 5 Intercompany Unsecured Claims (impaired):</b></p> <p>Estimated Aggregate Class Amount: <u>\$2,000,000</u></p>	<p>Holders of Allowed Class 5 Intercompany Unsecured Claims are not anticipated to receive any Distributions under the Indenture Trustee Plan. However, in the event that proceeds from the sale of Estate Property in accordance with the Indenture Trustee Plan are sufficient to pay all Allowed Claims of holders of Class 1 through Class 4 Claims in full, with interest, then holders of Allowed Class 5 Claims shall receive Pro Rata Distributions of all remaining Available Cash until such Allowed Claims are paid in full.</p> <p>Estimated Percentage of Recovery: <u>0%</u></p>
<p><b>Class 6 Allowed Subordinated Claims (impaired):</b></p> <p>Estimated Aggregate Class Amount: <u>\$0</u></p>	<p>Holders of Allowed Class 6 Subordinated Claims are not anticipated to receive any Distributions under the Indenture Trustee Plan. However, in the event that proceeds from the sale of Estate Property in accordance with the Indenture Trustee Plan are sufficient to pay all Allowed Claims of holders of Class 1 through Class 5 Claims in full, with interest, then holders of Allowed Class 6 Claims shall receive Pro Rata Distributions of all remaining Available Cash until such Allowed Claims are paid in full.</p> <p>Estimated Percentage of Recovery: <u>0%</u></p>
<p><b>Class 7 Equity Interests (impaired):</b></p>	<p>In the event that proceeds from the sale of Estate Property in accordance with the Indenture Trustee Plan are sufficient to pay all Allowed Claims of creditors in full, with interest, then holders of Class 7 Interests shall receive Pro Rata Distributions of all remaining Available Cash. In the event that the proceeds from the sale of Estate Property in accordance with the Indenture Trustee Plan are not sufficient to pay all Allowed Claims of creditors in full, with interest, then in such event, all Class 7 Interests shall be cancelled in</p>

	<p>accordance with Section 17.6 of the Indenture Trustee Plan, and holders of Class 7 Interests will not receive any Distributions under the Indenture Trustee Plan.</p> <p>Estimated Percentage of Recovery: <u>0%</u></p>
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### **7.3 Means of Implementation of the Indenture Trustee Plan**

*The means of implementation of the Indenture Trustee Plan are outlined in detail in Article 7-8 of the plan itself, and are incorporated herein by reference. All parties are urged to carefully review the Indenture Trustee Plan in detail before making a decision on how to vote. The following is a summary of the principal means of implementation of the Indenture Trustee Plan.*

The Indenture Trustee Plan contemplates an orderly sale of Scopac's assets and the recovery of funds through Avoidance Actions and Recovery Rights. On the Confirmation Date, the Indenture Trustee Plan provides for the appointment of Plan Agent to take over management and control of the Post-Confirmation Debtor and its operations and to implement the Indenture Trustee Plan. On the Effective Date, title to all Estate Property shall vest in the acquirer(s).

Anticipated recoveries to Classes 1 through 4 are derived from cash on hand and cash generated from the sales of the Estate Property after the distribution of that cash to pay various claims with priority over those Classes.

Attached as Exhibit B-3 are the Indenture Trustees's Proposed Monthly Cash Flows - Sources and Uses of Cash for the months March through September 2008.

Based on the projections set forth in Exhibit B-3, the Indenture Trustee believes that the Indenture Trustee Plan is feasible and Creditors in Class 1, 2(a), 2(b) 2(c), 3, and 4 should receive recoveries on their claims in the range specified above.

If priority, secured and administrative claims are reduced, then recoveries to Class 2(b), 3 and 4 Creditors will increase. On the other hand, if priority, secured and administrative claims are greater than the amounts projected by the Debtor, recoveries to Class 2(b), 3 and 4 Creditors will decrease.

#### **(a) Sale of Scopac's Assets as a Going Concern.**

As noted above, the Indenture Trustee Plan will be implemented through the sale of Scopac's assets. The Plan Agent will engage Houlihan Lokey to act as sales agent for the Post-Confirmation Debtor. The Scopac Estate Property to be sold includes, but is not limited to: (1) Scopac's Commercial Timberlands; (2) Scopac's interests in the Timber Permits; (3) Scopac's related personal property, including records, computers, vehicles, etc.; (4) Scopac's interest in executory contracts relating to the Scopac Timberlands (to the extent bidders wish to have such contracts assumed by Scopac and assigned to them); and (5) Scopac's interest in non-producing timberlands, including the MMCA lands. If Marathon so elects, and subject to appropriate Bankruptcy Court approval, it may choose to have its collateral sold with the Estate Property as part of the same sales process and subject to the same conditions as set forth herein.

The assets will be sold at an auction implemented through bidding and sale procedures approved by the Court in a form substantially similar to those attached as Exhibit B to the Indenture Trustee Plan. Currently, upon confirmation of the Indenture Trustee Plan, Houlihan Lokey anticipates conducting a commercially reasonable sale process with standard court-approved procedures.

Houlihan Lokey expects to contact a broad list of potentially interested parties concerning the purchase of the assets. Interested parties will execute confidentiality agreements and will receive a comprehensive offering memorandum containing detailed disclosures regarding the assets. Houlihan Lokey will work with all interested

parties to facilitate their due diligence, including creating and providing access to an online data room with necessary valuation documents.

It is anticipated that, upon completion of sufficient due diligence, interested parties will submit binding proposals to purchase some or all of the assets of the Debtor, and Houlihan Lokey and the Plan Agent will select a stalking horse bidder to provide a floor bid in connection with the ultimate auction process. The Indenture Trustee will have the right to credit bid at any sale of its Collateral. Following the selection of a stalking horse bidder, Houlihan Lokey will work with all qualified bidders to further their due diligence and generate interest in a Bankruptcy Court approved auction process.

Finally, it is anticipated that the sale of the assets will be consummated shortly after the completion of the auction. Sales will be free and clear of liens, claims, and encumbrances with any such liens, claims, and encumbrances to attach to the proceeds of sale. However, the Indenture Trustee Plan specifically provides that buyers of Scopac's timberlands must assume all Environmental Obligations associated with the Timberlands, including the HCP and all related obligations, as well as any and all permits, agreements, plans, orders, or other governmental agency authorizations or approvals issued by federal, state, and/or local government agencies with respect to timber harvesting activities on Scopac's timberlands. The transfer of certain of these authorizations will require approval by the appropriate regulatory agency, and such process may be complex and lengthy, with no guaranty of success.

**(b) Assumption of Environmental Obligations**

Implementation of the Indenture Trustee Plan will comply with all nonbankruptcy law approvals and permits for the transfers contemplated by the Indenture Trustee Plan as if no bankruptcy case had been filed. Moreover, the Plan Agent and the winning bidder at the sale contemplated by the Indenture Trustee Plan will satisfy, complete, perform, comply with and be subject to all Environmental Obligations as if no chapter 11 bankruptcy cases had been filed. Thus, the Indenture Trustee Plan will have no effect on the existing environmental and regulatory authority and scheme.

Notwithstanding any of its other provisions, the Indenture Trustee Plan specifically provides that all Environmental Obligations associated with the Commercial Timberlands and the MMCAs, including the HCP and all related obligations, the CC&Rs, as well as any and all permits, agreements, plans, orders, or other governmental agency authorizations or approvals issued by federal, state, and/or local government agencies with respect to timber harvesting activities or other land use activities on Scopac's timberlands will be assumed by the acquirer of the Commercial Timberlands and the MMCAs, including the Indenture Trustee if it acquires the property through a successful credit bid, and the property so transferred will continue to be subject to those Environmental Obligations.

The transfer of certain of these authorizations will require approval by the appropriate regulatory agency, and such process may be complex and lengthy, with no guaranty of success. Any disputes associated with the approvals required to transfer these authorizations or disputes over the Environmental Obligations will be resolved in the applicable nonbankruptcy forum.

**(c) Specific Bidding Requirements**

At the auction, bidders may bid on the Estate Property (including the Palco assets, if Marathon so elects), provided, however, that any bidder making an offer for all or substantially all of the Commercial Timberlands must agree that:

- (1) All current employees of Scopac, except the Chief Executive Officer, Chief Financial Officer and General Counsel shall continue to be employed in their current capacity by the successful bidder for a period of one year after closing (excepting discharge for cause); and
- (2) If a Palco stand-alone plan of reorganization is consummated or the Palco mill is not sold to the buyer of all or substantially all the Commercial Timberlands, the New Master Purchase Agreement between Scopac and Palco dated July 20, 1998 (as modified) that sets forth the terms of the sale of timber from Scopac to Palco, and all

existing Log Purchase Agreements entered into in the ordinary course of business in connection therewith, then bidders shall offer to assume those contracts as part of the sale. If none of the preceding conditions are met or the acquirer of the Palco mill does not wish to assume those agreements, then the New Master Purchase Agreement shall be rejected. (The feasibility or confirmability of the Indenture Trustee Plan is in no way conditioned on or dependant on the assumption of the New Master Purchase Agreement.)

In addition, any such bid must include sufficient cash, when combined with reasonably projected cash on hand at Scopac and the SAR Account (after the payment of Class 2(a) Claimants), as well as any unencumbered proceeds from the sale of Estate Property, to pay the reasonably projected Administrative Claims and Priority Claims in the Scopac Estate. These funds will be used to pay Administrative Claims and Priority Claims of the Scopac Estate on the Effective Date of the Indenture Trustee Plan.

Moreover, any such bid must include sufficient cash to fund the Unsecured Claim Distribution Account described in Section 5.3, in the amount of \$1.45 million.

A bidder for the Commercial Timberlands must submit offers for substantially all of the Commercial Timberlands. The requirements of 7.2.1.1 (i-iii) of the Indenture Trustee Plan shall apply only if the offer is for all or substantially all of the Commercial Timberlands.

Bidders who submit offers for both the Commercial Timberlands and the non-Commercial Timberland assets of Scopac must allocate the values they ascribe in their bids between the Commercial Timberlands and the non-Commercial Timberland assets. In the event that Marathon elects to have its collateral sold with the Estate Property as part of the same sales process and subject to the same conditions as set forth herein, bidders who submit offers on any of the Palco assets must also allocate values they ascribe in their bids between the Palco assets and the assets of Scopac.

Any cash proceeds from the sale of the Scopac assets shall be distributed in accordance with the terms of the Indenture Trustee Plan. It is anticipated that Class 2(a) Claimants will be paid in full out of the existing cash in the SAR Account and the proceeds of any sale.

**(d) Rejection of Executory Contracts and Unexpired Leases**

All Executory Contracts and Unexpired Leases not otherwise assumed or rejected pursuant to a Final Order, entered within thirty (30) days after the Effective Date, shall be deemed rejected as of the Confirmation Date. Pursuant to Bankruptcy Code section 365(a), the Indenture Trustee Plan constitutes a motion to reject all executory contracts and unexpired leases not listed on Exhibit A to the Indenture Trustee Plan or not otherwise assumed or rejected pursuant to a Final Order entered within 30 days after the Effective Date.

Entry of the Confirmation Order shall constitute the approval, pursuant to Bankruptcy Code section 365(a), of the rejection of the Executory Contracts and Unexpired Leases not assumed pursuant to Section 6.1 of the Indenture Trustee Plan.

Notwithstanding anything to the contrary contained herein, all Environmental Obligations associated with the Timberlands, including the HCP and all related obligations, as well as any and all permits, agreements, plans, orders, or other governmental agency authorizations or approvals issued by federal, state, and/or local government agencies with respect to timber harvesting activities on Scopac's timberlands will be assumed by the acquirer of all or substantially all of the Commercial Timberlands. Any disputes associated with the approvals required to transfer these authorizations or disputes over the Environmental Obligations will be resolved in the applicable non-bankruptcy forum.

Unless the acquirer of all or substantially all of the Commercial Timberlands otherwise elects, to the extent not already rejected pursuant to a Final Order, all employment and retirement practices and policies and all compensation, retirement and employee benefit plans (except as provided below), policies and programs of Scopac applicable to its current or former directors, officers, or employees (including all savings plans, retirement plans, health care plans, accrued unpaid vacation, sick leave, medical benefits, incentive plans, workers' compensation

programs, and life, disability and other insurance plans), all agreements between Scopac and the Palco Debtors related to pension liability, to the extent arising from Executory Contracts, shall be rejected as of the Effective Date, and shall not be binding on the Post-Confirmation Debtor or Plan Agent to any extent.

Subject to the occurrence of the Effective Date, the obligations of the Debtor and the Post-Confirmation Debtor, to indemnify, defend, reimburse or limit the liability of directors or officers who were or are directors or officers of Scopac at any time, against any claims or causes of action as provided in the Scopac's certificate of incorporation, by-laws, applicable state law, contract, or otherwise shall not survive confirmation of the Indenture Trustee Plan and shall be discharged.

**(e) Plan Agent**

The sale of the Estate Property and distributions to holders of Claims will be conducted by the Plan Agent. The Indenture Trustee Plan will appoint a Plan Agent with all the powers of a debtor-in-possession and trustee appointed under chapter 7 of the Bankruptcy Code who will answer to and be directed by a Post-Confirmation Board. The Indenture Trustee will, prior to the Confirmation Hearing, file a notice with the Bankruptcy Court identifying who it intends to nominate as the Plan Agent, and will seek the approval of that nomination at the Confirmation Hearing.

The Post-Confirmation Board will consist of at least the top three (3) Timber Noteholders by principal amount and such additional noteholders as are necessary to ensure that the Post-Confirmation Board members hold at least 51% or more of the total of the outstanding balance on the Timber Notes until such time as the Timber Notes are paid in full. If the Timber Notes are paid in full, the U.S. Trustee shall propose members of the Post-Confirmation Board, giving five (5) days notice and an opportunity for parties in interest to object.

The Plan Agent will, among other things, (a) be vested with control and authority over the Estate Property, over the acquisition, management, and disposition thereof, and over the management and conduct of the business of the Debtor to the same extent as if the Plan Agent were the sole owner thereof in his own right, (b) operate the business until all assets are sold, (c) together with Houlihan Lokey as sales agent, be responsible for the orderly sale of the Debtor's assets, (d) distribute proceeds of the sale pursuant to the Indenture Trustee Plan, (e) serve as the Liquidating Trustee of the Scotia Pacific Liquidating Trust, (f) serve as the Litigation Trustee of the Litigation Trust, and (g) bring any necessary objections to claims, except as otherwise provided in the Indenture Trustee Plan. In addition, by way of illustration and without limitation, the Plan Agent need not seek Bankruptcy Court approval to compromise any claim, cause of action, or right of recovery of the Estate post-confirmation. Similarly, and, subject to the discretion and power granted hereunder, the Plan Agent may settle any claim objection or agree to allow any proof of claim or similar dispute without further Court approval.

Following the Confirmation Date, the Plan Agent shall, under the supervision of the Post-Confirmation Board, and, together with Houlihan Lokey as sales agent, begin conducting an orderly sale of the Estate Property consistent with the terms and conditions of the Indenture Trustee Plan. Except as otherwise expressly limited in the Indenture Trustee Plan, the Plan Agent shall have control and authority over the Debtor and authority to manage and dispose of the Estate Property, including the Avoidance Actions and other causes of action that are owned by the Debtor or Post-Confirmation Debtor. With the exception of providing final approval of any sale of the Commercial Timberlands, and except as otherwise provided in the Indenture Trustee Plan, the Plan Agent need not obtain any court order or approval in the exercise of any power or discretion conferred under the Indenture Trustee Plan, or account to any court in the absence of a breach of fiduciary duty. The Indenture Trustee Plan Agent shall exercise his judgment for the benefit of the holders of Claims and Interests in order to maximize the value of Estate Property. An illustrative list of actions the Plan Agent is authorized to take in connection with the management of the Post-Confirmation Debtor and the use of the Estate Property is set forth in the Indenture Trustee Plan.

(f) **Creation of the Litigation Trust and the Scotia Pacific Liquidating Trust**

(1) **The Litigation Trust**

Except as otherwise provided in the Indenture Trustee Plan, on the Effective Date, the Recovery Rights of Scopac, other than Avoidance Actions, shall be transferred to the Litigation Trust for further disposition as provided in the Indenture Trustee Plan and the Litigation Trust Agreement. The Litigation Trust shall be established for the sole purpose of prosecuting the Recovery Rights, other than Avoidance Actions, and distributing the proceeds thereof in accordance with the Indenture Trustee Plan, with no objective to continue or engage in the conduct of a trade or business.

Scopac has stated the belief that damages will be recoverable from the Recovery Rights, particularly the Debtors' Lawsuit Against Regulators for restricting the Debtors' ability to harvest at levels agreed to in the Headwaters Agreement. Pursuant to the terms of the Indenture and Deed of Trust and related security documents, the Indenture Trustee asserts that it has a lien on the Recovery Rights, including a lien on Scopac's interest in the Debtors' Lawsuit Against Regulators (referred to elsewhere in this document as the "Headwaters Litigation"). Scopac disputes this assertion. Any proceeds derived from the Recovery Rights will become assets of the Litigation Trust and be distributed as Available Cash in accordance with the Indenture Trustee Plan and the Litigation Trust Agreement.

Upon creation of the Litigation Trust, holders of secured claims in Class 2(b) and holders of Claims in Class 3, 4, 5, and 6 shall be the Beneficiaries of the Litigation Trust as their respective interests may appear. The Litigation Trustee may make interim distributions to Beneficiaries of the Litigation Trust in the exercise of reasonable business judgment. Upon the settlement, conclusion of litigation and collection of all of the claims in the Litigation Trust, after the payment of all costs and expenses of collection, the Litigation Trustee must distribute the corpus of the Litigation Trust to the Beneficiaries of the Litigation Trust in accordance with their priority and percentage interests in the Litigation Trust. In the event that all Allowed Claims of the Beneficiaries of the Litigation Trust are paid in full, with interest, then any remaining Cash shall become Available Cash under the Indenture Trustee Plan.

(2) **The Scotia Pacific Liquidating Trust**

Ninety (90) days following the Effective Date, any unadministered Estate Property of the Post-Confirmation Debtor of any kind and nature whatsoever, real, personal, intellectual or otherwise, may, in the reasonable business judgment of the Plan Agent, be transferred to the Scotia Pacific Liquidating Trust, which shall be deemed to be the Scotia Pacific Liquidating Trust Transfer Date, for further disposition as provided in this Indenture Trustee Plan and the Scotia Pacific Liquidating Trust Agreement. The Scotia Pacific Liquidating Trust shall be established for the sole purpose of receiving the benefit of the ongoing obligations of third parties and liquidating and distributing the remaining assets of the Estate in accordance with the Indenture Trustee Plan, with no objective to continue or engage in the conduct of a trade or business.

Upon creation of the Scotia Pacific Liquidating Trust, holders of Class 2(b) secured Claims and holders of Claims in Class 3, 4, 5, and 6 shall be Beneficiaries of the Scotia Pacific Liquidating Trust. Upon the liquidation of any remaining assets of the Estate, and after the payment of all costs and expenses of collection, the Scotia Pacific Liquidating Trust Trustee must distribute the corpus of the Scotia Pacific Liquidating Trust to the Beneficiaries of the Scotia Pacific Liquidating Trust in accordance with their priority and percentage interests in the Scotia Pacific Liquidating Trust. In the event that all Allowed Claims of the Beneficiaries of the Scotia Pacific Liquidating Trust are paid in full, with interest, then any remaining Cash shall become Available Cash under the Indenture Trustee Plan.

(g) **The Retention, Enforcement, Compromise or Adjustment of Claims Belonging to the Bankruptcy Estate**

Pursuant to, among other authority, Bankruptcy Code section 1123(b)(3)(B), until unsecured creditors are paid in full with interest, the Plan Agent shall have, for the benefit of the Post-Confirmation Debtor's Estate, the sole



and full power, authority, and standing to prosecute, compromise, or otherwise resolve any Avoidance Actions. All proceeds derived from the Avoidance Actions shall become Estate Property and distributed as Available Cash in accordance with the Indenture Trustee Plan.

With respect to Recovery Rights other than Avoidance Actions, Plan Agent or the trustee of the Litigation Trust created pursuant to the Indenture Trustee Plan shall have full power, authority, and standing to prosecute, compromise, or otherwise resolve the Recovery Rights. The Post-Confirmation Debtor shall not be subject to any counterclaims with respect to the Avoidance Actions, Recovery Rights or any other claims and causes of actions constituting Estate Property provided, however, that the claims and causes of action constituting Estate Property will be subject to any applicable setoff rights that have been perfected and preserved by the holder of such rights.

As soon as practicable after the Confirmation Date, the Plan Agent shall set aside funds in a Litigation Expense Account to pay the professional fees and expenses for objecting to claims or prosecuting Avoidance Actions and Recovery Rights in accordance with the Indenture Trustee Plan. Any unused funds in the Litigation Expense Account shall become Available Cash for use pursuant to the Indenture Trustee Plan.

**(h) Effect of Confirming Indenture Trustee Plan**

Upon confirmation, the provisions of the Indenture Trustee Plan shall bind all Creditors and Interest holders, whether or not they accept the Indenture Trustee Plan. As of the Confirmation Date, all holders of Claims shall be precluded and enjoined from asserting any Claim against the Debtor or its assets or properties based on any transaction or other activity of any kind that occurred prior to the Effective Date except as permitted under the Indenture Trustee Plan.

Subject to the terms of the Indenture Trustee Plan and the Confirmation Order, on the Confirmation Date, all property of the Debtor's estate shall vest in and become the property of the Post-Confirmation Debtor (specifically subject to the lien rights of the Class 2 creditors), including without limitation all Claims, causes of action, alter-ego rights, derivative claims, breach of fiduciary duty claims, veil piercing rights and all other property of the estate as such property is defined by section 541 of the Bankruptcy Code and applicable Bankruptcy law. Except as otherwise specifically provided in the Indenture Trustee Plan or in the Confirmation Order, on the Confirmation Date all property vesting in and becoming property of the Post-Confirmation Debtor shall be free of all liens, claims and encumbrances. Notwithstanding the above, all Environmental Obligations associated with the Timberlands, including the HCP and all related obligations, as well as any and all permits, agreements, plans, orders, or other governmental agency authorizations or approvals issued by federal, state, and/or local government agencies with respect to timber harvesting activities on Scopac's timberlands will be assumed by the acquirer(s) of all or substantially all of the Commercial Timberlands.

In keeping with section 1123(b)(3) of the Bankruptcy Code, the Post-Confirmation Debtor will retain all claims it owned before the Confirmation Date, including all claims recoverable under Chapter 5 of the Bankruptcy Code, including all claims assertable under sections 544, 546, 547, 548 and 550 of the Bankruptcy Code, and all claims owned by the Debtor pursuant to section 541 of the Bankruptcy Code or similar state law, including all claims against third parties on account of any indebtedness, and all other claims owed to or in favor of the Debtor to the extent not specifically compromised and released pursuant to the Indenture Trustee Plan or an agreement referred to or incorporated herein; all claims the Post-Confirmation Debtor owned before the Confirmation Date will be preserved and retained for enforcement by the Plan Agent or the trustee of any trust created pursuant to the Indenture Trustee Plan, on behalf of the Post-Confirmation Debtor, after the Confirmation Date; no other party will have the right to assert these claims.

Except as otherwise provided in the Indenture Trustee Plan or the Confirmation Order, or in any contract, instrument, release, indenture, or other agreement entered into in connection with the Indenture Trustee Plan, in accordance with section 1123(b) of the Bankruptcy Code, the Plan Agent or the trustee of any trust created pursuant to the Indenture Trustee Plan, on behalf of the Post-Confirmation Debtor, will retain and may enforce, sue on, settle, or compromise (or decline to do any of the foregoing) all claims, rights or causes of action, suits, and proceedings, whether in law or in equity, whether known or unknown, that the Debtor or the Estate may hold against any Person. The Plan Agent or the trustee of any trust created pursuant to the Indenture Trustee Plan or their successor(s), on behalf of the Post-Confirmation Debtor, may pursue the retained claims, rights or causes of action, suits, or

proceedings as appropriate, in accordance with the best interests of the Post-Confirmation Debtor or its successor(s) who hold the rights.

(i) **Injunction Against Enforcement of Pre-Confirmation Debt and Discharge**

As of the Confirmation Date, except as provided in the Confirmation Order, all entities shall be precluded from asserting against the Post-Confirmation Debtor, its Estate, or the Plan Agent or its employees or agents, and the Plan Agent in its role as officer and director or in any other capacity of the Post-Confirmation Debtor, any claims, debts, rights, causes of action, liabilities, or equity interests relating to the Debtor or Post-Confirmation Debtor based upon any act, omission, transaction, or other activity of any nature that occurred prior to the Effective Date.

As of the Confirmation Date, the Plan Agent shall assume control over the Post-Confirmation Debtor, and, unless and until all Allowed Claims of classes senior in priority to Class 7 have been paid in full, any affiliate of the Debtor and any holder of Interests in the Debtor (i) shall be enjoined from exercising any control over or interest in the Post-Confirmation Debtor or its assets, and (ii) shall cooperate with, take no action that would be adverse to, and take such as actions as are directed by the Plan Agent to transfer Timber Permits to buyers of the Estate Property.

The Post-Confirmation Debtor will not be liable to any Claimholder or Interestholder, or other party with respect to any action, forbearance from action, decision, or exercise of discretion taken prior to the Effective Date in connection with the operation of the Post-Confirmation Debtor. On the Confirmation Date, all existing contractual obligations of the Debtor to indemnify the directors, officers and employees shall cease and no longer be an obligation of the Post-Confirmation Debtor. Notwithstanding any other provision of the Indenture Trustee Plan, no Claimholder or Interestholder, or other party-in-interest, nor their respective agents, employees, representatives, financial advisors, attorneys or affiliates, and no successors or assigns of the foregoing, shall have any claim, cause of action, or other legal or equitable right against the Debtor or the Post-Confirmation Debtor or their employees or agents, the Plan Agent, the professionals retained in the Debtor's chapter 11 case, advisors, attorneys, business consultants, representatives, financial advisors, or agents and any of such parties' successors and assigns, for any good faith solicitation of the Indenture Trustee Plan in accordance with section 1125(e) of the Bankruptcy Code or for good faith participation in the offer, issuance, sale or purchase of a security, offered or sold under the Indenture Trustee Plan in accordance with section 1125(e) of the Bankruptcy Code in connection with, relating to, or arising out of the Debtor's chapter 11 case, the pursuit of confirmation of the Indenture Trustee Plan, the consummation of the Indenture Trustee Plan, the administration of the Indenture Trustee Plan or the property to be distributed under the Indenture Trustee Plan, except for their willful misconduct. In all instances, the above-referenced parties shall be and have been entitled to reasonably rely on the advice of counsel with respect to their duties and responsibilities in connection with the Debtor's chapter 11 case and under the Indenture Trustee Plan.

**7.4 Recommendation of the Indenture Trustee.**

The Indenture Trustee believes that the Indenture Trustee Plan is feasible and will provide each holder of an Allowed Claim against the Debtor with an opportunity to receive greater benefits than those that would be received under the terms of the MRC/Marathon Plan, the Scopac Alternative Plan, or by termination of the Debtor's business and the liquidation of its assets by a chapter 7 trustee. The Indenture Trustee, therefore, urges interested parties to vote in favor of the Indenture Trustee Plan for Scopac.

**SECTION 8.  
THE DEBTORS PLAN AND ALTERNATIVE PLANS**

*The text of this section of the Joint Disclosure Statement has been prepared by the Debtors with reference to the Debtors Plan, the Palco Alternative Plan and the Scopac Alternative Plan. All statements and representations herein are the sole responsibility of the Debtors. The other Plan Proponents do not necessarily agree or disagree with any of the statements or representations herein, and expressly reserve all rights to contest any such statements or representations, if appropriate.*

*The defined terms used in this section have the meanings set forth in the Debtors Plan.*

## **8.1 Background to the Debtors Plan.**

A decade ago, the Debtors incurred a substantial portion of their secured debt with the expectation that the Headwaters Agreement would result in assured harvest levels. That expectation was thwarted by California's breach of the Headwaters Agreement. In filing these chapter 11 cases and proposing the Debtors Plan (and the Alternative Plans), the Debtors realized that business as usual would not solve this dilemma for the Debtors or for their creditors. The Debtors needed to find a way simultaneously to address the environmental and regulatory challenges and unlock trapped values in their embattled timberlands.

These bankruptcy cases have been pending for roughly a year. During that time, the Debtors have worked to stabilize their businesses, to resolve disputes over contested or unliquidated claims filed against their estates, and at all times to advance the goal of confirming a chapter 11 plan that would maximize values for all parties in interest. A critical part of the latter process involved consulting with the Debtors' financial advisors and valuation experts to determine and to maximize the value of their assets. This analysis led the Debtors to conclude that their asset values could be maximized by putting about 29,000 acres of Scopac's commercial timberlands (the total acreage of which exceeds 210,000 acres) to a higher and better use in the context of an environmentally sensitive forest preservation and development project that will unfold over the next three to nine years (the "Preserve Project"). The Debtors are confident that, even without this Preserve Project, the total value of their assets exceeds their total liabilities.<sup>9</sup> Nevertheless, they believe that, by distancing the most environmentally sensitive areas from the Debtors' timber harvest operations, the Preserve Project will assist them in resolving certain environmental and regulatory issues that have challenged their timber harvest programs for many years, and that it will unlock enormous values now trapped in certain unique tracts of those timberlands.

The parties in interest in this case differ sharply in their assessment of the value of the Debtors' assets. Their estimates of the value of Scopac's timberlands alone vary from a low of \$375 million (creditors' estimate) to \$1.4 billion (Debtors' estimate). Nowhere is the disagreement sharper than in the valuation of the proposed Preserve Project, though the divergence of views of the valuation even of the core commercial timberlands also is significant. What is more, regardless of the valuation of the Debtors' assets, the challenge facing any proponent of a reorganization plan in this case is the disparity between the long-term value of the assets and the near-term constraints on cash-flow. These constraints have resulted from at least three causes. First, the Debtors' operations are subject to severe regulatory pressure, which is being addressed in numerous pending lawsuits in non-bankruptcy forums that, realistically, cannot be concluded before a chapter 11 plan is confirmed. Second, operating in chapter 11 subjects a business to inherent disadvantages, including, for instance, the extraordinary administrative costs of bankruptcy litigation. In this case, the Debtors' estates have shouldered the burden not only of their own counsel and advisors but those of three different secured lenders, which has placed an enormous burden on cash-flow for the last year. Third, market pressures have impaired the near-term prices available for the Debtors' timber products at a time when the volume of production is impaired by regulatory obstacles.

The Debtors proposed a plan in September 2007 that met with significant resistance from creditors. One of the most contentious issues was the original plan's preservation of all of the equity interests of the Debtors, a logical outgrowth of the Debtors' informed belief that their assets were worth significantly more than their liabilities. At the same time, disputes erupted over the level of projected cash-flow available to service the full amount of the Scopac secured debt. Another source of contention was the size of the resulting exit financing required to fund debt service during the three-to-nine-year roll-out of the Preserve Project, and the resulting need to transfer of certain

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<sup>9</sup> Scopac's operating timberlands are worth approximately \$950 million by themselves, while the Palco Debtors' assets add another \$170 million in value. The appraised value of the Debtors' current operations, therefore, exceeds \$1.1 billion, which exceeds the Debtors' estimated aggregate liabilities, without placing any value on new developments, strategic sales, or litigation assets. For instance, although the proposed development project will increase the appraised value of the Debtors' assets by another \$450 million (after taking into account the removal of the Preserve Project from the commercial timberlands, thereby reducing the value of the remaining commercial timberlands from (\$950 million to \$850 million while adding \$550 million in present value attributable to the Preserve Project), the Plan does not depend for its feasibility on the successful completion of this development project. Nor does the Plan depend for its feasibility on the successful conclusion of the pending litigation being pursued by the Debtors against the State of California and others.

values from Scopac to its parent, Palco. In the Debtors Plan, therefore, the Debtors have reduced the level of exit financing, eliminated the inter-Debtor transfer, and converted significant portions of their secured debt to equity. This conversion achieves several objectives. First, it addresses the Debtors' need to de-leverage their capital structure to a level clearly serviceable from projected operating profits. Second, it dilutes existing equity interests, giving creditors significant influence over operating decisions and proposing a compromise or consensual approach to valuation disputes. Third, it offers secured lenders an opportunity to participate in enormous upside upon the successful conclusion of the Preserve Project, as well as the upside from the Debtors' pending litigation claims arising out of their regulatory disputes.

The Debtors believe that the Debtors Plan provides for the payment in full of all claims. At the same time, the structure of the Debtors Plan addresses the creditors' different views on valuation by permitting them to dilute existing equity and participate in a potentially enormous upside.

## **8.2 Structure of the Debtors Plan.**

From an operational perspective, the Debtors Plan contemplates a new business model for continued operation of the Scotia sawmill and continued forestry operations, but at harvest levels that are significantly lower than current or historical rates. All of the assets and businesses of the Palco Debtors will be merged into a single consolidated enterprise, which is referred to herein as Reorganized Palco. Scopac's assets and business will not be contributed to Reorganized Palco, but instead will emerge from bankruptcy as Reorganized Scopac. The existing liens of the Debtors' current creditors will continue to apply to their existing collateral. The new operating paradigm and capital structure will provide sufficient cash flow to meet the current and future debt obligations of the Reorganized Debtors.

The Reorganized Debtors will continue their commitment to being leaders in environmental stewardship and premier suppliers of quality, green-certified redwood and other forest products to worldwide markets. The Debtors Plan will be implemented in a manner that is consistent with all applicable environmental and regulatory requirements, including without limitation, the elements, terms, conditions and requirements of all applicable environmental permits, plans, approvals, restrictions, and covenants.

### **(a) The Preserve Project.**

A key element of the Debtors Plan is the Debtors' proposed Preserve Project, which arises out of the unique qualities of certain of its assets. The Timberlands consist of two components. The first is approximately 210,000 acres of commercially operated timberlands that historically have generated the bulk of the Debtors' cash flows. The second component consists of six groves totaling approximately 6,600 acres, which contain ancient redwood trees. Because these groves contain substantial amounts of old-growth redwood trees, they are habitat well suited for seasonal use by the marbled murrelet, a coastal seabird, and have been designated as "marbled murrelet conservation areas" or "MMCA's." (These areas are distinct from the Headwaters Forest, an area that was sold to the State of California and the United States in 1999 pursuant to the Headwaters Agreement and is now operated as a public preserve by the U.S. Bureau of Land Management.) The six groves, which are referred to herein as the Ancient Redwood Groves, are subject to extraordinary environmental restrictions and contain the bulk of the last remaining old-growth redwood trees on the Timberlands. Under the Debtors Plan, these most environmentally sensitive of all the areas contained within the Timberlands will become permanent preserves upon their sale to a buyer or buyers willing to commit to the permanent environmental protection of these unique and scarce resources.

The Debtors expect the sale of the Ancient Redwood Groves as preserves to yield a present value of \$300 million. In addition, the Debtors have engaged the services of valuation and marketing experts to explore and formulate other post-confirmation options that will generate additional liquidity. These options include an integrated real estate and forest management project comprising approximately 22,000 acres overall. This project would incorporate, on a very limited portion of the project area, a carefully designed master-planned development designed to meet perceived public needs for a range of development density, type and function, open space dedication, recreational facilities, focused near existing urban, municipal, or township boundaries for efficient use and delivery of public services (the "Redwood Preserve Development"). The Debtors estimate that such an environmentally sensitive forest preservation and development project will yield a present value of another \$250 million (net of the effect of removal of this acreage from the Commercial Timberlands), while leaving the Debtors

with at least 181,000 acres of commercial timberlands valued at \$850 million. The expected combined proceeds of \$550 million (present value) from the sale of the Ancient Redwood Groves and the Redwood Preserve Development (which together comprise the Preserve Project) will be allocated 85% to redeem the new preferred stock to be issued to Scopac's secured noteholders, up to a maximum of \$375 million, and 15% to retire the Scopac Exit Facility and to supply liquidity needs. Any excess will be retained by the reorganized Scopac, subject (in the discretion of the new Scopac Board) to a potential transfer to holders of common stock as a dividend, subject to preferred stock prior redemption rights.

**(b) The Debtors Plan Issues a Combination of Debt and Equity Securities to Secured Creditors with a Value Equal to the Full Outstanding Debt Amount.**

Palco's secured debt consists of the \$88 million Palco Term Loan (including accrued interest thereon) and the \$75 million DIP Facility, both of which are held by Marathon. The Palco Term Loan and the DIP Facility are both secured by perfected and first priority liens, mortgages, and security interests in substantially all of the assets of the Palco Debtors (i.e., all of the Debtors except Scopac) other than Palco's equity interest in Scopac. In full satisfaction of the existing \$85 million Palco Term Loan, Marathon will receive a transfer of title to assets consisting of the town of Scotia, California, and certain idle mill sites in the nearby communities of Carlota, Fortuna, and Britt with a combined appraised value of over \$100 million (together, the "Palco Town Assets"), and 17.7% of the New Palco Common Stock. In full satisfaction of the DIP Facility, Marathon will receive 45.7% of the New Palco Common Stock.

Scopac's largest group of secured claims is the Prepetition Timber Notes, for which The Bank of New York Trust Company, N.A., serves as Indenture Trustee. Scopac also had a secured Line of Credit administered by Bank of America, N.A., which could be drawn to pay interest on the Prepetition Timber Notes. At the end of 2006, there was \$713.8 million principal outstanding on the Prepetition Timber Notes and \$36.2 million principal outstanding on the Scopac Line of Credit. Scopac's obligations under both of these are secured by a jointly held senior lien on substantially all of Scopac's assets. The Scopac Line of Credit will be fully paid in cash on the Effective Date. Holders of the secured Prepetition Timber Notes will receive (i) 100% of a new class of preferred stock in Scopac with a liquidation preference of \$375 million (the "New Scopac Preferred Stock"); (ii) 49% of the common stock of reorganized Scopac (the "New Scopac Common Stock"); and (iii) 10-year notes with an aggregate principal amount of \$225 million, which will be secured by a lien on all of Reorganized Scopac's assets (the "New Timber Notes").

The ten-year term of the New Timber Notes represents a significant acceleration of the stated maturity date of the Prepetition Timber Notes, which was 2028. The notes will provide for semi-annual cash payments of interest at 7.5% and a bullet payment at maturity. Eighty-five percent of the net proceeds resulting from the sale of the Preserve Project will be used to redeem the New Scopac Preferred Stock (with the remaining fifteen percent of net proceeds being available to retire the Scopac Exit Facility or retained for working capital and other liquidity needs).

**(c) The Debtors Plan Pays Unsecured Debt in Full.**

The Debtors Plan provides that all of the allowed unsecured claims against the Debtors will be paid in full over a eleven-year period. Unsecured creditors of both the Palco Debtors and Scopac will receive semi-annual interest payments at 8.25% per year, over seven years, with a bullet payment at maturity, while claims between the Palco Debtors and Scopac will be paid over eleven years with interest.

**(d) The Debtors Plan Calls for Reduced Exit Financing.**

The Debtors Plan provides for Palco to obtain exit financing in the form of a new revolving credit facility in the amount of \$40 million (the "Palco Exit Facility"), of which \$21.2 million is projected to be drawn on the effective date of the Debtors Plan. This \$21.2 million draw, in addition to the \$10 million equity contribution to be made by MAXXAM (see below), will fund \$8 million in administrative priority claims, \$5.7 million in other priority claims and transaction costs at consummation, including payments to the "convenience class," and \$17.5 million to fund the acquisition of inventory. The Palco Exit Facility will be secured by the Scotia Mill (including associated working capital) and the Palco power plant.

Scopac will obtain a new revolving credit facility in the amount of \$50 million (the “Scopac Exit Facility”), to be secured by a first-priority lien on the Commercial Timberlands. Of the total \$50 million availability, approximately \$18 million is projected to be drawn on the Effective Date to fund the payment of approximately \$10 million in administrative priority claims and \$8 million in other claims (including a “convenience class”) and transaction costs payable at consummation. No portion of the Scopac Exit Facility will be used to satisfy obligations of the Palco Debtors.

(e) **MAXXAM Will Make Important Economic Contributions to the Debtors Plan.**

MAXXAM is the indirect owner of MGI, which owns all of the equity in Palco, which in turn owns all of the equity of the other Debtors, including Scopac. As a proponent of the Debtors Plan, MAXXAM will provide the following important economic contributions to the Debtors by:

- (i) contributing \$10 million of capital to Palco on the effective date;
- (ii) contributing an additional \$6-12 million of liquidity to Palco (in addition to the \$6 million already provided) throughout the remainder of the case through redwood log and/or redwood lumber purchases with MAXXAM (either directly or indirectly);
- (iii) using its best efforts to assist the Reorganized Debtors in obtaining their Exit Financing;
- (iv) assisting the Reorganized Debtors in “unlocking” the market value of the Preserve Project;
- (v) forgiving \$40 million of intercompany indebtedness; and
- (vi) consenting to the dilution of its indirect equity in both Palco and Scopac.

In addition, MAXXAM's consolidated U.S. federal income group will currently recognize approximately \$330 million of built-in gains inherent in the Debtors' assets pursuant to the tax structure contemplated by (and reflected in the financial projections underlying) the Debtors Plan. This will provide approximately \$330 million of U.S. federal income tax basis step-up in the assets of the Reorganized Debtors and will therefore benefit Creditors that receive equity in the Reorganized Debtors (which, as noted in the financial projections, are expected to be treated as partnerships for U.S. federal income tax purposes). Although other structures were considered that would not have yielded the same tax benefit to the Reorganized Debtors (and Creditors that receive equity in the Reorganized Debtors), MAXXAM, as a proponent of the Debtors Plan is prepared to currently recognize the built-in gains that yield the asset basis step-up to the Reorganized Debtors.

(f) **The Debtors Plan Obligates the Debtors and Reorganized Debtors to Comply with and Perform all Environmental Obligations.**

The Debtors Plan contemplates the sale of the Ancient Redwood Groves and the pursuit of the Redwood Preserve Development, all in accordance with and in compliance with applicable non-bankruptcy law requirements, terms, conditions, permits, plans, approvals, restrictions and covenants. In other words, the Debtors and Reorganized Debtors will implement the Debtors Plan, including the Preserve Project, by obtaining all non-bankruptcy law approvals and permits for the transactions contemplated by the Debtors Plan as if no bankruptcy case had been filed. Moreover, the Debtors and Reorganized Debtors will satisfy, complete, perform, and comply with all Environmental Obligations as if no chapter 11 bankruptcy cases had been filed. Thus, the Debtors' bankruptcy cases will have no effect on the existing environmental and regulatory authority and scheme.

(g) **Summation.**

The Debtors urge all creditors to vote to accept the Debtors Plan.

### **8.3 Structure of the Alternative Plans.**

The Debtors believe that the Debtors Plan is the only plan that will provide for all constituencies in these cases to receive the full value of their Claims and Interests. Nevertheless, the Debtors Plan cannot be imposed on the Debtors' creditors, because it does not meet the standards for "cramdown" under the Bankruptcy Code. Accordingly, because there can be no guarantee that the necessary consents will be obtained to permit confirmation of the Debtors Plan, both Palco and Scopac have proposed alternative stand-alone plans that they believe can be confirmed over the dissent of their primary secured lenders.

The Alternative Plans will be presented to the Bankruptcy Court for confirmation only if the Debtors Plan cannot be confirmed. If the Debtors Plan is not confirmed, the Debtors will proceed with the Alternative Plans. If the Palco Alternative Plan is not confirmed, Scopac will proceed alone with the Scopac Alternative Plan. If neither the Debtors Plan nor the Alternative Plans are confirmed, the Debtors believe that the most likely result is that they will be forced to liquidate under chapter 7 of the Bankruptcy Code. In either event, the Debtors believe that the Holders of Allowed Claims and Interests would realize a less favorable distribution of value, or, in certain cases, nothing at all, for their Claims and Interests, than could have been achieved under the Debtors Plan. See the Liquidation Analysis attached to this Joint Disclosure Statement as Exhibit E.

#### **(a) The Scopac Alternative Plan Satisfies the Scopac Noteholders with a Transfer of the Commercial Timberlands.**

Under the Scopac Alternative Plan, the Timber Noteholders will receive title to that portion of Scopac's Timberlands that is not included in the Preserve Project (the "Commercial Timberlands") in full satisfaction of the Timber Notes. The Commercial Timberlands will be transferred subject to a log purchase agreement under which Palco will have the right to purchase specified quantities of harvested timber for three years at market prices to be determined at the time of sale and on commercially reasonable terms (the "Postconfirmation Log Purchase Agreement"). The Timber Noteholders' liens on all assets other than the Commercial Timberlands will be extinguished. Scopac believes that the value of the assets transferred to the Timber Noteholders is at least \$850 million and therefore sufficient to extinguish their claim.

#### **(b) Scopac's Other Creditors Will Be Paid in Full.**

The mechanism for satisfying Claims under the Scopac Alternative Plan varies depending on whether the Palco Alternative Plan is confirmed. If so, then Palco and Scopac will cooperate (with the assistance of MAXXAM on a best-efforts basis) in obtaining an exit financing that will be secured by a combination of Palco's remaining assets and a first-priority lien on the Preserve Project. The proceeds of Scopac's \$18 million portion of this Exit Financing will secure obligations to pay Scopac's remaining creditors in Cash on the Effective Date, or (in the case of general unsecured creditors) within six months of the Effective Date. In this scenario, the total exit facility will be in the projected amount of \$110 million. Palco's \$92 million portion of this facility will be used to satisfy the \$75 million Marathon DIP and \$17 million to fund other Cash payments required under the Palco Alternative Plan and to fund working capital needs. All remaining Claims against Scopac will be paid in full. General Unsecured Claims will be paid within six months of the Effective Date. Bank of America will receive a cash payment of \$20 million on the Effective Date and the remainder of its Claim (approximately \$19 million), secured by the Preserve Project, payable with interest at 8.25% per annum six months after the Effective Date.

If the Palco Alternative Plan is not confirmed, then Scopac will not enter into an exit financing, but all remaining Claims against Scopac nevertheless will be paid in full. General Unsecured Claims will be paid within six months of the Effective Date. Bank of America will receive a cash payment of \$20 million on the Effective Date and the remainder of its Claim (approximately \$19 million), secured by the Preserve Project, payable with interest at 8.25% per annum six months after the Effective Date. All other claims will be satisfied with Scopac's available cash assets.

Upon the satisfaction in full of all Claims against Scopac, its remaining assets, including its litigation claims against third parties, such as the Headwaters Litigation, will revert in Scopac free and clear of Claims other than the remaining secured obligation to BofA and the obligation to pay certain unsecured claims under the Scopac Alternative Plan over a period of six months.

Scopac believes that the stand-alone Scopac Alternative Plan can be confirmed regardless of whether the Palco Alternative Plan is confirmed. In contrast, the Palco Alternative Plan, which depends on the preservation of a portion of Palco's equity in Scopac via a successful confirmation of the Scopac Alternative Plan, can be confirmed only if the Scopac Alternative Plan, or its economic equivalent, also is confirmed. .

(c) **The Palco Alternative Plan Satisfies the \$88 Million Marathon Term Loan with a Transfer of Town Assets.**

Under the Palco Alternative Plan, Marathon will receive title to the Palco Town Assets and the Scotia Mill in full satisfaction of the Marathon Term Loan. The Palco Town Assets have an appraised value of \$100 million. Palco projects that the actual net proceeds from the sale of the Palco Town Assets (net of certain developmental costs associated with the transformation of these assets from company-owned to private-owned) will be at least \$59 million. Based on its appraisal, Palco also believes that the going-concern value of the Scotia Mill, exclusive of inventory, is at least \$30 million. Palco therefore believes that the transfer of these assets will satisfy the Marathon Term Debt in full.

(d) **Palco's Other Creditors Will Be Paid in Full.**

As described above, Palco's portion of an Alternative Exit Facility will be used to satisfy the \$75 million Marathon DIP and \$17 million to fund other Cash payments required under the Palco Alternative Plan and to fund working capital needs. Holders of general Unsecured Claims against Palco in the estimated aggregate amount of \$11 million will be paid with interest over eleven years. The unfunded pension obligation will remain with Reorganized Palco and be repaid in the ordinary course of business as required under applicable non-bankruptcy law. MAXXAM will use its best efforts to assist Palco in obtaining this facility.

As noted above, Palco's ability to achieve the Palco Alternative Exit Facility will depend on its ability to depend on the value of its preserved equity in Scopac. Accordingly, if the Scopac Alternative Plan is not confirmed, Palco will be unable to confirm the Palco Alternative Plan and none of the payments described in the paragraph above will be achieved. .

(e) **Summation.**

The Palco Debtors urge their creditors to vote to accept the Palco Alternative Plan. Scopac urges its creditors to vote to accept the Scopac Alternative Plan.

*The position of the Debtors with respect to the competing plans of reorganization proposed by MRC/Marathon and the Indenture Trustee is set forth in the attached Exhibit C-5.*

#### **8.4 Summary Description of Classes and Distributions Under the Debtors Plan.**

The Debtors Plan *does not* substantively consolidate Scopac with the Palco Debtors for purposes of voting or Confirmation. However, the Debtors Plan does substantively consolidate the Palco Debtors with one another for the purposes of Confirmation, leaving Scopac as a separate entity.

If the Bankruptcy Court authorizes the Debtors to substantively consolidate the Palco Debtors, each Class of Claims and Interests in or against each of the Palco Debtors will be treated as a Claim or Interest in or against a single consolidated Estate, without regard to the separate identification of the Palco Debtors. If the Bankruptcy Court authorizes the Debtors to substantively consolidate fewer than all of the Palco Debtors, the Debtors may, among other options, proceed with separate classifications for any such non-consolidated Palco Debtor. If the Debtors elect to proceed with separate classifications for any such non-consolidated Palco Debtor, each Class of Claims and Interests will be treated as against each individual non-consolidated Palco Debtor for voting and distribution purposes. To provide for such an event, the Debtors Plan divides each Class of Claims and Interests of the Palco Debtors into five subclasses; one for each of the Palco Debtors as set forth below.



PL – The Pacific Lumber Company  
 BL – Britt Lumber Co., Inc.  
 SC – Salmon Creek LLC  
 SD – Scotia Development LLC  
 SI – Scotia Inn Inc.

For example, Class 1 – “Palco Other Priority Claims” -- can be divided into five sub-classes for voting purposes: Class 1-PL, Class 1-BL . . . through Class 1-SI. Class 1-PL relates to Other Priority Claims asserted against Palco, Class 1-BL relates to Other Priority Claims asserted against Britt, and so on. In some situations a particular Palco Debtor may not have any claims asserted against it in a particular Class.

The classification of Claims and Interests, the estimated aggregate amount of Claims in each Class and the amount and nature of distributions to Holders of Claims or Interests in each Class are summarized in the table below. **Please refer to the Debtors Plan for the details relevant to classification of, and distributions to, holders of Claims and Interests.**

No representation can be made that the information below is without inaccuracy. Moreover, such information is subject to the uncertainties of litigation with respect to many of the Claims and other factors that may not be resolved in the Debtors' favor. Therefore, no assurance can be given that the estimated Claims are exact or that the estimated recoveries will be achieved. .

(a) **Unclassified Claims Under Debtors Plan**

In accordance with section 1123(a)(1) of the Bankruptcy Code, Administrative Expense Claims and Priority Tax Claims have not been classified under the Debtors Plan.

Description and Estimate of Claims	Description of Distributions or Treatment Under Debtors Plan	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Administrative Expense Claims	<p>Allowed Professional Compensation Claims for Professionals employed pursuant to the Bankruptcy Code will be paid pursuant to applicable orders of the Bankruptcy Court.</p> <p>Allowed Administrative Expense Claims resulting from (a) postpetition liabilities incurred in the ordinary course of business by a Debtor or (b) postpetition contractual liabilities arising as a result of loans and advances (whether or not incurred in the ordinary course) will be paid in accordance with the terms of the underlying transactions.</p> <p>All other Allowed Administrative Expense Claims will be paid in Cash on the later of (a) the Effective Date, or (b) the date of Allowance, unless the Holder agrees to other, lesser treatment.</p>	<p>PL – \$8 million</p> <p>BL – \$0</p> <p>SC – \$0</p> <p>SD – \$0</p> <p>SI – \$0</p> <p>Scopac – \$10 million</p> <p><b>total: \$18 million</b></p>	100%
Priority Tax Claims	<p>On the Distribution Date, Holders of Allowed Priority Tax Claims will receive Cash in the amount of such Allowed Claim (excluding interest).</p>	<p>PL – \$25,000</p> <p>BL – \$1,000</p> <p>SC – \$0</p> <p>SD – \$0</p>	100%

Description and Estimate of Claims	Description of Distributions or Treatment Under Debtors Plan	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
		SI – \$6,000 Scopac – <u>\$507,000</u> <b>total: \$539,000</b>	

(b) **Classified Claims and Interests for the Palco Debtors Under Debtors Plan**

The following Claims and Interests for the Palco Debtors have been classified under the Debtors Plan:

Description of Claims	Description of Distributions or Treatment Under Debtors Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 1: Palco Other Priority Claims	On the Distribution Date, each Holder of an Allowed Palco Other Priority Claim will receive:  i. payment of Cash in full, plus Postpetition Interest; or  ii. such other, lesser treatment as the Palco Debtors and the Holder may agree to in writing.	<b>Unimpaired</b>  Deemed to Accept the Debtors Plan  Not Entitled to Vote	PL – \$884,000 BL – \$4,000 SC – \$0 SD – \$0 <u>SI – \$0</u> <b>total: \$605,000 to \$1,010,000</b>	100%
Palco Class 2: Palco Secured Tax Claims	On the Distribution Date, each Holder of an Allowed Palco Secured Tax Claim will be paid in full through two equal installments of principal and simple interest accruing from the Petition Date, the rate of which will be determined under applicable non-bankruptcy law. The first installment will be paid six months after the Effective Date and the second installment will be paid on the first anniversary of the Effective Date.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Debtors Plan	PL – \$0 BL – \$0 SC – \$0 SD – \$0 <u>SI – \$0</u> <b>total: \$0<sup>10</sup></b>	100%

<sup>10</sup> The County of Humboldt, California asserts a Secured Tax Claim in the approximate amount of \$1,287,120. If Allowed, such Claim shall receive the treatment provided for Holders of Allowed Palco Secured Tax Claims under the Debtors Plan.

Description of Claims	Description of Distributions or Treatment Under Debtors Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 3: Palco Term Loan Claims	On the Distribution Date, the Holder of the Palco Term Loan Claim will receive the Palco Town Assets and 17.7% of the New Palco Common Stock.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Debtors Plan	PL – \$87.1 million  BL – \$87.1 million  SC – \$87.1 million  SD – \$87.1 million  SI – <u>\$87.1 million</u>  <b>total: \$87.1 million<sup>11</sup></b>	100%
Palco Class 4: Palco General Unsecured Claims	Each Holder of an Allowed Palco General Unsecured Claim will be paid in full over a seven-year period as follows:  i. semi-annual Cash interest payments at 8.25%; and  ii. a bullet at maturity.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Debtors Plan	PL– \$10.1 million  BL – \$164,000  SC – \$0  SD – \$180,000  SI – <u>\$0</u>  <b>total: \$10.4 million</b>	100%
Palco Class 5: Palco Inter-Debtor Claims	On the Effective Date, Palco Inter-Debtor Claims will be satisfied in full by operation of law upon consummation of the post-confirmation merger of the Palco Debtors.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Debtors Plan	N/A	100%

<sup>11</sup> The Palco Debtors are each liable for the Palco Term Loan.

Description of Claims	Description of Distributions or Treatment Under Debtors Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 6: Scopac Claims	On the Effective Date, Allowed Scopac Claims will be released.	<b>Impaired</b> Entitled to Vote to Accept or Reject the Debtors Plan	PL – \$0 BL – \$0 SC – \$0 SD – \$0 SI – <u>\$0</u> <b>total: \$0</b>	100%
Palco Class 7: Palco Non-Debtor Affiliate Claims	On the Effective Date, Allowed Palco Non-Debtor Affiliate Claims will be released.	<b>Impaired</b> Entitled to Vote to Accept or Reject the Debtors Plan	PL – \$40.7 million BL – \$692,000 SC – \$0 SD – \$190,000 SI – <u>\$0</u> <b>total: \$41.6 million</b>	100%
Palco Class 8: Palco Convenience Class Claims	On the Distribution Date, each Holder of an Allowed Palco Convenience Class Claim will receive Cash equal to the lesser of (a) the Allowed Amount of the Claim (excluding any interest) or (b) \$10,000.	<b>Impaired</b> Entitled to Vote to Accept or Reject the Debtors Plan	PL – \$27,000 BL – \$3,320 SC – \$0 SD – \$500 SI – <u>\$0</u> <b>total: \$30,820</b>	100%

Description of Claims	Description of Distributions or Treatment Under Debtors Plan	Status/Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 9: Palco Debtors Interests	The Holders of Interests in the Palco Debtors will receive 36.6% of the New Palco Common Stock.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Debtors Plan	N/A	100%

(c) **Classified Claims and Interests for Scopac Under Debtors Plan**

The following Claims and Interests for Scopac have been classified under the Debtors Plan:

Description of Claims	Description of Distributions or Treatment Under Debtors Plan	Status/Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Scopac Class 1: Scopac Other Priority Claims	On the Distribution Date, each Holder of an Allowed Scopac Other Priority Claim will receive: <ul style="list-style-type: none"> <li>i. payment of Cash in full, plus Postpetition Interest; or</li> <li>ii. such other, lesser treatment as Scopac and the Holder may agree to in writing.</li> </ul>	<b>Unimpaired</b>  Deemed to Accept the Debtors Plan  Not Entitled to Vote	\$96,000	100%
Scopac Class 2: Scopac Secured Tax Claims	On the Distribution Date, each Holder of an Allowed Scopac Secured Tax Claim will be paid in full through two equal installments of principal and simple interest accruing from the Petition Date, the rate of which will be determined under applicable non-bankruptcy law. The first installment will be paid six months after the Effective Date and the second installment will be paid on the first anniversary of the Effective Date.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Debtors Plan	\$28,000	100%
Scopac Class 3: Scopac Timber Noteholder Claims	On the Distribution Date, Reorganized Scopac will issue to the Prepetition Indenture Trustee (i) the ten-year New Timber Notes, with a principal balance of \$225 million, bearing interest at 7.5% per annum, paid in Cash semiannually, with a bullet at maturity, secured by the same collateral as the old Timber Notes; (ii) non-voting New Scopac Preferred Stock with a liquidation preference of \$375 million and no rights to receive dividends; and (iii) 49% of the New Scopac Common Stock. Of the proceeds of any sale	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Debtors Plan	\$788 million	100%

Description of Claims	Description of Distributions or Treatment Under Debtors Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
	of the Preserve Project, 85% will be applied to redeem the New Scopac Preferred Stock.			
Scopac Class 4: Scopac Line of Credit Claims	<p>On the Distribution Date, each Holder of an Allowed Scopac Line of Credit Claim will receive:</p> <ul style="list-style-type: none"> <li>i. full Cash payment, plus any accrued but unpaid interest at the applicable non-default interest rate under the Scopac Line of Credit Agreement; or</li> <li>ii. such other, lesser treatment as Scopac and the Holder may agree to in writing.</li> </ul>	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the Debtors Plan</p>	\$37.6 million	100%
Scopac Class 5: Scopac General Unsecured Claims	<p>Each Holder of an Allowed Scopac General Unsecured Claim will be paid in full over a seven-year period as follows:</p> <ul style="list-style-type: none"> <li>i. semi-annual Cash interest payments at 8.25%; and</li> <li>ii. a bullet at maturity.</li> </ul>	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the Debtors Plan</p>	\$362,000	100%
Scopac Class 6: Palco Debtor Claims	Palco Debtor Claims will be released on the Effective Date.	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the Debtors Plan</p>	\$1.2 million	100%
Scopac Class 7: Scopac Non-Debtor Affiliate Claims	On the Effective Date, Allowed Scopac Non-Debtor Affiliate Claims will be released.	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the Debtors Plan</p>	\$807,000	N/A

Description of Claims	Description of Distributions or Treatment Under Debtors Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Scopac Class 8: Scopac Convenience Class Claims	On the Distribution Date, each Holder of an Allowed Scopac Convenience Class Claim will receive Cash equal to the lesser of (a) the full amount of the Claim (excluding any interest) or (b) \$10,000.	<b>Impaired</b> Entitled to Vote to Accept or Reject the Debtors Plan	\$700	100%
Scopac Class 9: Scopac Interests	The Holders of Interests in Scopac will receive 51% of the New Scopac Common Stock.	<b>Impaired</b> Entitled to Vote to Accept or Reject the Debtors Plan	N/A	100%

**8.5 Summary Description of Classes and Distributions Under the Alternative Plans.**

The classification of Claims and Interests, the estimated aggregate amount of Claims in each Class, and the amount and nature of distributions to Holders of Claims or Interests in each Class under the Palco Alternative Plan and the Scopac Alternative Plan are summarized in the table below. **Please refer to the Alternative Plans for the details relevant to classification of, and distributions to, holders of Claims and Interests.**

In accordance with section 1123(a)(1) of the Bankruptcy Code, Administrative Expense Claims and Priority Tax Claims have not been classified.

**(a) Unclassified Claims Under Palco Alternative Plan**

In accordance with section 1123(a)(1) of the Bankruptcy Code, Administrative Expense Claims and Priority Tax Claims against Palco have not been classified under the Palco Alternative Plan. In addition, Claims arising under Palco's pre-petition pension and workers' compensation plans and programs have not been classified, but these obligations will be paid in the ordinary course of business.

Description and Estimate of Claims	Description of Distributions or Treatment Under Palco Alternative Plan	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Administrative Expense Claims	Allowed Professional Compensation Claims for Professionals employed pursuant to the Bankruptcy Code will be paid pursuant to applicable orders of the Bankruptcy Court.  Allowed Administrative Expense Claims resulting from (a) postpetition liabilities incurred in the ordinary course of business by a Debtor or (b) postpetition contractual liabilities arising as a result of loans and advances (whether or not incurred in the ordinary course) will be paid in accordance with the terms of the underlying	PL – \$884,000  BL – \$4,000  SC – \$0  SD – \$0  <u>SI – \$0</u>	100%

Description and Estimate of Claims	Description of Distributions or Treatment Under Palco Alternative Plan	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
	<p>transactions.</p> <p>All other Allowed Administrative Expense Claims will be paid in Cash on the later of (a) the Effective Date, or (b) the date of Allowance, unless the Holder agrees to other, lesser treatment.</p>	<b>total: \$605,000 to \$1,010,000</b>	
Priority Tax Claims	On the Distribution Date, Holders of Allowed Priority Tax Claims will receive Cash in the amount of such Allowed Claim (excluding interest).	PL – \$25,000 BL – \$1,000 SC – \$0 SD – \$0 SI – \$6,000 <b>total: \$532,000</b>	100%

(b) **Classified Claims and Interests Under Palco Alternative Plan.**

The following Claims and Interests have been classified under the Palco Alternative Plan:

Description of Claims	Description of Distributions or Treatment Under Palco Alternative Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 1: Palco Other Priority Claims	<p>On the Distribution Date, each Holder of an Allowed Palco Other Priority Claim will receive:</p> <p>i. payment of Cash in full, plus Postpetition Interest; or</p> <p>ii. such other, lesser treatment as Scopac and the Holder may agree to in writing.</p>	<p><b>Unimpaired</b></p> <p>Deemed to Accept the Palco Alternative Plan</p> <p>Not Entitled to Vote</p>	PL – \$884,000 BL – \$4,000 SC – \$0 SD – \$0 SI – \$0 <b>total: \$605,000 to \$1,010,000</b>	100%



Description of Claims	Description of Distributions or Treatment Under Palco Alternative Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 2: Palco Secured Tax Claims	On the Distribution Date, each Holder of an Allowed Scopac Secured Tax Claim will be paid in Cash and in Full.	<b>Unimpaired</b>  Not Entitled to Vote to Accept or Reject the Palco Alternative Plan	PL – \$0 BL – \$0 SC – \$0 SD – \$0 SI – <u>\$0</u>  <b>total: \$0<sup>12</sup></b>	100%
Palco Class 3: Term Loan Claims	On the Distribution Date, Marathon will receive title to the Palco Town Assets.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Palco Alternative Plan	PL – \$87.1 million BL – \$87.1 million SC – \$87.1 million SD – \$87.1 million SI – <u>\$87.1 million</u>  <b>total: \$87.1 million<sup>13</sup></b>	100%
Palco Class 4: Palco General Unsecured Claims	Each Holder of an Allowed Palco General Unsecured Claim will receive full Cash payment, plus simple interest at 8.25% per annum, seven years after the Effective Date.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Palco Alternative Plan	PL – \$10.1 million BL – \$164,000 SC – \$0 SD – \$180,000 SI – <u>\$0</u>  <b>Total: \$10.4 million</b>	100%

<sup>12</sup> The County of Humboldt, California asserts a Secured Tax Claim in the approximate amount of \$1,287,120. If Allowed, such Claim shall receive the treatment provided for Holders of Allowed Palco Secured Tax Claims under the Palco Alternative Plan.

<sup>13</sup> The Palco Debtors are each liable for the Palco Term Loan.

Description of Claims	Description of Distributions or Treatment Under Palco Alternative Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 5: Palco Inter-Debtor Claims	On the Effective Date, Palco Inter-Debtor Claims will be satisfied in full by operation of law upon consummation of the post-confirmation merger of the Palco Debtors.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Palco Alternative Plan	N/A	100%
Palco Class 6: Scopac Debtor Claims	Scopac Debtor Claims will be paid on the eleventh anniversary of the Effective Date with interest at 8.25% per annum.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Palco Alternative Plan	PL – \$0 BL – \$0 SC – \$0 SD – \$0 SI – <u>\$0</u>  <b>total: \$0</b>	100%
Palco Class 7: Palco Non-Debtor Affiliate Claims	On the Effective Date, Allowed Palco Non-Debtor Affiliate Claims will be released.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Palco Alternative Plan	PL – \$40.7 million BL – \$692,000 SC – \$0 SD – \$190,000 SI – <u>\$0</u>  <b>total: \$41.6 million</b>	N/A

Description of Claims	Description of Distributions or Treatment Under Palco Alternative Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Palco Class 8: Palco Convenience Class Claims	On the Distribution Date, each Holder of an Allowed Palco Convenience Class Claim will receive Cash equal to the lesser of (a) the full amount of the Claim (excluding any interest) or (b) \$10,000.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Palco Alternative Plan	PL – \$27,000  BL – \$3,320  SC – \$0  SD – \$500  SI – \$0  <b>total: \$30,820</b>	100%
Palco Class 9: Palco Interests	The Holders of Interests in Palco will retain their Interests.	<b>Unimpaired</b>  Not Entitled to Vote to Accept or Reject the Palco Alternative Plan	N/A	100%

(c) **Unclassified Claims Under Scopac Alternative Plan**

In accordance with section 1123(a)(1) of the Bankruptcy Code, Administrative Expense Claims and Priority Tax Claims have not been classified under the Scopac Alternative Plan.

Description and Estimate of Claims	Description of Distributions or Treatment Under Scopac Alternative Plan	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Scopac Administrative Expense Claims	Allowed Professional Compensation Claims for Professionals employed pursuant to the Bankruptcy Code will be paid pursuant to applicable orders of the Bankruptcy Court.  Allowed Administrative Expense Claims resulting from (a) postpetition liabilities incurred in the ordinary course of business by a Debtor or (b) postpetition contractual liabilities arising as a result of loans and advances (whether or not incurred in the ordinary course) will be paid in accordance with the terms of the underlying transactions. All other Allowed Administrative Expense Claims will be paid in Cash on the later of (a) the Effective Date, or (b) the date of Allowance, unless the Holder agrees to other, lesser treatment.	\$10 million	100%

Description and Estimate of Claims	Description of Distributions or Treatment Under Scopac Alternative Plan	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Scopac Priority Tax Claims	On the Distribution Date, Holders of Allowed Priority Tax Claims will receive Cash in the amount of such Allowed Claim (excluding interest).	\$507,000	100%

(d) **Classified Claims and Interests Under Scopac Alternative Plan**

The following Claims and Interests have been classified under the Scopac Alternative Plan:

Description of Claims	Description of Distributions or Treatment Under Scopac Alternative Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Scopac Class 1: Scopac Other Priority Claims	On the Distribution Date, each Holder of an Allowed Scopac Other Priority Claim will receive: <ul style="list-style-type: none"> <li>i. payment of Cash in full, plus Postpetition Interest; or</li> <li>ii. such other, lesser treatment as Scopac and the Holder may agree to in writing.</li> </ul>	<p><b>Unimpaired</b></p> <p>Deemed to Accept the Scopac Alternative Plan</p> <p>Not Entitled to Vote</p>	\$96,000	100%
Scopac Class 2: Scopac Secured Tax Claims	On the Distribution Date, each Holder of an Allowed Scopac Secured Tax Claim will be paid in Cash and in full.	<p><b>Unimpaired</b></p> <p>Not Entitled to Vote to Accept or Reject the Scopac Alternative Plan</p>	\$28,000 <sup>14</sup>	100%
Scopac Class 3: Scopac Timber Noteholder Claims	On the Distribution Date, the Timber Noteholders will receive title to the Scopac Commercial Timberlands, subject to the Palco Postconfirmation Log Purchase Agreement.	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the Scopac Alternative Plan</p>	\$788 million	100%

<sup>14</sup> The County of Humboldt, California asserts a Secured Tax Claim in the approximate amount of \$1,287,120. If Allowed, such Claim shall receive the treatment provided for Holders of Allowed Scopac Secured Tax Claims under the Scopac Alternative Plan.

Description of Claims	Description of Distributions or Treatment Under Scopac Alternative Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Scopac Class 4: Scopac Line of Credit Claims	<p>On the Distribution Date, if the Palco Alternative Plan has not been confirmed, each Holder of an Allowed Scopac Line of Credit Claim will receive:</p> <ul style="list-style-type: none"> <li>(i) a cash payment of \$20 million; and</li> <li>(ii) a note secured by the Preserve Project for the remaining Allowed amount of the Claim, plus any accrued but unpaid interest at the applicable non-default interest rate under the Scopac Line of Credit Agreement<sup>7</sup> payable with interest at 8.25% per annum six months after the Effective Date; or</li> <li>(iii) such other, lesser treatment as Scopac and the Holder may agree to in writing.</li> </ul> <p>On the Distribution Date, if the Palco Alternative Plan has been confirmed, each Holder of an Allowed Scopac Line of Credit Claim will receive:</p> <ul style="list-style-type: none"> <li>(i) full Cash payment, plus any accrued but unpaid interest at the applicable non-default interest rate under the Scopac Line of Credit Agreement; or</li> <li>(ii) such other, lesser treatment as Scopac and the Holder may agree to in writing.</li> </ul>	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the Scopac Alternative Plan</p>	<p>\$37.6 million</p>	<p>100%</p>
Scopac Class 5: Scopac General Unsecured Claims	<p>Holders of Allowed Scopac General Unsecured Claims will receive full payment of the Allowed Amount of their Claim, excluding interest, six months after the Effective Date, with interest at 8.25% per annum from and after the Effective Date.</p>	<p><b>Impaired</b></p> <p>Entitled to Vote to Accept or Reject the Scopac Alternative Plan</p>	<p>\$362,000</p>	<p>100%</p>

Description of Claims	Description of Distributions or Treatment Under Scopac Alternative Plan	Status/ Entitled to Vote	Estimated Aggregate Amount of Claims	Estimated Percentage Recovery
Scopac Class 6: Palco Debtor Claims	Scopac Debtor Claims will be paid on the eleventh anniversary of the Effective Date with interest at 8.25% per annum.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Scopac Alternative Plan	\$1.2 million	100%
Scopac Class 7: Scopac Non-Debtor Affiliate Claims	On the Effective Date, Allowed Scopac Non-Debtor Affiliate Claims will be released.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Scopac Alternative Plan	\$807,000	N/A
Scopac Class 8: Scopac Convenience Class Claims	On the Distribution Date, each Holder of an Allowed Scopac Convenience Class Claim will receive Cash equal to the lesser of (a) the full amount of the Claim (excluding any interest) or (b) \$10,000.	<b>Impaired</b>  Entitled to Vote to Accept or Reject the Scopac Alternative Plan	\$700	100%
Scopac Class 9: Scopac Interests	The Holders of Interests in Scopac will retain their Interests.	<b>Unimpaired</b>  Not Entitled to Vote to Accept or Reject the Scopac Alternative Plan	N/A	100%

**8.6 Means of Implementation of Debtors Plan and Alternative Plans**

*The means of implementation of the Debtors Plan and Alternative Plans are outlined in detail in the plan themselves, and are incorporated herein by reference. All parties are urged to carefully review the Debtors Plan, Palco Alternative Plan and Scopac Alternative Plan in detail before making a decision on how to vote. The following is a summary of the principal means of implementation of the Debtors Plan and Alternative Plans.*

An analysis of the Debtors' financial condition is included in exhibits to this Joint Disclosure Statement. This information is provided to permit Holders of Claims and Interests to better understand the Debtors' financial condition.

The Debtors are required to file monthly operating reports with the Bankruptcy Court. Such financial information is on file with the clerk of the Bankruptcy Court and publicly available for review on the Bankruptcy Court's public website: [www.txs.uscourts.gov](http://www.txs.uscourts.gov).

Exhibit C-6 to this Joint Disclosure Statement includes financial projections which represent the Debtors' present judgment of the projected business operations of Reorganized Palco and Reorganized Scopac. The projections are estimates by the Debtors' management based on what are currently believed to be reasonable assumptions regarding the future earnings of the Reorganized Debtors and are subject to the limitations and conditions stated in the notes to the projections. Unanticipated events and circumstances occurring subsequent to the preparation of the financial projections may affect the actual financial results of the Reorganized Debtors. While the Debtors' management believes that the financial projections are reasonable, as they are based upon the assumptions set forth in connection with such projections, some or all of the estimates will vary. Variations between the actual financial results and those projected, moreover, may be material and adverse.

The financial projections are based upon numerous assumptions regarding (a) the tax consequences of the Debtors Plan and the Alternative Plans; (b) the anticipated future performance of the Reorganized Debtors; (c) the Confirmation and consummation of the Debtors Plan or the Alternative Plans in accordance with their terms; (d) general business and economic conditions; and (e) certain other matters, many of which are beyond the control of the Debtors and Reorganized Debtors. There can be no assurance that such assumptions will prove to be valid, and the effect of any variance from the projections may be material and adverse.

**WHILE THE DEBTORS BELIEVE THAT THE FINANCIAL PROJECTIONS ARE REASONABLE IN LIGHT OF CURRENT FACTS AND CIRCUMSTANCES KNOWN TO THE DEBTORS' MANAGEMENT, THE PROJECTIONS ARE BASED ON A NUMBER OF ASSUMPTIONS AND ARE SUBJECT TO SIGNIFICANT UNCERTAINTIES WHICH ARE BEYOND THE CONTROL OF THE REORGANIZED DEBTORS. THEREFORE, THERE CAN BE NO ASSURANCE THAT THESE PROJECTIONS WILL BE REALIZED. THE ACTUAL OPERATING RESULTS MAY BE MATERIALLY HIGHER OR LOWER THAN THE PRESENT FORECAST.**

#### **8.7 Substantive Consolidation (Debtors Plan and Palco Alternative Plan).**

The Debtors Plan authorizes the Palco Debtors to substantively consolidate their estates for all purposes and actions associated with consummation of the Debtors Plan, including, without limitation, for purposes of voting and Confirmation. **The Debtors Plan does not, however, seek to (i) substantively consolidate Scopac with the Palco Debtors for the purposes of Confirmation or (ii) merge Scopac with the Palco Debtors.** On and after the Effective Date, all assets and liabilities of the Palco Debtors will be treated as though they were merged into the Palco Estate solely for purposes of the Debtors Plan. For all purposes associated with Confirmation, including, tallying acceptances and rejections of the Debtors Plan, the estates of the Palco Debtors will be deemed to be one consolidated Estate for Palco. Any Claim filed or in the Reorganization Cases of the Palco Debtors will be deemed filed against Palco and to constitute a Claim against and an obligation of Palco. As a result of the consolidation, any guaranty by one or more of the Palco Debtors of the obligations of another Palco Debtor will be eliminated.

Substantive consolidation will not affect Distributions from any insurance policies or proceeds of such policies. See Section 8.2 of the Debtors Plan for the postpetition legal and organizational structure of the Debtors.

#### **8.8 Executory Contracts and Unexpired Leases (Debtors Plan and Alternative Plans).**

Article 7.1. of the Debtors Plan and Article 6.1 of the Scopac Alternative Plan provides that, except as otherwise provided in each Plan or pursuant to the Confirmation Order, all executory contracts and unexpired leases between the Debtors and any Person, will be rejected pursuant to section 365(a) of the Bankruptcy Code as of the

Effective Date, except for any such contract or lease (a) that has been assumed or rejected, or renegotiated and either assumed or rejected on renegotiated terms, pursuant to an order of the Bankruptcy Court entered prior to the Effective Date, (b) that has been entered into by the Debtors during the pendency of the Reorganization Cases in the ordinary course of business or pursuant to an order of the Bankruptcy Court, (c) that is the subject of a motion to reject, or a motion to approve renegotiated terms and to assume or reject on such renegotiated terms, that has been filed and served prior to the Effective Date, or (d) that is specifically treated otherwise in each Plan. Entry of the Confirmation Order will constitute approval, pursuant to section 365(a) of the Bankruptcy Code, of the rejection of executory contracts and unexpired leases provided for herein; *provided, however*, that any Environmental Obligation will be treated as indicated in Article 2.8 of the Palco Alternative Plan, Article 2.5 of the Scopac Alternative Plan, and any order entered in connection with confirmation of each Plan is not intended to be, and will not be construed as, a finding that any Environmental Obligation is an “executory contract.”

Article 6.1 of the Palco Alternative Plan provides Marathon to supply the Palco Debtors with a list of executory contracts and leases which it seeks to have the Palco Debtors assume and assign to it as part of the Distributions it receives on account of the Palco Term Loan Claims. The list of Assumed Contracts is to be provided in the Plan Supplement, together with the Palco Debtors’ estimate of the cure costs that would result from such assumption; provided, however, that any Environmental Obligation shall be treated as described above in connection with the Debtors Plan and the Scopac Alternative Plan. The Palco Debtors will seek to have the Assumed Contracts assumed and assigned to Marathon at the Confirmation Hearing.

Notwithstanding anything to the contrary contained in the Debtors Plan or the Alternative Plans, including the immediately preceding Section, the Debtors will provide a list of executory contracts and unexpired leases in the Plan Supplement to be deemed assumed pursuant to section 365(a) of the Bankruptcy Code as of the Effective Date, together with the Debtors’ estimate of the cure costs that would result from such assumption; *provided, however*, that any Environmental Obligation will be treated as indicated in Article 2.9 of each Plan and any order entered in connection with confirmation of each Plan is not intended to be, and will not be construed as, a finding that any Environmental Obligation is an “executory contract.”

## **8.9 Employee Benefits.**

### **(a) Pension Claims.**

Upon Confirmation and consummation of either the Debtors Plan or the Palco Alternative Plan, Reorganized Palco will continue to pay its obligations under the Palco Pension Plan in accordance with applicable law with respect to continued funding of such plans. Nothing in the Debtors Plan will be deemed to discharge, release or relieve the Debtors, or the Reorganized Debtors, of or from any current or future liability under applicable law with respect to the Palco Pension Plan. Any and all obligations to participants under the Palco Pension Plan will be paid in accordance with applicable law.

### **(b) Worker’s Compensation Programs.**

Upon Confirmation and consummation of the Debtors Plan, the reorganized entities will continue any pre-petition workers’ compensation programs in accordance with applicable law, and the Debtors’ obligations under applicable law with respect to continued funding of such programs will remain unaltered. The Debtors Plan will not relieve the Debtors or their successors from any current or future liability for their workers’ compensation programs under applicable law. The Debtors will be responsible for all valid Claims for benefits and liabilities under the workers’ compensation programs in accordance with applicable law regardless of when the actual injuries occurred.

### **(c) Employee Incentive Plans.**

Upon Confirmation and consummation of the Debtors Plan, the reorganized entities will continue any incentive plans proposed in the Reorganization Cases and approved by the Bankruptcy Court in accordance with the terms of such incentive plans.



#### **8.10 DIP Facility (Debtors Plan).**

Notwithstanding any other provision of the Debtors Plan dealing with Administrative Expense Claims, Administrative Expense Claims arising under the DIP Facility will be satisfied by the issuance to Marathon of 45.7% of the New Palco Common Stock.

#### **8.11 Treatment of Post-Petition Tax Claims.**

Section 2.10 of the Debtors Plan provides that any Tax Claim against any of the Palco Debtors that first arose on or after the Petition Date, will be timely paid by Reorganized Palco in the ordinary course of its business or will be subject to applicable state-court or federal-court, as the case may be, collection efforts without further recourse to the Bankruptcy Court. Similarly, any Tax Claim against Scopac that first arose on or after the Petition Date, will be timely paid by Reorganized Scopac in the ordinary course of its business or will be subject to applicable state-court or federal-court, as the case may be, collection efforts without further recourse to the Bankruptcy Court.

#### **8.12 Restructuring Transactions (Debtors Plan and Alternative Plans).**

##### **(a) Continued Corporate Existence.**

Except as provided herein, each Debtor will continue to exist on or after the Effective Date as a separate corporate entity, with all the powers of a corporation or limited liability company, as the case may be, under applicable law and without prejudice to any right to alter or terminate such existence (whether by merger, dissolution, or otherwise) under applicable law.

##### **(b) Revesting of Assets.**

Except as expressly provided herein, the Assets of each Debtor's Estate will revert with the respective Reorganized Debtor on the Effective Date. The Bankruptcy Court will retain jurisdiction to determine disputes as to property interests created or vested by each Plan. From and after the Effective Date, the Reorganized Debtors may operate their businesses, and may use, acquire, and dispose of property free of any restrictions of the Bankruptcy Code, except as provided in each Plan. As of the Effective Date, all property of the Reorganized Debtors will be free and clear of all Claims and Interests, except as provided in each Plan.

##### **(c) Merger (Debtors Plan and Palco Alternative Plan).**

On the Effective Date of the Debtors Plan—but after the cancellation of debt, discharge of Claims against the Debtors and re-vesting of Assets in the Reorganized Debtors—Britt, Salmon Creek, Scotia Inn and Scotia Development will merge into Palco, with Reorganized Palco being the sole surviving entity. The Debtors Plan does not provide for Reorganized Scopac to be merged into Reorganized Palco.

In addition to such merger, the Debtors may, (i) merge, dissolve, transfer assets, or otherwise consolidate any of the Debtors in furtherance of the Debtors Plan or (ii) engage in any other transaction in furtherance of the Debtors Plan. Any such transaction may be effected on or subsequent to the Effective Date without any further action by the Interest Holders or directors/managers of any of the Debtors or Reorganized Debtors.

##### **(d) Revesting of the SAR Account.**

On or after the Effective Date, but before the re-vesting of Assets in the Reorganized Debtors, all property currently held in the SAR Account will be transferred to the general corporate accounts of Scopac held at U.S. Bank of California, account number 153490135040, or some other unencumbered account, at the sole discretion of Scopac. The proceeds of the SAR Account will be available for all uses including, funding obligations under each Plan, paying Administrative Expense Claims, and paying ongoing working capital requirements.

(e) **Cancellation of Debt and Debt Agreements.**

On the Effective Date, the Palco Term Loan Agreement, the Prepetition Indenture, the Prepetition Timber Notes, and the Scopac Line of Credit will be cancelled and extinguished and all obligations of the Debtors will be discharged. Notwithstanding the foregoing, the Prepetition Indenture will continue in effect solely for the purposes of allowing the Prepetition Indenture Trustee to make Distributions to Holders of Allowed Scopac Timber Noteholder Claims pursuant to each Plan.

(f) **Issuance of New Debt Instruments (Debtors Plan Only).**

The issuance of the New Timber Notes, the New Term Note, the New Palco Common Stock, the New Scopac Preferred Stock, and the New Scopac Common Stock will be authorized under section 1145 of the Bankruptcy Code as of the Effective Date without further act or action by any person, unless required by applicable non-bankruptcy law, regulation, order, or rule; and all documents evidencing the same will be executed and delivered as provided for in the Debtors Plan, the Alternative Plans, or the Plan Supplements.

(g) **Post Effective-Date Management of the Reorganized Debtors.**

The operation, management, and control of the reorganized entities will remain the general responsibility of their respective boards of directors or managers and senior officers. Entry of the Confirmation Order will ratify and approve all actions taken by each of the Palco Debtors from the Petition Date through and until the Effective Date; *provided, however*, that nothing in each Plan will protect any Person from liability for any conduct in violation of any Environmental Obligation, any liability for which will be determined under non-bankruptcy law in the appropriate forum.

(h) **Directors and Officers of the Reorganized Debtors (Debtors Plan Only).**

On and after the Effective Date, the business and affairs of Reorganized Palco and Reorganized Scopac will be managed by the officers and directors, or managers in the case of Reorganized Scopac.

The Palco Board will be comprised of seven members, and at all times will include (i) four representatives designated by Marathon (each, a "Marathon Director"), (ii) two representatives designated by MGI (each, an "MGI Director"), and (iii) the Chief Executive Officer of Reorganized Palco, who shall be jointly agreed upon by the Marathon Directors and the MGI Directors.

The Scopac Board will be comprised of five members, and at all times shall include (i) two representatives designated by the New Indenture Trustee (each, a "Noteholder Director"), (ii) two representatives designated by Palco (each, a "Palco-Designated Director"), and (iv) the Chief Executive Officer of Reorganized Scopac, who will be jointly agreed upon by the Noteholder Directors and the Palco-Designated Directors.

Biographical information regarding the proposed officers, directors, and managers selected by Reorganized Palco or MGI as the case may be, will be set forth in the Plan Supplement. A schedule of the annual compensation to be paid to all persons serving as executives, officers and directors or managers as of the Effective Date will be set forth in the Plan Supplement.

(i) **Super-Majority Board Approvals.**

All decisions of the Palco Board or Scopac Board, as the case may be, will require a simple majority, except for the following which shall require the affirmative vote or written consent of six of the seven members of the Palco Board (for matters requiring approval of the Palco Board) or four of the five members of the Scopac Board (for matters requiring approval of the Scopac Board):

- amend or repeal any provision of such Reorganized Debtor's Bylaws and Certificate of Incorporation or Articles of Organization, as the case may be;

- authorize or effect the payment of dividends on any capital stock, or the redemption or repurchase of any capital stock;
- authorize or effect the issuance of any shares of capital stock or rights to acquire capital stock;
- authorize or effect (a) any sale, lease, transfer or other disposition of a material asset of such Reorganized Debtor outside of the ordinary course of business; (b) any merger or consolidation or other reorganization of such Reorganize Debtor with or into another corporation; (c) the acquisition of another entity by means of a purchase of all or substantially all of the capital stock or assets of such entity; (d) a Qualified Public Offering (as defined below); or (e) a liquidation, winding up, dissolution or adoption of any plan for the same;
- reclassify, cancel or in any manner alter or change the terms, designations, powers, preferences or relative, optional or other rights, or the qualifications, limitations or restrictions thereof, of any capital stock of such Reorganized Debtor;
- incur, either through the issuance of debt securities or the borrowing of money, unsecured indebtedness in excess of \$10 million in the aggregate;
- guarantee the indebtedness of any third party outside of the ordinary course of business in excess of \$1 million in the aggregate;
- enter into or engage in any business or activity outside of the ordinary course of business or otherwise not contemplated by the annual operating or capital budget or business plan approved by the Board;
- spend or commit to spend fifteen percent (15%) in excess of the aggregate amount specified in the budget approved for each year by their respective Boards in expenditures that are or should be classified as “capital expenditures” under U.S. generally accepted accounting principles;
- acquire any single asset or group of related assets in a single transaction or series of related transactions for an aggregate consideration (including any indebtedness incurred in connection therewith) in excess of \$10 million;
- enter into any transaction, other than employment agreements on a basis consistent with past practice, with any officer, director or beneficial owner of five percent (5%) or more of the capital stock of Reorganized Palco or Reorganized Scopac;
- grant registration rights with respect to any security or shares of capital stock of such Reorganized Debtor;
- with respect to Reorganized Palco, select the Palco-Designated Directors for Reorganized Scopac; or
- enter into any agreement or commitment or otherwise become bound or obligated to do or perform any of the foregoing actions.

In addition, Palco’s selection of each Palco-Designated Director is subject to a super-majority vote of the Palco Board.

For purposes hereof, “Qualified Public Offering” means an underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933, as amended, covering the offer and sale of Common Stock for the account of Palco to the public generally in which the aggregate net proceeds to such

Reorganized Debtor are not less than \$10 million, and as a result of which shares of Common Stock are designated for trading on The New York Stock Exchange, The American Stock Exchange or the Nasdaq National Market.

**(j) Corporate Governance Documents for the Reorganized Debtors (Debtors Plan Only).**

As of the Effective Date, the articles of organization and the by-laws of Reorganized Scopac shall be substantially in the forms included in the Plan Supplement, with such changes as may be necessary to conform to the applicable laws of the state of organization. The initial articles of organization and by-laws of Reorganized Scopac, among other things, shall implement the super-majority requirements set forth above and shall prohibit the issuance of nonvoting equity securities to the extent required by section 1123(a) of the Bankruptcy Code. After the Effective Date, Reorganized Scopac may amend and restate its articles of organization and by-laws, as permitted under applicable state laws, subject to the terms and conditions of such documents..

**(k) New Employment, Retirement, Indemnification and Other Related Agreements.**

The Reorganized Debtors will be authorized to maintain or amend existing employment, retirement, welfare, incentive, severance, indemnification and other agreements with their active and retired directors or managers, officers, and employees, subject to the terms and conditions of any such agreement; and to enter into new employment, retirement, welfare, incentive, severance, indemnification and other agreements for active and retired employees.

**(l) Potential for Modification of Corporate Structure (Debtors Plan Only).**

The Debtors' intent is to structure the transaction under the Debtors Plan so as to achieve the economic and control attributes described above in the most tax-efficient method possible. Upon consultation with their creditors, the Debtors reserve the right to employ equivalent structures such as LLCs, limited partnerships, or REITS in order to achieve these goals.

**8.13 Capital Contribution by MAXXAM (Debtors Plan Only).**

As a proponent of the Debtors Plan, MAXXAM has agreed to contribute \$10 million to Reorganized Palco on the Effective Date in the form of a capital contribution.

**8.14 Implementation of the Preserve Project.**

**(a) Overview of the Preserve Project.**

In addition to the revenues generated by their ongoing timber operations, the Debtors also have developed a plan to unlock and monetize the high value of the Ancient Redwood Groves, six groves of ancient redwood trees (totaling approximately 6,600 acres) that are subject to extraordinary environmental protections. On the basis of the proposal developed by the Debtors' valuation and marketing experts, the Debtors expect the sale of the Ancient Redwood Groves, coupled with an integrated project comprised of forest conservation and carefully reviewed and designed development and sale of the surrounding Redwood Preserve Development parcels, to yield almost \$1.2 billion in gross proceeds. The Preserve Project is generally divided into two parts.

The first part of the project integrates forest conservation and carefully sited and designed development, master-planned to meet perceived public needs for a range of development density, type and function, open space dedication, recreational facilities, focused near existing urban, municipal, or township boundaries for efficient use and delivery of public services. The Debtors' plan to market and sell each of the Ancient Redwood Groves as old-growth redwood conservation forests to a buyer or buyers who are willing to commit to the permanent environmental protection of these unique and scarce old-growth redwood trees. The Debtors believe that the sale of the Ancient Redwood Groves can be accomplished within 36 months from the Effective Date. The sales are expected to generate approximately \$400 million (\$300 million on a present-value basis), which is based on a value of \$60,000 per acre.

The second part of the project is to develop and sell the Redwood Preserve Development as a master-planned development concept, including strategically clustered development and individual parcels of land near or adjacent to unique natural features and one or more of the Ancient Redwood Groves or the Headwaters Forest. The development values will vary depending on amenities, resources, location, development type and proximity to the Ancient Redwood Groves or the Headwaters Forest. The Debtors expect to raise a present value of \$250 million through the sale of the Redwood Preserve Development, which is in addition to the funds raised through the sale of the Ancient Redwood Groves. Eighty-five percent of the net proceeds from the Preserve Project will be used to redeem the New Scopac Preferred Stock to be issued to the Timber Noteholders (with the remaining fifteen percent of net proceeds being available to retire the Scopac Exit Facility of retained for working capital and other liquidity needs).

**(b) Recent Revisions to the Redwood Preserve Development.**

Since filing their initial plan of reorganization in September 2007, the Debtors and their professionals have met with various representatives of Humboldt County and certain California state agencies. Debtors' management team also has attended meetings with the Humboldt County Board of Supervisors, and the Debtors' have recently retained and consulted with experienced land use, design, and development experts. As a result of these efforts, the Debtors have refined the Redwood Preserve Development to address potential concerns.

The Redwood Preserve Development will be guided by current and projected land use policies and procedures, such as those now under public review and consideration in connection with the Humboldt County General Plan Update. These policies and procedures will allow the Debtors to advance a variety of potential project configurations which address or avoid the concerns expressed in response to the initial description of the Preserve Project.

Policies under consideration may, for example, favor a General Plan Amendment and rezoning for projects meeting certain public interest standards. Immediate zoning change may be available where the master-planned development helps meet perceived public needs for a range of development density, type and function, open space dedication, recreational facilities, affordable as well as high-value and low-density residences, and where the development is focused near existing urban, municipal, or township boundaries for efficient use and delivery of public services.

The General Plan Update, which is currently under review, emphasizes the opportunity to increase development densities—so called “clustering” development—in certain locations and under certain conditions. If adopted, the policy may encourage increased development values as a trade-off for conveying development rights in adjacent wild and scenic lands. Generally this may involve dedicating remaining forestland to timber production through the adoption of conservation easements or through land trust or conservancy administration. Land use policies under review in Humboldt County now include allowing doubling, or even trebling, development densities with increasing proportions of forest management dedication through such recorded legal mechanisms.

The Debtors believe the Redwood Preserve Development can be structured to fit within any number of the alternatives already being discussed as part of Humboldt County's General Plan Update. Moreover, the Debtors remain committed to working hand-in-hand with local, state, and federal parties to ensure that the entire Preserve Project not only complies with all applicable laws, but also is supported at every level of government. To that end, the Debtors renewed their efforts following the initial reaction by the Humboldt County Board of Supervisors and committed that, among other things, the Preserve Project would comply with all laws and that the Debtors would involve local leaders at every step of the process. See Section 1.5 for additional information.

In part as a result of the Debtors' commitments, the Humboldt County Board of Supervisors has abandoned further efforts to adopt a permanent version of the ordinance specifically designed to halt the Preserve Project.

**(c) Tax Benefits May Attract Potential Purchasers.**

The Debtors believe that state and federal tax benefits may be available to attract potential purchasers. Purchasers of portions of the Ancient Redwood Groves or Redwood Preserve Development who in turn donate fee

title or conservation easements with respect to such property to state resource departments, local government entities or designated nonprofit organizations for conservation purposes may be eligible for California and Federal tax benefits in connection with such donations. California currently provides a tax credit, which may offset a donor's California state income tax liabilities, for qualifying donations of real estate for conservation purposes, in an amount equal to 55% of the fair market value of the donated property. For U.S. federal income tax purposes, a charitable deduction may also be available for contributions of real estate for conservation purposes, subject to certain caps that apply to charitable deductions.

**(d) MAXXAM Has Past Experience With Similar Development Strategies.**

MAXXAM, through certain of its non-debtor wholly owned subsidiaries, invests in and develops residential and commercial real estate and has substantial expertise in creating value by transforming undeveloped land into high-end property. In short, MAXXAM acquires undeveloped land, subdivides the land, builds the infrastructure required to create resort and master-planned communities, including utilities and roads, and either sells the land to other third parties at a premium, enters into a joint venture with a third party, or develops lots for retail sale. MAXXAM's real estate business model has been profitable and is similar to the strategy that will be employed for the Redwood Preserve Development.

Among other things, MAXXAM has successfully developed master-planned communities in Puerto Rico, Arizona and California, which are similar to the community that will result from the Redwood Preserve Development. They are as follows:

**(1) Lake Havasu City.**

Lake Havasu City, home to the historic London Bridge, is located on the western border of Arizona overlooking the Colorado River. Development of the master planned community began in 1963 and continued for a number of years thereafter. This was MAXXAM's first real estate development project.

**(2) Palmas del Mar.**

Palmas Del Mar is a master-planned community and resort located on the southeastern coast of Puerto Rico, consisting of 2,700 acres of land. As a result of MAXXAM's developments, MAXXAM has been able to sell acreage at a significant profit. MAXXAM's portion of the revenues generated from this project has been \$300 million to date.

**(3) Fire Rock.**

FireRock Country Club is a gated community with commanding views from 379 custom home sites and three luxury projects, developed on 800 acres in Fountain Hills, Arizona, which is located close to Scottsdale, Arizona. The custom home site development features large lots that offer dramatic rolling topography. A MAXXAM subsidiary is the managing partner of FireRock, a joint venture project with a third party developer. The development of FireRock began in 1998 and sales of the custom home sites and three luxury attached parcels commenced in 1999. The sell-out of real estate at FireRock was completed in 2004. FireRock generated revenues of \$100 million.

**(4) Eagles Nest.**

Eagles Nest is a prestigious, gated community on more than 500 acres of high-altitude Sonoran Desert located on the eastern slopes of the McDowell Mountains. Construction of this luxury community began in early 2004 and lot sales commenced in Fall 2004. The 244 custom-home sites range in size from one to twenty-one acres. The development is surrounded on three sides by natural preserve and has enhanced the recreation area with environmentally sensitive architecture and a public trailhead to the McDowell Mountain Regional Park. Eagles Nest has generated revenues of \$66 million to date and is expected to generate another \$75 million in revenues in future periods.

(5) **SunRidge Canyon.**

SunRidge Canyon is a 950-acre golf community located in Fountain Hills, Arizona developed jointly by a MAXXAM subsidiary and Suncor Development. The community includes 541 production homes, 286 custom home sites, neighborhood parks connected by bike paths, and open tracts of undisturbed, natural open space. Development of SunRidge Canyon began in 1996, with sales completed in 2002. The SunRidge Canyon development generated revenues of \$67 million in future periods.

(6) **Mirada.**

Mirada is a luxury mountainside community located in the City of Rancho Mirage, California. Surrounded by the Santa Rosa and Jacinto Mountains National Monument, this custom lot community is the highest development in the greater Palm Springs/Rancho Mirage area. The community was developed with a five-star Ritz Carlton hotel as its focal point and very limited development disturbance on only 150 acres of the over 1,300 acres of community land and former President Gerald Ford was the Chairman of the entity that started this development. The balance of the property has been left as a natural preserve. The development had two phases of custom lots. The company has sold 60 of the 63 lots in the second phase at an average price of more than \$1 million per lot. This development has generated more than \$75 million of revenues to date and is expected to generate another \$15-20 million in revenue.

Among other things, during 2005, MGI loaned a total of \$6 million to Palco on an unsecured and subordinated basis in order to support Palco's operations. During 2006, MGI loaned an additional \$30.9 million to Palco on the same basis, also to support its operations. These loans remain outstanding.

During 2006, MGI and Scopac also consummated the Lump Sum Purchases, three "lump-sum" timber/log purchases pursuant to which MGI (rather than Palco) purchased timber and logs from Scopac, in certain instances earlier than Palco would have been required to purchase them from Scopac. Such purchases provided Scopac with a total of \$8.1 million of additional liquidity, which was used to support Scopac's operations and to pay interest to the Holders of Prepetition Timber Notes. MGI later resold to Palco the timber and logs purchased from Scopac pursuant to the Lump Sum Purchases. The MGI sales to Palco were at the then-current market price, resulting in a loss to MGI. As a result, MGI bore 100% of the capital costs and price risk required to fund the Lump Sum Purchases, and MGI's purchases from Scopac effectively functioned as interest-free loans from MGI to Palco and Scopac.

MAXXAM has also historically furnished, at cost, important general and administrative assistance and other services to the Debtors (as well as its other subsidiaries), including risk-management services, accounting services, income tax reporting and compliance services, treasury and cash-management services, legal services, and employee-benefit services. As of the Petition Date, a significant amount of the allocable cost of these services had not been paid for by the Debtors, including: \$759,026 worth provided to Palco, \$23,331 worth provided to Britt, \$807,165 worth provided to Scopac and \$193,020 worth provided to Scotia Development for corporate services provided prior to the Petition Date, which has not been paid. MAXXAM has continued to furnish important general and administrative services, worth approximately \$1.4 million, to the Debtors postpetition for which it will not seek reimbursement.

Most recently, MAXXAM has purchased logs and/or lumber from Palco, providing operating liquidity of approximately \$6 million.

MAXXAM will make significant and important contributions to the Debtors Plan by fully utilizing its real estate expertise in support of the Debtors and the Preserve Project, or by associating with someone with even more real estate experience. MAXXAM's support will be crucial to the success of the Reorganized Debtors and adds significant value to the estates.

#### **8.15 Treatment of Environmental Obligations.**

*This Joint Disclosure Statement contains a discussion of the Debtors' position on the regulatory and environmental factors relevant to the Debtors Plan and the Alternative Plans. The state and federal regulators do not necessarily agree with the Debtors' positions as described herein and much of the interpretation of the laws, regulations, and agreements is the subject of pending litigation. Nothing contained herein is to be construed as an admission or agreement by the state and federal regulators to the Debtors' positions as stated in this Joint Disclosure Statement. Similarly, the Bankruptcy Court's approval of this Joint Disclosure Statement is not to be construed as any finding by the Bankruptcy Court that the Debtors' positions are correct or that can be used by any party in interest in any other case or proceeding.*

The Debtors, or Reorganized Debtors as the case may be, must comply, complete, perform, satisfy, and/or provide for satisfaction or completion of all Environmental Obligations. Each Plan proposed by the Debtors is specifically conceived and will be implemented in a manner which complies with the California state and federal ITPs and consistency determinations under CESA, including the associated HCP and IA, as well as AB 1986, including the Agreement Relating to Enforcement of AB 1986 and the associated, recorded CC&Rs.

The Debtors are obligated to various Governmental Units to comply, complete, perform, satisfy and/or provide for satisfaction of prepetition, current, ongoing, executory and future Environmental Obligations. These obligations arise or result from, or may arise or result from, the following: (i) approved Timber Harvest Plans, Waste Discharge Requirements, Cleanup and Abatement Orders, Streambed Alteration Agreements, and related permits or authorizations, and may include, for example, requirements for completion or correction, monitoring and reporting, winterization, drainage improvement, restoration, inspection, study; (ii) the California State and federal Incidental Take Permits (ITPs), which include the Habitat Conservation Plan for the Properties of Pacific Lumber, Scotia Pacific, and Salmon Creek Corporation, dated February, 1999 (HCP), and the associated Implementation Agreement (IA), and the Agreement Relating to Enforcement of AB 1986; and (iii) consistency determinations under the California Endangered Species Act (CESA) that are based upon the federal ITPs, including the HCP and IA ("Environmental Obligations"). Generally, the Environmental Obligations are described in the protective proofs of claim filed by the California Resources Agency, the California Department of Forestry and Fire Protection, the California Department of Fish and Game, the California Wildlife Conservation Board, the California State Water Resources Board, the California Regional Water Quality Control Board, North Coast Region, the U.S. Fish and Wildlife Services, the U.S. Department of the Interior, the National Marine Fisheries Service, and the U.S. Department of Commerce.

Notwithstanding any other provision in the Debtors Plan, as amended from time to time, the Debtors (including the Reorganized Debtors as of the Effective Date) will comply, complete, perform, satisfy, and/or provide for satisfaction of any prepetition, current, ongoing, executory, and future Environmental Obligations. Each Environmental Obligation will be satisfied in full in the ordinary course of Reorganized Palco's or Reorganized Scopac's business, as the case may be, at such time and in such manner as Reorganized Palco or Reorganized Scopac, as the case may be, is obligated to satisfy such Environmental Obligation under applicable non-bankruptcy law. Each Environmental Obligation will survive the Effective Date of the Debtors Plan as if the chapter 11 cases had not been commenced, will not be discharged under section 1141(d), will not otherwise be adversely affected by the chapter 11 cases. Moreover, the Agreement Relating to Enforcement of AB 1986, including all restrictions and obligations set forth in Section 3.1 therein, are and will remain recorded as valid covenants, conditions and restrictions (CC&Rs) which run with the land and remain binding on successors and assigns, and will be senior in priority to all Liens provided in each Plan as to the land which the CC&Rs effect.

The Debtors also will comply with the following principles communicated by the Governor of California in a pleading filed with the Bankruptcy Court on January 29, 2008:



(1) Manage the Scopac Timberlands in accordance with state and federal laws, including without limitation the existing regulatory permits and authorizations such as the Headwaters Agreement and the HCP and all other state permits, AB 1986, the Agreement Relating to Enforcement of AB 1986, and the conditions, covenants, and restrictions recorded in accordance with AB 1986.

(2) Manage the Scopac Timberlands in a manner that complies with all required regulatory permits and other authorizations in coordination with state and federal regulatory agencies.

(3) Preserve the Scopac Timberlands by maintaining a level of commercial harvest that will ensure sustainable, high-quality timber production over the long term while preserving and enhancing watershed and wildlife protection.

(4) Minimize adverse impacts to the local economy and preserve as many local employment opportunities as possible.

(5) Maximize the greenhouse gas reduction benefits that could be generated in timberland management.

Notwithstanding any other provision of each Plan, the Debtors Plan (and the Alternative Plans, as the case may be) and the Preserve Project are intended, designed and will be implemented in such manner as to continue to be consistent with all elements, terms and conditions of the environmental permits and with all applicable environmental and regulatory requirements, including without limitation, the elements, terms, conditions, and requirements of all applicable environmental permits, plans, approvals, restrictions and covenants. More particularly, each Plan and the Preserve Project will be undertaken in compliance with all applicable statutory and regulatory land use, resource protection and environmental laws, including but not limited to the following:

- the federal Endangered Species Act (ESA) and associated regulations;
- the California Endangered Species Act (CESA) and other provisions of the California Fish and Game Code, including without limitation, section 1602 regarding streambed alterations, and sections 3503 and 3503.5 and associated regulations;
- the California Environmental Quality Act (CEQA) and associated regulations;
- the National Environmental Policy Act (NEPA) and associated regulatory guidelines;
- the California Forest Practices Act (FPA);
- the California Forest Practice Rules (FPR) and associated Maximum Sustained Production (MSP) regulations;
- the California Timber Productivity Act (TPA), including zoning requirements applicable to the affected lands;
- the California Porter-Cologne Water Quality Control Act and related Basin Plan provisions and regulations;
- the U.S. Clean Water Act (CWA);
- the California Subdivision Map and Subdivided Lands Acts); and
- California State Assembly Bill 1986 (AB 1986).

The Preserve Project may involve the transfer, sale and development of certain lands and properties now held in fee by certain of the Debtors and currently managed in accordance with the terms of the California State and federal ITPs, CESA consistency determinations, and Agreement Relating to Enforcement of AB 1986, described above. Many provisions of the HCP, IA and Agreement Relating to Enforcement of AB 1986, specifically address land transactions. The Preserve Project is intended, designed, and will be implemented in compliance with these provisions. For example, Section 5.5 of the IA, entitled "Disposition of Land in MMCAs" provides, in pertinent part, as follows:

“PALCO may sell, exchange, or otherwise transfer to a third person one or more of the MMCAs, or a portion thereof, so long as PALCO demonstrates to the reasonable satisfaction of the Wildlife Agencies that the protection to be afforded by such third party (and its successors) to the marbled murrelet and the habitat of the marbled murrelet in such MMCA(s) and to the other Covered Species [under the Incidental Take Permits] is equal to or greater than that afforded under the HCP....”

With specific respect to land transfers under the Preserve Project, and consistent with all of the foregoing assurances, the Agreement Relating to Enforcement of AB 1986, including all restrictions and obligations set forth in Section 3.1 therein, are and will remain recorded as valid covenants, conditions and restrictions (CC&Rs) which run with the land and remain binding on successors and assigns. An Assignment and Assumption Agreement will be employed in all property sale transactions in accordance with applicable provisions of the HCP, IA, and Agreement Relating to Enforcement of AB 1986.

#### **8.16 The Debtors' Authority Under Applicable Law to Sell the Ancient Redwood Groves for a Variety of Land Uses.**

Buying and selling, trading, optioning, dividing, and otherwise dealing in real property are part and parcel of the timber business. Timber companies are constantly changing the shape and size of their ownerships depending upon a number of factors, including harvest rotations, the age or maturity of timber crops on lands bought and sold, geology, soil type, species presence and abundance, and habitat considerations. Many timber companies engage in land sales and land development programs with non-core assets and non timber producing lands. This is especially true in the context of “special purpose” lands that are subject to extraordinary environmental conditions or that feature scarce resources or amenities, such as the Ancient Redwood Groves.

As recently as the early 1990's, the Timberlands included substantial acreage of remnant old-growth and second-growth groves of redwood forest, which included eight noncontiguous aggregations of timberland considered to contain habitat well-suited for seasonal use by a robin-sized seabird, brachyramphus marmoratus or “marbled murrelet.” These areas, which are distributed throughout the Timberlands, are commonly referred to as the Marbled Murrelet Conservation Areas or “MMCAs” and are referred to in this Disclosure Statement as the Ancient Redwood Groves. As noted above, two of the MMCAs (Owl Creek and Grizzly Creek) were purchased from the Debtors by the State of California in connection with, and following consummation of, the Headwaters Agreement, and are now held publicly for purposes of preservation. The remaining six MMCAs owned by the Debtors, making up the Ancient Redwood Groves, contain approximately 6,600 acres in the aggregate. The MMCAs contain very valuable timber, but also constitute extremely desirable real estate for a variety of commercial and non-commercial uses, all permissible under applicable state and federal environmental and other land-use rules and restrictions.

The Debtors pay taxes on and maintain all of the Timberlands, including the Ancient Redwood Groves, in accordance with the HCP and related plans and permits. These instruments expressly allow management and land use throughout the Timberlands, subject to certain restrictions intended both to advance conservation goals and to provide the Debtors with predictable commercial timber operations and continued economic viability. For instance, the HCP conservation measures govern, but do not prohibit, land use and management in the Ancient Redwood Groves consistent with the conservation goals of the HCP and not detrimental to the marbled murrelet. Several land use activities are specifically described in the final HCP as compatible with these goals, including road use, upgrading, and construction; blasting; drilling and mining; hunting; thinning; timber removal; and related land-use activities. Similarly, the HCP and related authorizations, plans, and permits do not prevent marketing or sale of the Ancient Redwood Groves to any party, so long as certain approvals are obtained. Pursuant to Articles 2.9 and 8.6 of each Plan, the Debtors and Reorganized Debtors, as the case may be, will comply with all applicable laws, regulations, permits, conditions, restrictions and agreements for any transaction involving the Ancient Redwood Groves.

The Debtors' continued freedom to sell or otherwise use or dispose of the Ancient Redwood Groves was an important part of the heavily negotiated Headwaters Agreement. The Headwaters Implementation Agreement took many months to draft and negotiate. From the very beginning of those negotiations, the parties recognized that the property retained by the Debtors that would be subject to the HCP would remain available for land use,

management, and sales to third parties, consistent with the provisions of the ITPs. Accordingly, as summarized below, the agreements and documents by which the Headwaters Agreement were implemented acknowledge and authorize the Debtors' continuing right to sell the Ancient Redwood Groves to third parties either for continued timber operations, as well as for any new use that is compatible with applicable law.

As noted above, California Assembly Bill 1986, or AB 1986, required specified certain minimum restrictions and management measures that to be included in the HCP. Section 2(g) of AB 1986 prohibits only those activities in the Ancient Redwood Groves that are "detrimental" to marbled murrelets or their habitat. In compliance with the legislation, Implementation Agreement Section 3.1.1(a)(i) through (ix) lists management activities that are specifically found to be compatible with murrelet conservation. Moreover, consistent with the HCP measures which address the breeding, nesting and related habitat needs of marbled murrelets, a wide variety of management and conservation activities are expressly recognized as compatible with murrelet conservation, subject only to seasonal limitations or consultation requirements. For example, the wildlife agencies have determined that the following are compatible with protection of, or beneficial to, murrelets and "shall be allowed within MMCAs" in accord with HCP provisions at Section 6.1.2.2.1 ("Management in the MMCAs"):

- (i) road use, maintenance, upgrading, storm proofing (heavy construction and excavation, drainage improvement, etc), closing and decommissioning of existing, active roads, as depicted on the map of the Debtors' properties referenced in the draft HCP (all property roads);
- (ii) the removal of trees as reasonably necessary to accomplish road use, maintenance and storm-proofing;
- (iii) rock and gravel mining (including blasting, drilling, extraction, screening, loading and trucking) at quarry sites;
- (iv) scientific surveys;
- (v) the removal of trees blocking roads;
- (vi) fuel removal, in both old-growth residual stands and second-growth stands;
- (vii) fire suppression;
- (viii) stream enhancement projects; and
- (ix) hunting (outside the murrelet breeding season).

Many provisions in the Headwaters HCP and Implementation Agreement deal expressly with buying and selling property. The Implementation Agreement specifies criteria for review and approval of certain transfers of covered lands, such as whether those lands can be sold with or without restriction, and to what extent regulatory review or approval will be required for transfer. In essence, all of these provisions may apply to the way that the HCP will be implemented, including by a potential new owner. Implementation Agreement Section 5.5 describes the potential disposition and sale of lands within the Ancient Redwood Groves. Similarly, HCP Section 6.1.2.2 lists activities that are specifically allowed in the Ancient Redwood Groves, including timber removal, as described in Section 6.1.2.2.2.

As in the case of all land transfers under the HCP and the Implementation Agreement, an Assignment and Assumption Agreement is employed in all HCP property sale transactions to provide notice and to assure that the applicable measures run with the land to the new owner. Other than in this important particular, there are relatively few applicable HCP provisions that affect use or management of HCP-covered property by a new owner that does not plan to manage the property intensively, such as for timber production. In connection with any proposed transfer of HCP-covered lands to a third party, the wildlife agencies will adopt a form of Implementation Agreement "supplement" that demonstrates clearly which provisions of the original Implementation Agreement will or will not

apply to the subject property under the new ownership. Essentially, where not specifically or otherwise described, the original HCP provisions apply and are incorporated by reference.

The Headwaters Implementation Agreement Section 3.1.1 makes clear that the Ancient Redwood Groves were not yet “preserves.” They are owned and operated consistent with the current zoning as Timber Production lands (TPZ), and such are clearly subject to marketing and sale. Moreover, Section 5.5 of the Implementation Agreement provides, in pertinent part, as follows:

PALCO may sell, exchange, or otherwise transfer to a third person one or more of the MMCAs, or as a portion thereof, so long as PALCO demonstrates to the reasonable satisfaction of the Wildlife Agencies that the protection to be afforded by such third party (and its successors) to the marbled murrelet and the habitat of the marbled murrelet in such MMCA(s) and to the other covered species [under the Incidental Take Permits] is equal to or greater than that afforded under the HCP. . . .

Sale of the Ancient Redwood Groves necessarily will include such required assurances of adequate conservation by operation of law for a very simple reason: the restrictions and obligations set forth in the HCP are recorded as covenants, conditions, and restrictions that run with the land and remain binding on successors and assigns.

Section 6.1.2.2.2 of the HCP specifically recognizes that the Debtors are not prohibited from undertaking timber removal, except to the extent such activity would be detrimental to marbled murrelets. The HCP provides that commercial harvest opportunities may be limited in un-entered old-growth stands within the Ancient Redwood Groves, apart from road clearing and construction, fire suppression and fuel removal practices otherwise specifically identified as compatible. However, the HCP provides that “residual [i.e., remnant old growth] stand components are to be managed to recruit functional murrelet habitat.” Recruitment of murrelet habitat through forest “thinning” (harvest of less than all of the standing trees) has been accelerated in the Headwaters Forest and in other habitat management areas by the Bureau of Land Management (Headwaters Forest), the U.S. Forest Service, the National Park Service (Redwood National Park), and the Save the Redwoods League (Mill Creek Park) through selective tree removal to release and increase growth characteristics within stands suppressed by competition and shade.

#### **8.17 Humboldt County Actions in Response to Proposed Redwood Preserve Development.**

The Debtors’ initial plan of reorganization was filed and served on September 30, 2007. Following the filing, on October 9, 2007, the Humboldt County Board of Supervisors (“Board”) held a public meeting and passed an interim, 45-day “urgency ordinance” prohibiting residential uses on lands zoned Timberland Production Zone in the county.

On November 7, 2007, the Board held another public meeting to consider extending the urgency ordinance. At that meeting George A. O’Brien, President and CEO of Palco, indicated to the Board that the Redwood Preserve Development would be developed as a master plan and made the following commitments:

- to commit to transparency and dialogue with Humboldt County and the Board;
- to design and implement the Redwood Preserve Development in coordination with, and based on input from, the Humboldt County Building and Planning and other department staff and counsel;
- to determine what permits and authorizations would be necessary and appropriate for the Redwood Preserve Development given its design, density, location, configuration scale and scope, all of which are yet to be determined, and will be based on such coordination with staff, the Board and upon public input;
- to process a master planned project, and as appropriate, following project design;

- not to piecemeal or segment any permitting or review process;
- to comply with all applicable laws and regulations, including but not limited to the California Environmental Quality Act, National Environmental Policy Act, Endangered Species Act, and the Clean Water Act;
- to include a general plan amendment and/or rezone application if and where appropriate;
- to maintain consistency with the HCP, which runs with the land as a matter of record;
- to continue productive, environmentally appropriate, selective harvest forest management as a part of the Redwood Preserve Development through a joint forest management plan, including a wildlife management plan;
- to minimize conversion of productive resource lands to incompatible uses;
- to utilize existing, storm-proofed roads and landings to the maximum extent practicable; and
- to employ conservation easements, land-trust administration, open-space dedication and/or management planning to enhance resource and conservation values of the Redwood Preserve Development, in keeping with the HCP, while permitting compatible residential development.

The ordinance expired by operation of law, and on December 11, 2007, the Board decided to abandon further efforts to adopt any permanent version of the ordinance.

#### **8.18 Exit Financing.**

On the Effective Date, the Debtors will be authorized to enter into the Palco Exit Facility **and** the Scopac Exit Facility (or the Palco Alternative Exit Facility or the Scopac Exit Facility, as the case may be), as well as any documents or agreements in connection with any of the forgoing. The form of any such documents will be included in the appropriate Plan Supplement. Confirmation of each Plan will constitute an approval of the transactions contemplated thereby and all the actions to be taken, undertakings to be made and obligation to be incurred by the Reorganized Debtors in connection therewith, including the granting of senior Liens on the Scopac Timberlands in favor of the Scopac Exit Facility and the granting of senior Liens on Palco's current assets in favor of the Palco Exit Facility. The Exit Financing may be used for any purpose permitted by the respective facilities, including the funding of obligations under each Plan, such as the payment of Administrative Expense Claims and the satisfaction of ongoing working capital requirements.

In order for the Palco Alternative Plan to become effective, the Debtors will be required to obtain exit financing of approximately \$110 million (the "Palco Alternative Exit Financing"). The financing will be secured by liens on the Preserve Project in addition to certain Palco assets. MAXXAM and Blackstone have agreed to use their best efforts to assist the Debtors in obtaining the Palco Alternative Exit Financing from third parties. In addition, MAXXAM will consider, in good faith, but in its sole discretion, either infusing additional equity into the Reorganized Debtor or participating itself as a lender if that is required as part of the Palco Alternative Exit Financing. As noted above, MAXXAM has successfully completed real estate developments similar in size and scope to the Redwood Preserve Development around the country, including in California. As a result, MAXXAM is familiar with the real estate development financing markets, the process of funding development projects similar to the Redwood Preserve Development, and the various third parties that may be interested in providing the required financing. MAXXAM believes, on the basis of its previous experience, that there is a reasonable probability that it will be able to raise the financing necessary to fund the Palco Alternative Plan, or that MAXXAM will agree to infuse additional equity or participate as a lender. Among other things, the Debtors and MAXXAM note that the present value of the Ancient Redwood Groves alone is \$300 million, which is substantially more than the \$125 million required to fund the Palco Alternative Plan, and is well within the debt/equity ratios required by lenders in most real estate financings. The Debtors and Maxxam, along with the Debtors' Financial Advisors and Greenfield, are working diligently to obtain exit financing. Approximately 25 potential financing sources have been identified

(consisting of institutional investors, asset-backed lenders and special purpose acquisition companies), a summary financing memorandum has been prepared, and discussions with potential lenders are ongoing. Notwithstanding the foregoing, there is no guarantee that MAXXAM and/or Blackstone will be successful in raising the Palco Alternative Exit Financing from third parties or that MAXXAM will agree to infuse additional equity or participate as a lender.

As is customary for exit financing commitments, including those offered by the institutions that the Debtors have approached, the Debtors will likely be required to pay an underwriting deposit so that the Exit Lender(s) can begin due diligence and a field audit. Once the Exit Lender(s) has been selected by the Debtors, the Debtors will file a motion with the Bankruptcy Court requesting authority to pay these fees and expenses. The definitive Exit Financing documents will be filed with the Bankruptcy Court as part of the Plan Supplement.

The Debtors expect that the material terms of the Exit Financing in connection with the Debtors Plan will include the following:

<b><u>Debtors Plan</u></b>		
	<b><u>Palco Exit Facility</u></b>	<b><u>Scopac Exit Facility</u></b>
<b><u>Amount:</u></b>	\$40 million revolver (of which \$21.2 million will be drawn on the Effective Date)	\$50 million revolver (of which \$18 million will be drawn on the Effective Date)
<b><u>Security/Collateral:</u></b>	Scotia Mill	First Priority Lien on all of Scopac's Assets
<b><u>Term:</u></b>	Up to five years	Up to ten years
<b><u>Use of Proceeds (together with \$10 million contributed by MAXXAM):</u></b>	<ul style="list-style-type: none"> <li>• \$8 million Administrative Claims</li> <li>• \$5.7 million other Priority Claims</li> <li>• \$17.5 million to fund Reorganized Palco's turnaround costs and working capital.</li> </ul>	<ul style="list-style-type: none"> <li>• \$10 million Administrative Claims</li> <li>• \$8 million other Priority Claims</li> </ul>
<b><u>Source</u></b>	to be determined	to be determined

The Debtors expect that the material terms of the Exit Financing in connection with the Alternative Plans will include the following, assuming confirmation of the Palco Alternative Plan:

	<b><u>Alternative Exit Facility (Palco and Scopac)</u></b>
<b><u>Amount:</u></b>	\$110 million revolver to be fully drawn on the Effective Date
<b><u>Security/Collateral:</u></b>	Palco Town Assets
<b><u>Term:</u></b>	Up to five years.
<b><u>Use of Proceeds:</u></b>	<ul style="list-style-type: none"> <li>• \$75 Marathon DIP</li> <li>• \$17 million other Palco Cash obligations on the Effective Date</li> <li>• \$18 million other Scopac Cash Obligations on the Effective Date</li> </ul>
<b><u>Source</u></b>	to be determined

If neither the Debtors Plan nor the Palco Alternative Plan is confirmed, Scopac will not enter into an Exit Facility, but the treatment of the Bank of America Line of Credit will be altered. Instead of receiving full Cash payment of its Claim on the Effective Date, it will receive \$20 million in Cash on the Effective Date and a secured note for the estimated \$19 million remainder of its claim.

#### **8.19 Claims Administration Responsibility.**

##### **(a) Prosecution of Objections to Claims.**

As of the date hereof, approximately 642 Proofs of Claim have been filed in the Debtors' Reorganization Cases, asserting Claims in excess of \$7.6 billion. The Debtors have commenced the process of analyzing and categorizing each of these Proofs of Claim. While the Debtors intend to commence the Proof of Claim objection process prior to the Voting Deadline, it is unlikely that the process will be completed before the Confirmation Date.

Article 9.2.1. of the Debtors Plan and Article 8.2.1 of each of the Alternative Plans provides Reorganized Palco or Reorganized Scopac, as the case may be, with the exclusive responsibility and authority for administering, disputing, objecting to, compromising and settling, or otherwise resolving and finalizing Distributions (if any) with respect to all Claims. Reorganized Palco or Reorganized Scopac, as the case may be, also will have the right to litigate any Claims in any other court of competent jurisdiction, subject to any applicable state or federal statute of limitations. In addition, the Debtors may, at any time, request that the Bankruptcy Court estimate any contingent or unliquidated Claim pursuant to section 502(c) of the Bankruptcy Code regardless of whether the Debtors have previously objected to such Claim.

##### **(b) Claims Objection Deadline.**

Article 9.2.2. of the Debtors Plan and Article 8.2.2 of each of the Alternative Plans provides that the Debtors or Reorganized Debtors, as the case may be, will have until the date that is 180 days after the Effective Date to bring any objections to Claims; *provided, however*, that such deadline may be extended by the Bankruptcy Court upon motion of Reorganized Palco or Reorganized Scopac without notice or a hearing.

##### **(c) Compromise and Settlements.**

From and after the Effective Date, and without any further approval by the Bankruptcy Court, Reorganized Palco or Reorganized Scopac, as the case may be, may compromise and settle (i) various Claims against the Debtors or their respective Estates and (ii) Causes of Action that Reorganized Palco or Reorganized Scopac, as the case may

be, has against other Entities. Prior to the Effective Date, Debtors expressly reserve the right to compromise and settle (subject to the approval of the Bankruptcy Court) Claims against them or other claims they may have against other Entities.

## **8.20 Injunctions, Releases, and Discharge.**

The Debtors Plan, the Palco Alternative Plan and the Scopac Alternative Plan provide for entry of various releases and permanent injunctions in favor of the Released Parties and Exculpated Parties. These releases and injunctions are an essential part of each Plan and, if entered, will limit the rights of Holders of Claims against the Released Parties and Exculpated Parties. If these releases and injunctions are not entered, the Debtors will have the right not to proceed with each Plan.

### **(a) Discharge.**

Article 10.1. of the Debtors Plan and Article 9.1 of each of the Alternative Plans provides that except as otherwise expressly provided in the respective Plan or the Confirmation Order, the Confirmation of each Plan will, as of the Effective Date: (i) discharge the Debtors, Reorganized Debtors or any of their Assets from all Claims, demands, liabilities, other debts and Interests that arose on or before the Effective Date, including all debts of the kind specified in sections 502(g), 502(h) or 502(i) of the Bankruptcy Code, whether or not (A) a Proof of Claim based on such debt is filed or deemed filed pursuant to section 501 of the Bankruptcy Code, (B) a Claim based on such debt is Allowed pursuant to section 502 of the Bankruptcy Code or (C) the Holder of a Claim based on such debt has accepted each Plan; (ii) cancel all Interests and other rights of Interests in the Debtors except to the extent that each Plan expressly provides for the retention of such Interests, whether or not (A) a proof of Interest is filed or deemed filed pursuant to section 501 of the Bankruptcy Code, (B) an Interest is Allowed pursuant to section 502 of the Bankruptcy Code or (C) the Holder of an Interest has accepted each Plan; and (iii) preclude all Persons from asserting against the Debtors, Reorganized Debtors or any of their Assets, any other or further Claims or Interests based upon any act or omission, transaction, or other activity of any kind or nature that occurred prior to the Effective Date, all pursuant to sections 524 and 1141 of the Bankruptcy Code. The discharge provided in Article 10.1 of each Plan will void any judgment obtained against any of the Debtors at any time, to the extent that such judgment relates to a discharged Claim or cancelled Interest. Reorganized Debtors will not be responsible for any obligations of the Debtors except those expressly assumed by Reorganized Debtors in each Plan.

### **(b) Discharge Injunction.**

Article 10.1.2. of the Debtors Plan and Article 9.1 of each of the Alternative Plans contains an injunction to implement the discharge granted under each Plan. Except as specifically provided to the contrary in each Plan, the discharge set forth in each Plan will operate as an injunction permanently prohibiting and enjoining all Entities with past or present known or unknown Claims against the Debtors from doing any of the following in respect of such a Claim against the Debtors, Reorganized Debtors, or any of their Assets: (i) commencing or continuing any action any action other than to enforce any right to a Distribution pursuant to each Plan; (ii) enforcing and judgment or similar order against; (iii) creating, perfecting, or enforcing any Lien; (iv) asserting any right of setoff, subrogation or recoupment of any kind against any obligation owed to the Debtors or Reorganized Debtors; (v) commencing or continuing any action that is inconsistent with the provisions of each Plan or the Confirmation Order. This injunction will extend to any successor of the Debtors, Reorganized Debtors, or any of their Assets. Any Entity injured by any willful violation of such injunction will be entitled to recover actual damages, including costs and attorneys' and experts' fees and disbursements, and, in appropriate circumstances, may recover punitive damages. Except as otherwise provided in each Plan, all Entities will be forever barred from asserting against the Debtors, Reorganized Debtors, their successors or assigns, or any of their Assets, any other Claims of any kind that occurred before the Effective Date, whether or not the factual or legal basis for any Claim were known or existed before the Effective Date. The injunctive relief sought is intended to be as broad as allowed under applicable law.

### **(c) Releases by the Debtors.**

**Article 10.2.1 of the Debtors Plan and 9.2.1 of each of the Alternative Plans provide that, as of the Effective Date, the Debtors will be deemed to release and forever waive and discharge all claims (broadly defined) that they may have against the Released Parties that are based in whole or in part on any act**



(broadly defined), that relate in any way to the Debtors, the Reorganization Cases, each Plan, or this Disclosure Statement, if the claims could have been asserted by or on behalf of the Debtors or their Estates at any time up to the Effective Date.

The Released Parties under each of the Plans include each of the Debtors' respective officers, directors, Professionals, agents and employees (the "Debtor Released Parties") and each of MAXXAM, MGHI, MGI and their respective officers, directors, attorneys, professionals, agents and employees (the "MAXXAM Released Parties"). Under the Debtors Plan, the Released Parties also include Marathon, the Indenture Trustee, the Timber Noteholders, and the Committee and their agents and counsel. If any of the Plans is confirmed, the Debtors will be deemed to have released all Claims and Causes of Action the Debtors may currently have, may have had in the past or may in the future have against such parties based on any conduct or events that occurred on or before the Effective Date, including any Claims and Causes of Action asserting liability under sections 544, 547, 548 and 550 of the Bankruptcy Code. The releases set forth in each Plan in favor of the Debtor Released Parties and the MAXXAM Released Parties are commonly found in plans of reorganization similar to each Plan and are clearly justified in this case in light of the Debtors' solvency and the important economic contributions that have been and will be made by such parties to the Debtors' reorganization as more particularly described in this Disclosure Statement.

Notwithstanding anything in any Plan to the contrary, nothing herein will be construed as a release by the Debtors of any Claim, obligation, suit, judgment, damage, demand, debt, right, Cause of Action, or liability related to the Headwaters Litigation.

**(d) Preservation of Rights of Action by the Debtors and Reorganized Debtors.**

Article 10.2.3. of the Debtors Plan provides that certain Causes of Action will be retained by the Debtors and Reorganized Debtors. Except as provided in the Debtors Plan or in any contract, instrument, release or other agreement entered into or delivered in connection with the Debtors Plan, in accordance with section 1123(b) of the Bankruptcy Code and to the fullest extent possible under applicable law, Reorganized Palco will retain the sole right to enforce any claims (broadly defined) that any of the Palco Debtors or Estates may hold against any Entity. Reorganized Palco or its successors may pursue such retained claims as appropriate, in accordance with their best interests. Further, Reorganized Palco retains the sole right to file and pursue any adversary proceedings against any trade creditor or vendor related to debit balances or deposits owed to any of the Palco Debtors.

Article 10.2 of each Plan also provides that the Reorganized Debtors will waive and release certain Causes of Action against third parties arising under the Bankruptcy Code, including preference actions and fraudulent transfers.

**(e) Injunction Related to Releases.**

Article 10.2.4. of the Debtors Plan and Article 9.2.4 of each of the Alternative Plans contain an injunction to implement the releases granted under each Plan. Except as otherwise provided in any Plan or the Confirmation Order, all Entities with past and current claims (broadly defined) that are released pursuant to each Plan are permanently enjoined, on and after the Effective Date, from taking any of the following actions against a Released Party, any of its Assets, or any of its successors on account of any such claims: (i) commencing or continuing in any manner any action (broadly defined); (ii) enforcing any judgment or similar award; (iii) creating, perfecting, or enforcing any Lien or encumbrance; (iv) asserting any right of setoff, subrogation or recoupment of any kind against any obligation owed to any Released Party or any of its Assets or successors; or (v) commencing or continuing any action that is inconsistent with the provisions of each Plan or the Confirmation Order. Any Entity injured by any willful violation of this injunction will be entitled to recover actual damages, including costs and attorneys' fees and experts' fees and disbursements, and in appropriate circumstances, may recover punitive damages.

**(f) Term of Injunctions and Automatic Stay.**

Article 10.6. of the Debtors Plan and Article 9.6 of each of the Alternative Plans provides that all injunctions or stays provided in connection with the Reorganization Cases that are in effect immediately prior to

Confirmation will remain in full force and effect until the injunctions become effective and, if so provided in each Plan, the Confirmation Order or by their own terms, thereafter. These injunctions or stays include, for instance, any injunction or stay that may have been issued by the Bankruptcy Court or that may have arisen by operation of the Bankruptcy Code under section 105, section 362, or any other provision of the Bankruptcy Code, or under any other applicable law or court order. In addition, on and after Confirmation Date, the Debtors may seek further orders to preserve the status quo during the time between the Confirmation Date and the Effective Date.

**(g) Exculpation.**

Article 10.3 of each Plan sets forth protections for certain participants in the plan process, including the Debtors' management and their Professionals and the management and Professionals of MAXXAM, designated as Exculpated Parties. Under the Debtors Plan, the Exculpated Parties also include Marathon, the Indenture Trustee, the Timber Noteholders, and the Committee and their agents and counsel. If any of the Exculpated Parties will be protected from liability other than for gross negligence or willful misconduct in connection with:

- the management or operation of the Debtors or the discharge of their duties under the Bankruptcy Code;
- the implementation of any of the transactions provided for, or contemplated in, each Plan or the other Plan Documents;
- any action taken in connection with either the enforcement of the rights of any Debtor against any Entities or the defense of Claims asserted against any such Debtor with regard to the Reorganization Cases;
- any action taken in the negotiation, formulation, development, proposal, solicitation, disclosure, Confirmation, or implementation of each Plan or the other Plan Documents; or
- the administration of each Plan or the assets and property to be distributed pursuant to each Plan.

None of the Plans protects the Exculpated Parties from liability for any conduct in violation of any Environmental Obligations. Any such liability will be determined under non-bankruptcy law in an appropriate forum. Thus, Article 10.3 of the Debtors Plan and Article 9.3 of each of the Alternative Plans will not apply to Environmental Obligations.

In connection with this provision, the Exculpated Parties are entitled to rely reasonably on the opinions of their respective counsel, accountants, and other experts or professionals. Such reasonable reliance will conclusively establish the absence of gross negligence or willful misconduct. A determination of "unreasonable reliance," however, will not, by itself, establish willful misconduct or gross negligence; it will merely leave the issue to be determined upon appropriate independent proof.

If the Holder of a Claim or Interest or other Entity brings an unsuccessful action for gross negligence or willful misconduct against an Exculpated Party, it will be obligated to pay the reasonable attorneys' fees and costs of the Exculpated Party. Moreover, a condition to going forward with such action will be prior proof that the complaining party is able to pay the Exculpated Party's reasonable attorneys' fees and costs upon failure in the action. The Exculpated Parties have no reciprocal obligation to establish their capacity to pay reasonable attorneys' fees and costs if the complaining party prevails.

## **8.21 Certain Matters Incident to Plan Confirmation.**

### **(a) No Successor Liability.**

Article 10.4 of the Debtors Plan and Article 9.4 of each of the Alternative Plans provide that, except as otherwise expressly provided in each Plan, none of the Released Parties will be determined to be successors to the Debtors or to any Entity for which the Debtors may be held legally responsible, by reason of any theory of law or equity, and none can be responsible for any successor or transferee liability. Article 10.4. of each Plan also provides that the Released Parties do not agree to perform, pay, or indemnify creditors or otherwise have any responsibilities for any liabilities or obligations of the Debtors or Reorganized Debtors, whether arising before, on, or after the Confirmation Date, except as otherwise expressly provided in each Plan.

### **(b) Vesting and Enforcement of Causes of Action.**

Article 10.2.2 of the Debtors Plan and Article 9.2.2 of each of the Alternative Plans provide that all Causes of Action will remain property of the Reorganized Debtors, and may be pursued or compromised as deemed fit by the Reorganized Debtors in their sole discretion without need for approval of the Bankruptcy Court. However, an exception to this retention of rights is that each Plan provides for the waiver and release of preference and fraudulent transfer Causes of Action that might otherwise be brought under sections 544(b), 547, or 548 of the United States Bankruptcy Code.

### **(c) Preferences and Fraudulent Transfers.**

The Debtors believe they will have no preference actions that they or anyone acting on their behalf should pursue in the Reorganization Cases. A preference is a transfer to a creditor in payment of an existing debt made within certain statutorily determined time periods before the commencement of the case. The trustee or the debtor in possession may recover preferences for the benefit of all creditors of the estate in order to prohibit the debtor from favoring some creditors over others on the eve of bankruptcy and frustrating the Bankruptcy Code's goal of equitable distribution to all creditors. To establish a preference and recover funds paid out, the trustee or the estate must prove that a transfer of a debtor's property was made:

- to or for the benefit of a creditor;
- on account of an existing debt;
- while the debtor was insolvent;
- within 90 days (one year, if to an "insider") before the debtor's bankruptcy petition was filed; and
- so as to enable the creditor to receive more than it would have received if the transfer had not been made, the debtor was liquidated under chapter 7 and the creditor received the distributions it would have received in a chapter 7 case.

The preference statute excepts payments made "in the ordinary course of business" according to ordinary business terms, and these payments are not recoverable from creditors. Also excepted are payments made for new value or a substantially contemporaneous exchange of money and goods. Most payments made to creditors within 90 days prior to the Petition Date will be payments to vendors and other trade creditors in the ordinary course of their business. The Debtors believe the ordinary-course defense provided by section 547(c)(2) of the Bankruptcy Code would protect these payments from avoidance.

The Debtors also believe there will be no fraudulent-transfer or conveyance actions that they or anyone else acting on behalf of their unsecured creditors should pursue in the Reorganization Cases. The successful prosecution

of a claim by or on behalf of a debtor or its creditors under the applicable fraudulent-transfer law generally would require a determination that the debtor effected a transfer of an asset or incurred an obligation to an entity either:

- with an actual intent to hinder, delay, or defraud its existing or future creditors (a case of “actual fraud”); or
- in exchange other than for “reasonably equivalent” value or “fair consideration,” when the debtor:
  - was insolvent or rendered insolvent by reason of the transfer or incurrence;
  - was engaged or about to engage in a business or transaction for which its remaining assets would constitute unreasonably small capital; or
  - intended to incur, or believed that it would incur, debts beyond its ability to pay as they mature.

In the case of either actual fraud or constructive fraud involving a transfer of assets, the unpaid creditors affected thereby might be entitled to equitable relief against the transferee of the assets in the form of a recovery of the lesser of (i) the relevant value of the avoided transfer or (ii) the amount necessary to satisfy their claims. The relief in the case of an avoided obligation might take the form of a subordination of that obligation to the claims of creditors entitled to relief.

The measure of insolvency for purposes of a constructive-fraud action would depend on the fraudulent-transfer law being applied. Generally, a transferor is insolvent if, at the relevant time, either:

- the sum of its debts and liabilities, including contingent liabilities, was greater than the value of its assets, at a fair valuation; or
- the fair salable value of its assets was less than the amount required to pay the probable liability on its total existing debts and other liabilities, including contingent liabilities, as they become absolute and mature.

Transactions of the Debtors that could be subject to review and, upon the required showing, avoidance under the applicable fraudulent transfer law would be limited to those occurring within the relevant limitations period. In the case of actions under section 548 of the Bankruptcy Code, that period would be the twelve-month period ending on the Petition Date. In the case of actions under a state fraudulent-transfer law, the limitations period ranges from one year to six or more years after the questioned transfer or incurrence of an obligation is effected. Under most state laws, including the laws of California and Texas, the limitations period generally would be four years. Under these standards, if a debtor makes a payment when it is solvent or the payee does not receive more than it would receive in a chapter 7 liquidation of that Debtor, the payment will not be avoidable as preferential or as a fraudulent transfer.

The Debtors believe they are now solvent and that they were solvent on the Petition Date. Because each Plan provides for payment in full of all unsecured creditors of the Debtors, the Debtors also believe their pre-filing payments will not cause unsecured creditors in the Reorganization Cases to receive more favorable treatment than other of their creditors. Moreover, since each Plan provides for payment in full of unsecured creditors, any claim arising under 11 U.S.C. § 502 (h) as a result of a successful preference or fraudulent transfer action would be paid in full under each Plan. Accordingly, each Plan provides for the waiver and release of preference and fraudulent transfer Causes of Action that might otherwise be brought under sections 544(b), 547, or 548 of the United States Bankruptcy Code.

## **8.22 Recommendation of the Debtors.**

As to the Debtors Plan, the Debtors strongly recommend that all Holders of Claims in Palco Classes 2, 3, 4, and 8 and Scopac Classes 2, 3, 4, 5,, and 8 vote to accept the Debtors Plan and return their Ballots in the enclosed envelope to the Balloting Agent *so that they will be received*, on or before **4:00 p.m.**, prevailing Central Time, on **March 25, 2008**

As to the Alternative Plans, the Debtors strongly recommend that all Holders of Claims or Interests in Palco Classes 3 and 8 and Scopac Classes 3, 4, and 8 vote to accept each Alternative Plan and return their Ballots in the enclosed envelope to the Balloting Agent *so that they will be received*, on or before **4:00 p.m.**, prevailing Central Time, on **March 25, 2008**

The Debtors ask you to vote for both the Debtors Plan and the Alternative Plans. There is not expected to be an opportunity to solicit votes for the Alternative Plans at a later point in these cases. In order for the Alternative Plans to serve as an alternative for Scopac, your vote needs to be received now.

In the view of the Debtors, each Plan provides the best available alternative for providing equitable and expeditious distributions to Holders of Claims out of the Debtors' Estates. Your support of each Plan will enable it to be implemented and help ensure its success.

## **SECTION 9. RISKS UNDER THE COMPETING PLANS**

### **9.1 General.**

The following is a summary of various risks associated with each of the proposed Plans. However, it is not exhaustive and should be supplemented by careful analysis and evaluation of each Plan and this Joint Disclosure Statement as a whole by each holder of a claim or an interest with that holder's own advisors. In addition to the various risks associated with each of the proposed Plans, each of the Plans has certain conditions precedent that each of the Plan Proponents state must be satisfied prior to consummation of their Plan. *All parties are urged to carefully review each of the Plans in detail with respect to the conditions precedent for each of the Plans.*

### **9.2 Confirmation Risks.**

In order for a plan to be confirmed, the Bankruptcy Code generally requires that impaired classes vote to accept each Plan. This requires that voting creditors in each class approve a Plan by:

- over one-half in number of creditors (50% + 1); and
- at least two-thirds in dollar amount.

There is no guarantee that these thresholds will be reached as to any Plan or that the Bankruptcy Court will concur with the vote tally. Objections to any Plan also could prevent confirmation of the Plan or delay such confirmation for a significant period of time.

### **9.3 Variance from Pro Forma Financial Projections.**

The feasibility of each of the competing Plans is based on pro forma financial projections, which are estimates of future performance prepared by each of the Plan Proponents. Each of the Plan Proponents believes that their respective financial projections are based on reasonable assumptions. Unanticipated events and circumstances occurring subsequent to the preparation of such projections, however, may affect the actual pro forma financial results of the reorganized Debtors. Although the Plan Proponents' believe that their respective projections are reasonable and attainable, some or all of the estimates will vary from actual results, and variations between the actual financial results and those projected may be material and adverse.

#### **9.4 Regulatory and Environmental Risks.**

Laws, regulations and related judicial decisions and administrative interpretations dealing with forest product operations and real estate developments such as those contemplated by the Debtors Plan and Alternative Plans are subject to change and new laws and regulations are frequently introduced concerning the California timber industry and real estate industry. From time to time, bills are introduced or ballot initiatives commenced relating to the Debtors' forest products operations. Such regulatory and legislative actions have the ability to significantly restrict and ultimately limit harvest levels and may require Reorganized Entities to incur additional costs, cause delays in obtaining THP approvals, reduce cash flows, and have other material adverse consequences.

#### **9.5 Litigation Risks.**

Litigation proceedings could result in adverse effects on the Debtors. Palco and Scopac were involved in a variety of pending legal proceedings as of the Petition Date. While these legal proceedings are in general stayed as against the Debtors while the companies are in bankruptcy, such proceedings could be continued if the stay is modified by the Bankruptcy Court, if the cases are dismissed, or in certain circumstances, upon the emergence of the Debtors from bankruptcy. Were such legal proceedings to then be decided against one or more of the Debtors, there could be an adverse effect upon them, which could under certain circumstances be materially adverse to their financial condition, results of operation, or liquidity. Moreover, additional legal proceedings could be filed against any of the Debtors, further increasing litigation costs and subjecting the Debtors to potential adverse decisions.

#### **9.6 Commodity Risk.**

Lumber is a commodity and subject to the particular vagaries and unpredictability of commodity markets and commodity pricing. Historically, lumber prices have been subject to wide swings in price. The demand for lumber is affected primarily by the level of new construction activity, and to a lesser extent, remodeling and repair activity, and other industrial uses. These activities are subject to fluctuations due to factors including, but not limited to, the following: changes in domestic and international economic conditions, interest rates or the availability of financing, population growth and changing demographics, availability of contract loggers, damage by fire, insect infestation, or disease, prolonged drought, seasonal weather cycles and other weather driven events. Also, decreases in the level of residential construction activity or repair and remodeling activity generally reduce demand for logs and wood products. In addition, timber owners generally increase production volumes for logs and related products during favorable price environments. Such increased production, however, when coupled with declines in demand for products in general, could lead to oversupply and lower prices. The foregoing can adversely affect cash flows for the Debtors.

#### **9.7 Risks Associated with the MRC/Marathon Plan.**

MRC and Marathon believe that there is sufficient committed capital and operating cash flow to meet the operating requirements of the Reorganized Entities under the MRC/Marathon Plan, including obligations with respect to Priority Tax Claims and any notes issued under the MRC/Marathon Plan. At the Confirmation Hearing, the Bankruptcy Court will be required to make a judicial determination that the Plan is feasible and legally confirmable. MRC has operated a similar amount of redwood timberland acreage since July 1998, and has formulated the business plan for Newco based on MRC's experience. Notwithstanding MRC's experience, redwood timberlands are subject to significant federal state and local regulation as more fully discussed in the above Section entitled "Regulatory and Environmental Risks." In addition, the end products from redwood timberlands are subject to cyclicity of demand and price swings as more fully discussed in the above Section entitled "Commodity Risk." In addition, there are numerous other risks associated with owning and operating timberlands and a sawmill including, without limitation, fire, pests, unforeseen costs, all of which are more fully discussed in the above Section entitled "Commodity Risk." Finally, availability of skilled labor at costs that can be borne by the business is one of the many factors that can affect future performance, as more fully discussed in the above section entitled "Variance from Pro Forma Financial Projections."

## **9.8 Risks Associated with the Indenture Trustee Plan.**

Both the confirmation and consummation of the Indenture Trustee Plan are subject to a number of risks. Specifically, the sale proposed in the Indenture Trustee Plan may not generate the proceeds that are estimated. In addition, there are certain risks inherent in the confirmation process under the Bankruptcy Code. If certain standards set forth in the Bankruptcy Code are not met, the Bankruptcy Court will not confirm the Indenture Trustee Plan even if Claimholders accept the Plan. Although the Indenture Trustee believes that the Indenture Trustee Plan meets such standards, there can be no assurance that the Bankruptcy Court will reach the same conclusion. The Indenture Trustee believes that the solicitation of votes on the Indenture Trustee Plan will comply with section 1126(b) and that the Bankruptcy Court will confirm the Indenture Trustee Plan.

## **9.9 Risks Associated with the Debtors Plan and Alternative Plans.**

### **(a) Confirmation Risk**

The Debtors do not believe that the Debtors Plan is eligible to be crammed down on creditors who vote against it. Although the Debtors believe that, in contrast, the Alternative Plans will satisfy all requirements necessary for Confirmation by the Bankruptcy Court, there is no assurance that the Bankruptcy Court will reach the same conclusion or that the Confirmation, if challenged on appeal, will be affirmed.

### **(b) Sale of the Ancient Redwood Groves (Debtors Only).**

Although the Debtors believe that environmental considerations, potential tax benefits to certain buyers, and the uniqueness of the Ancient Redwood Groves will facilitate their sale within 36 months at the prices that are included in the Debtors' projected cash flows, there can be no guarantee that the sales will occur on schedule or for the expected amounts.

### **(c) Redwood Preserve Development (Debtors Plans Only).**

The design, density, location, configuration scale and scope of the Redwood Preserve Development are yet to be determined. Therefore, there can be no guarantee that the Redwood Preserve Development will proceed at all or that it can receive the necessary entitlements within the Debtors' schedule or that it will yield the projected returns. Among the many factors that might influence the success of this project are the substantial existing environmental and land use regulatory requirements with which the Redwood Preserve Development must comply and the regulatory hurdles that could be imposed.

### **(d) Exit Facilities.**

Both the Debtors Plan and the Alternative Plans can be consummated only if the Debtors succeed in obtaining the Exit Facilities. MAXXAM has agreed to use its best efforts to assist the Debtors in obtaining these Facilities, but there can be no guarantee that MAXXAM or the Debtors will be successful.

### **(e) Risk of Post-Confirmation Default.**

The Debtors believe that sufficient operating cash flow will be generated to meet the Reorganized Debtors' operating requirements under the Debtors Plan, including obligations with respect to Priority Tax Claims and any notes issued under the Debtors Plan or the Alternative Plans. At the Confirmation Hearing, the Bankruptcy Court will be required to make a judicial determination that the Debtors Plan is feasible. The Debtors believe that the risk of post-confirmation default under the Palco Alternative Plan is de minimis, because that Plan calls for the immediate satisfaction of most of Palco's obligations by means of a significant oversecured exit facility, and the payment of certain unsecured claims over seven years in an amount well within the projected cashflow available to Palco postconfirmation. Likewise, the Debtors believe that the risk of post-confirmation default under the Scopac Alternative Plan is de minimis, because that Plan calls for the immediate satisfaction of Scopac's obligations followed by a revesting of assets in Scopac free and clear of most Claims.

**(f) Variance from Reorganized Debtors' Pro Forma Financial Projections (Debtors Plan Only).**

The Pro Forma Financial Projections are based upon numerous assumptions regarding (a) the tax consequences of the Debtors Plan and the Alternative Plans (see below), (b) the anticipated future performance of the Reorganized Debtors, (d) the Confirmation and consummation of each Plan in accordance with its terms, (e) general business and economic conditions, and (f) certain other matters, many of which are beyond the control of the Debtors. There is no assurance that such assumptions will prove to be valid. The effect of any variance from the projections may be material and adverse.

**(g) Regulatory and Environmental Risks (Debtors Plan Only).**

As mentioned above, laws, regulations and related judicial decisions and administrative interpretations dealing with forest product operations are subject to change and new laws and regulations are frequently introduced concerning the California timber industry. Specific regulatory action that could impact Reorganized Debtors includes, but is not limited to, the following:

(1) The North Coast Water Board has adopted WWDRs for the Freshwater and Elk River watersheds. This decision allows harvesting in these two watersheds once THPs are reviewed and enrolled by the staff of the North Coast Water Board. In addition, the Executive Officer of the North Coast Water Board has approved a monitoring and reporting program, which has the effect of allowing enrollment by the staff of the North Coast Water Board of additional THPs for these two watersheds. There can be no assurance that THPs for these two watersheds will ultimately be enrolled or harvested as planned in future years. If there are delays in the enrollment of these THPs, there could be a further significant adverse impact on current and future harvest levels and the cash flows of the Reorganized Debtors.

(2) The final TMDL requirements applicable to the Timberlands may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the watershed analysis process provided for in the HCP. These requirements may further reduce harvesting on the Timberlands and the cash flows of Reorganized Debtors.

(3) The North Coast Water Board has issued the Elk River Orders, which are aimed at addressing existing sediment production sites through clean up actions in the Elk River watershed, and has initiated the process which could result in similar orders for other watersheds. The Elk River Orders have resulted in increased costs that could extend over a number of years, and additional orders for other watersheds could have similar effects.

(4) The North Coast Water Board has imposed requirements for certain mitigation and erosion control practices in several watersheds within the Timberlands. The requirements imposed to date have significantly increased operating costs. Additional requirements imposed in the future could further increase costs and cause delays in THP approvals.

(5) The Debtors are uncertain of the operational and financial effects that will ultimately result from California Senate Bill 810, which provides regional water quality control boards with additional authority related to the approval of THPs within impaired watersheds. Implementation of this law could, however, result in delays in obtaining approvals of THPs, lower harvest levels, and increased costs.

(6) While the HCP covers 17 different species, it is possible that additional species could be designated as endangered or threatened under the Federal Endangered Species Act or the California Endangered Species Act. The designation of a species as endangered or threatened under the Federal Endangered Species Act or the California Endangered Species Act can significantly reduce harvest levels if that species inhabits the Timberlands or if habitat found on the Timberlands is deemed favorable to the species.

(7) The U.S. District Court for the Northern District of California has held that forest roads and their associated drainage features in the Bear Creek watershed may require special stormwater permitting. If the



court eventually rules that such permitting is required, plaintiff would likely seek to have the requirement applied to the Debtors' other watersheds. See Section 3.1(b) for more information.

(8) In October 2003, the court upheld the validity of an EPA regulation that exempts harvesting and other forestry activities from certain discharge requirements. Both state and federal agencies, along with Palco and other timber companies, have relied upon this regulation for more than 25 years. However, the court interpreted the regulation in such a way as to narrow the forestry operations that are exempted, thereby limiting the regulation's applicability and subjecting culverts, ditches and other "point sources" to permit requirements. This ruling has widespread implications for the timber industry in the United States. Should the court's October 2003 decision ultimately become final and be held to apply to all of the timber operations of Palco and Scopac, it may have some or all of the following effects: imposing additional permitting requirements, delaying approvals of THPs, increasing harvesting costs, and adding water protection measures beyond those contained in the HCP. The Debtors believe that civil penalties should not be awarded for operations that occurred prior to the court's decision due to timber companies' historical reliance on the EPA regulation and Palco's belief that the requirements under the HCP are adequate to ensure that sediment and pollutants from harvesting activities on the Timberlands will not reach levels harmful to the environment. While the impact of a conclusion to this case that upholds the October 2003 ruling may be adverse, the Debtors do not believe that such an outcome should have a material adverse impact on their consolidated financial condition, results of operations or liquidity. Nevertheless, due to the numerous ways in which the court's interpretation of the regulation could be applied to actual operations, there can be no assurance that this will be the case.

**(h) Risk of Post-Confirmation Default.**

The Debtors believe that sufficient operating cash flow will be generated to meet the Reorganized Debtors' operating requirements under the Debtors Plan, including obligations with respect to Priority Tax Claims and any notes issued under such Plan. At the Confirmation Hearing, the Bankruptcy Court will be required to make a judicial determination that the Debtors Plan is feasible. The Debtors believe that the risk of post-confirmation default under the Palco Alternative Plan is de minimis, because that Plan calls for the immediate satisfaction of most Palco's obligations by means of a significant oversecured exit facility, and the payment of certain unsecured claims over seven years in an amount well within the projected cashflow available to Palco postconfirmation. Likewise, the Debtors believe that the risk of post-confirmation default under the Scopac Alternative Plan is de minimis, because that Plan calls for the immediate satisfaction of Scopac's obligations followed by a revesting of assets in Scopac free and clear of most Claims.

**(i) Transactions in Bankruptcy.**

As a part of their businesses, the Debtors sell or acquire assets, or enter into similar types of corporate transactions, from time to time, when determined to be appropriate by their respective boards or managing members. If appropriate opportunities arise, any of the Debtors may enter into one or more of such transactions during the pendency of the Reorganization Cases. Depending on the size and nature of the transaction, the transaction may require Bankruptcy Court approval and, in certain instances, may require the Debtors to make additional disclosures or offer creditors an opportunity to change their votes. The need to make additional disclosures or to offer creditors an opportunity to change their votes could delay these bankruptcy cases and occurrence of the Effective Date under a Plan.

**(j) Appointment of Trustee or Conversion of Cases to Chapter 7 Liquidation.**

The Bankruptcy Court has indicated that a possible result of the failure of any of the Plans to be confirmed could well be either the appointment of a trustee to take control of the Debtors' operations, or the conversion of these chapter 11 reorganization cases to chapter 7 liquidation cases. Moreover, as noted above, there can be no assurance that the Indenture Trustee's motion for appointment of a trustee for Scopac's estate will not be granted. The Debtors believe that the appointment of a trustee at this late stage of the chapter 11 cases probably would result in the failure of the reorganization effort, as a result, among other factors, of the practical inability of a trustee to get up to speed on the Debtors' business and the reorganization effort in sufficient time to permit significant progress before liquidity pressures on the Debtors' proved insupportable. The Debtors believe, therefore, that the appointment of a trustee, or the conversion of these cases to chapter 7 liquidation cases, would result in the failure of

the Debtors' businesses, the loss of jobs, the destruction of going-concern value, and the lack of meaningful distributions to or recoveries by any party in this case other than Marathon and the Timber Noteholders represented by the Indenture Trustee.

The Indenture Trustee believes that, given the Debtors' declining financial performance, including Palco's imminent depletion of all of its available cash and existing equity interest holders unwillingness to fund the Palco Debtors' operations, the Palco Debtors' reorganization efforts are already unworkable and the appointment of a chapter 11 trustee for Scopac who recognizes the separate nature of Scopac as a special purpose entity formed for the benefit of Scopac's creditors rather than primarily as a source of funding for the Palco Debtors would ultimately reduce reorganization costs and lead to a more streamlined consensual administration of the assets for the benefit of Scopac's creditors.

## **SECTION 10. ALTERNATIVES TO THE COMPETING PLANS**

If none of the competing Plans are confirmed and consummated, alternatives to the Plans include (a) an alternative plan of reorganization, (b) liquidation of the Debtors under chapter 7 of the Bankruptcy Code, and (c) dismissal of the Debtors' cases.

### **10.1 Alternative Plan of Reorganization.**

Because exclusivity has been terminated, any party in interest could attempt to formulate a different plan of reorganization. The Plan Proponents believe that the confirmation and implementation of each of their respective Plans is preferable to any liquidation alternatives because such Plans would provide greater recoveries than those available in liquidation.

### **10.2 Liquidation under Chapter 7.**

If none of the competing Plans is confirmed, the Debtors' chapter 11 cases may be converted to cases under chapter 7 of the Bankruptcy Code, pursuant to which a trustee or trustees would be appointed to liquidate the assets of the Debtors for distribution in accordance with the priorities established by the Bankruptcy Code.

The Liquidation Analysis prepared by the Debtors is attached to this Disclosure Statement as Exhibit E. As indicated in the assumptions listed in the Liquidation Analysis, two of the principal assumptions underlying the results of the Liquidation Analysis are that the trustee in a chapter 7 proceeding would not sell the assets of the Debtors on a going-concern basis. The Plan Proponents agree that maintaining the value of the Debtors' business as a going concern maximizes the value of the estates.

The Liquidation Analysis takes into account the nature, status, and underlying value of the Debtors' assets, the ultimate realizable value of their assets, and the extent to which such assets are subject to liens and security interests. Although the Plan Proponents (other than the Debtors) do not necessarily agree or disagree with the Liquidation Analysis, each of the Plan Proponents believes, as to their respective Plan only, that a chapter 7 liquidation of the Debtors' assets would produce less value for distribution to creditors than that recoverable under such Plan.

The Liquidation Analysis is based upon a number of estimates and assumptions which, while considered reasonable by the Debtors, are inherently beyond the control of the Debtors or any chapter 7 trustee. There can be no assurances that the values reflected in the Liquidation Analysis would be realized if the Debtors were to undergo such liquidation. Instead, actual results could vary materially from those shown in the Liquidation Analysis. In addition, any liquidation necessarily would take place in the future under circumstances that presently cannot be predicted. Accordingly, if the Debtors' Estates were liquidated, the actual liquidation proceeds could be materially lower or higher than the amounts set forth in the Liquidation Analysis, and no representation or warranty can be made with respect to the actual proceeds that could be received in chapter 7 liquidation proceedings.

### 10.3 Dismissal.

If none of the competing Plans are confirmed, or if all conditions to effectiveness of the respective Plans are not met, the Debtors or other parties-in-interest could request dismissal of these cases, the effect of which would be to return the Debtors to their pre-filing status as nondebtors. The Bankruptcy Court would determine whether dismissal was appropriate.

## SECTION 11. CERTAIN FEDERAL INCOME TAX CONSEQUENCES OF THE COMPETING PLANS

**IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the IRS, you are hereby notified that: (a) any discussion of U.S. federal tax issues in this document is not intended or written by us to be relied upon, and cannot be relied upon by Creditors, for the purpose of avoiding penalties that may be imposed on such Creditors under the Internal Revenue Code; (b) such discussion is written in connection with the promotion or marketing of the transactions or matters addressed herein; and (c) each Creditor should seek advice based on its particular circumstances from an independent tax advisor.**

The following is a summary of the anticipated material federal income tax consequences of the implementation of any of the Plans to the Debtors or creditors. *No Plan Proponent adopts the tax analysis provided by any other competing Plan Proponent and does not express any views about the tax consequences of any competing Plan. Information about each Plan Proponent's views on the tax consequences of their respective Plan is specifically designated below.*

### 11.1 Scope of This Summary.

This summary is based on the Internal Revenue Code, final and temporary Treasury Regulations promulgated thereunder, administrative pronouncements or practices, and judicial decisions, all as of the date hereof. Future legislative, judicial, or administrative modifications, revocations, or interpretations, which may or may not be retroactive, may result in federal income tax consequences significantly different from those discussed herein. This summary is not binding on the U.S. Internal Revenue Service ("IRS") or U.S. courts, and no assurance can be given that the conclusions reached in this summary will not be challenged by the IRS or will be sustained by a U.S. court if so challenged. In addition, the Debtors have not requested, and do not intend to request, a ruling from the IRS regarding any of the federal income tax consequences of the implementation of any of the Plans to the Debtors or creditors.

This summary does not address the federal income tax consequences to certain categories of creditors subject to special rules, including creditors that are (a) banks, financial institutions, or insurance companies, (b) real estate investment trusts, cooperatives, regulated investment companies, mutual funds, or small business investment companies, (c) brokers or dealers in securities, (d) tax-exempt organizations, (e) investors in pass-through entities and such entities themselves, and (f) foreign taxpayers. Furthermore, this summary is limited to U.S. federal income tax consequences and does not discuss state, local or foreign tax consequences or federal estate or gift tax consequences.

This summary is for general information purposes only and does not purport to be a complete analysis or listing of all potential federal income tax consequences that may apply to the Debtors and creditors as a result of the implementation of any of the Plans. In addition, this summary does not take into account the individual facts and circumstances of any particular creditor that may affect the federal income tax consequences to such creditor of the implementation of any of the Plan. Accordingly, this summary is not intended to be, and should not be construed as, legal or federal income tax advice with respect to any creditor. Each creditor should consult its own tax advisor regarding the federal, state, local, and foreign tax consequences of each of the proposed Plans.

In the case of the Debtors Plan and the Alternative Plans, the discussion that follows is based on the assumptions that Reorganized Palco will be treated as a corporation, and Reorganized Scopac will elect to be treated

as a partnership, for U.S. federal income tax purposes. In the case of the MRC/Marathon Plan, the discussion that follows is based on the assumptions that the reorganization will result in a transfer of the assets of the Debtors to Newco and Townco, two limited liability companies that will elect to be treated as partnerships for U.S. federal income tax purposes.

## **11.2 Federal Income Tax Consequences to the Debtors.**

As more particularly discussed below, MRC/Marathon and the Indenture Trustee do not believe that the implementation of the MRC/Marathon Plan and the Indenture Trustee Plan, respectively, will create a federal tax liability or a tax refund for the Debtors. This belief is based on the assumption that the amount of gain recognized by the Debtors under the Marathon/MRC Plan and the Indenture Trustee Plan would not exceed the NOLs of the Debtors.

The Joint Debtor Proponents also do not believe that the implementation of the Debtors Plan will create a federal tax liability or a tax refund for the Debtors, although this conclusion is subject to confirmation that either (i) the amount of gain recognized by the Debtors under the Debtors Plan would not exceed their NOLs or (ii) if the gain would exceed available NOLs, the Debtors would not be required to reimburse MAXXAM for the tax paid by the MAXXAM consolidated group on such gain. *The federal income tax consequences to the Debtors under the Alternative Plans are discussed in a separate section below.*

### **(a) Cancellation of Indebtedness.**

Under the Internal Revenue Code, a taxpayer generally must include in gross income the amount of any cancellation of indebtedness income (“COD Income”) realized during the taxable year. Section 108 of the Internal Revenue Code provides that a taxpayer does not realize COD Income from cancellation of indebtedness to the extent that payment of such indebtedness would have given rise to an income tax deduction. Section 108 of the Internal Revenue Code provides further that if (i) a cancellation occurs in a case under the Bankruptcy Code, (ii) the taxpayer is under the jurisdiction of a bankruptcy court, and (iii) the cancellation is granted by the court or is pursuant to a Plan approved by the court, then the COD Income may be excluded from gross income but must be applied to reduce certain tax attributes of the taxpayer.

#### **(1) MRC/Marathon Plan.**

Under the MRC/Marathon Plan, although certain debt will be cancelled, this should not give rise to COD Income to the reorganized entities because the MRC/Marathon Plan is a transfer of assets pursuant to a reorganization. Any COD Income would apply to the Debtors. However, the Debtors should not recognize COD Income (except to the extent that any interest previously accrued and deducted by the Debtors is not required to be paid) with respect to Administrative Expense Claims, Priority Tax Claims, or Claims in all Classes because of the operation of section 108 of the Internal Revenue Code.

#### **(2) Indenture Trustee Plan.**

No cancellation of indebtedness is contemplated under the Indenture Trustee Plan.

#### **(3) Debtors Plan.**

Under the Debtors Plan, Holders of all Claims, except for the Claims under the DIP Facility, the Palco Term Loan Claim, the Scopac Timber Noteholder Claims, the Palco Non-Debtor Affiliate Claims, and the Scopac Non-Debtor Affiliate Claims will be paid the full amount of their Allowed Claims. Although the entire amount of the Palco Non-Debtor Affiliate Claims and Scopac Non-Debtor Affiliate Claims will be contributed to the capital of the Debtors, this should not give rise to COD Income. Accordingly, satisfaction of all Claims under the Debtors Plan, other than the Claims under the DIP Facility, the Palco Term Loan, and the Scopac Timber Notes, should not give rise to COD Income to the Debtors (except to the extent that any interest previously accrued and deducted by the Debtors is not required to be paid) so as to bring into operation section 108 of the Internal Revenue Code with respect to those other Claims.

The Debtors would realize COD Income with respect to the satisfaction of the Claims under the DIP Facility, the Palco Term Loan, and the Scopac Timber Notes if and to the extent that:

- The fair market value of the Reorganized Palco common stock paid to the Holder of Claims under the DIP Facility is less than the adjusted issue price of the indebtedness represented by the DIP Facility;
- The fair market value of the Reorganized Palco common stock and Palco Town Assets paid in satisfaction of the Palco Term Loan Claim is less than the adjusted issue price of the indebtedness represented by the Palco Term Loan; and
- The sum of the fair market value of the Scopac Class A Shares and Scopac Class B Shares and the issue price of the New Timber Notes paid in satisfaction of the Scopac Timber Noteholder Claims, is less than the adjusted issue price of the indebtedness represented by the Scopac Timber Notes.

Any COD Income recognized by the Debtors under the foregoing provisions will be excluded from taxable income. The Debtors will, however, be required to reduce their net operating loss carryovers (“NOLs”) by such COD Income.

**(b) Tax Treatment of Mergers.**

**(1) MRC/Marathon Plan.**

There are no mergers proposed under the MRC/Marathon Plan. The transfer of assets pursuant to a reorganization will constitute a taxable transaction for federal tax purposes for the Debtors. However, with respect to federal income taxes, taxable gain to the Debtors from the transfer of assets pursuant to the reorganization should be offset to the extent of the net operating losses of the Debtors. This belief is subject to confirmation that the amount of gain recognized by the Debtors under the MRC/Marathon Plan would not exceed the NOLs of the Debtors, and any tax due for taxable gain that is not subject to offset shall result in a New Timber Note Adjustment.

With respect to California state taxes, taxable gain to the Debtors from the transfer of assets pursuant to the reorganization may not be completely offset to the extent of the NOLs of the Debtors because of certain limitations on the use of NOLs under California state tax laws compared to federal tax laws. Any state tax due for taxable gain that is not subject to offset shall result in a New Timber Note Adjustment.

**(2) Indenture Trustee Plan.**

No mergers are contemplated under the Indenture Trustee Plan.

**(3) Debtors Plan.**

Under the Debtors Plan, the mergers of Salmon Creek and Scotia Development with and into Palco will not constitute a taxable transaction for federal tax purposes because Salmon Creek and Scotia Development are disregarded entities for federal tax purposes. The mergers of Britt and Scotia Inn with and into Palco would not constitute a taxable transaction for federal tax purposes if the value of the assets of Britt and Scotia, as the case may be, exceeds the amount of their respective liabilities. Otherwise, such mergers of Britt and Scotia Inn with and into Palco could constitute a taxable transaction for federal tax purposes.

**(c) Impact on Debtors’ NOLs; Section 382 Limitations.**

In general, if a taxpayer has NOLs, it may carry such NOLs back to the 2 previous taxable years and forward to the next 20 taxable years. If the taxpayer paid income taxes in a carryback year, it may be entitled to a refund of those taxes. An NOL carryforward, on the other hand, will generally reduce or eliminate the taxes payable in one or more carryforward years. Section 382 of the Internal Revenue Code, however, limits a corporate taxpayer’s utilization of an NOL following a Section 382 Ownership Change. A Section 382 Ownership Change

occurs when the percentage of stock (determined on the basis of value) owned by one or more holders of at least 5% of such stock increases by more than 50 percentage points (in relationship to the corporation's total stock considered to be outstanding for this purpose) from the lowest percentage of stock that was owned by such 5% shareholders at any time during the applicable "testing period." The testing period is ordinarily the shorter of (i) the three-year period preceding the date of testing or (ii) the period of time since the most recent ownership change of the corporation. In general, for purposes of determining stock ownership under section 382 of the Internal Revenue Code, stock owned by an entity is deemed owned proportionately by its owners and, with certain exceptions, all persons holding less than 5% of the value of the corporation's stock are treated as a single 5% shareholder.

When the limitation under section 382 (the "Section 382 Limitation") applies, the maximum amount of Pre-Section 382 Ownership Change NOLs that may be utilized by the corporate taxpayer to offset taxable income in taxable years following the Section 382 Ownership Change is limited to an annual amount generally equal to the product of (i) the applicable federal long-term exempt rate in effect on the date of the ownership change and (ii) the value of the corporation's equity immediately prior to the Section 382 Ownership Change (the "Annual Limitation"). Any unused Annual Limitation may be carried forward to increase the amount of income that may be offset by the NOL in subsequent years. However, special rules apply in cases where a Section 382 Ownership Change occurs in bankruptcy. Under these special rules:

- If a corporation is under the jurisdiction of the court in a title 11 or similar case and undergoes a Section 382 Ownership Change, and the existing stockholders and "qualified creditors" of the corporation own at least 50% of the corporation's stock immediately after the Section 382 Ownership Change, the Section 382 Limitation does not apply (the "Section 382(l)(5) Exception"). A "qualified creditor" includes any creditor who holds indebtedness that (i) was held by such creditor at least 18 months prior to the filing of bankruptcy or (ii) arose in the ordinary course of the debtor's trade or business and has been held at all times by such creditor.
- If a corporation exchanges debt for stock in a title 11 or similar case and undergoes a Section 382 Ownership Change, and the requirements in the preceding paragraph are not met (or the corporation elects not to have the rule described in the preceding paragraph apply), the Annual Limitation is generally equal to the product of (i) the applicable federal long-term exempt rate in effect on the date of the ownership change and (ii) the value of the corporation's equity immediately after taking into account the equity that is issued in exchange for debt in the bankruptcy restructuring (rather than the value of the corporation's equity immediately prior to the bankruptcy restructuring).

(1) **Effects of the Implementation of the MRC/Marathon Plan on Debtors' NOLs**

Internal Revenue Code section 382 will not apply as a result of the transactions contemplated under the MRC/Marathon Plan since the net operating losses will remain a tax attribute of the entities transferring the assets pursuant to a reorganization. Moreover, Internal Revenue Code section 382 will not apply to limit, or deny in full, the availability of the Debtors' net operating loss and tax credit carry-forwards as a result of the transactions contemplated under the MRC/Marathon Plan.

(2) **Effects of the Implementation of the Indenture Trustee Plan on the Debtors' NOLs**

Internal Revenue Code section 382 could substantially limit, or deny in full, the availability of the Debtor's net operating loss and tax credit carry-forwards as a result of the transactions contemplated under the Indenture Trustee Plan. Moreover, Internal Revenue Code section 108 could result in the reduction of the loss and credit carry-forward based on the amount of debt discharged as provided by the Indenture Trustee Plan.

(3) **Effects of the Implementation of the Debtors Plan on the Debtors' NOLs**

*Reduction of NOLs Due to COD Income Realization and Gain Recognition.* As indicated in "Cancellation of Indebtedness" above, the Debtors may realize COD Income from the satisfaction of the Claims under the DIP Facility, the Palco Term Loan, and the Scopac Timber Notes under the Debtors Plan. The Debtors' NOLs will be

reduced by the amount of such COD Income. Moreover, the transfers of the Palco Town Assets, Scopac Class A Shares and Scopac Class B Shares to Creditors will generate taxable gain to the Debtors, which will also reduce the NOLs of the Debtors.

*Limitation on Remaining NOLs Due to Section 382 Ownership Change.* Under the Debtors Plan, the transfer of Palco common stock in satisfaction of the Claims under the DIP Facility and the Palco Term Loan will result in a Section 382 Ownership Change. Moreover, the Debtors do not believe that the Holder of the Claims under the DIP Facility and the Palco Term Loan is a “qualified creditor” and, thus, that the Section 382(l)(5) Exception described in “Section 382 Limitation on NOLs” above will be applicable. Thus, it is expected that the NOLs of the Debtors which remain after taking into account the impact of any COD Income and gain recognition described in the preceding paragraph, if any, will be subject to the Section 382 Limitation. The amount of the Annual Limitation is expected to equal the product of (i) the applicable federal long-term exempt rate in effect on the date of the Section 382 Ownership Change (which rate is currently approximately 4.34% for Section 382 Ownership Changes during February 2008) and (ii) the value of Reorganized Palco’s equity immediately after taking into account the equity that is issued under the Debtors Plan.

### **11.3 Federal Income Tax Consequences to Creditors.**

#### **(a) Distributions in Satisfaction of Claims.**

To the extent that any amount received by a creditor is received in satisfaction of accrued interest or accrued original issue discount during the creditor’s holding period, such amount will be taxable to the creditor as interest income (but only to the extent not previously included in the creditor’s gross income) regardless of whether the creditor otherwise recognizes a loss as a result of the overall transaction. In addition, creditors may realize gain or loss as more particularly described below.

In general, each creditor who receives solely cash in satisfaction of its claims will recognize gain or loss in an amount equal to the difference between (a) the amount of any cash received by such creditor in satisfaction of such claim (other than amounts attributable to accrued interest which has not previously been taken into income) and (b) the creditor’s adjusted tax basis in such claim.

The federal income tax consequences to creditors under the MRC/Marathon Plan, the Indenture Trustee Plan and the Debtors Plan are discussed below. *The federal income tax consequences on creditors under the Alternative Plans are discussed in a separate section below.*

#### **(1) MRC/Marathon Plan.**

Under the MRC/Marathon Plan, a Creditor who receives New Timber Notes in satisfaction of Scopac Timber Noteholder Claims will probably be deemed to have made a taxable exchange of a portion of the Scopac Timber Notes for the New Timber Notes. Such Creditor would realize gain or loss for tax purposes equal to the difference between the issue price of the New Timber Notes and the Creditor’s adjusted tax basis in the portion of the Scopac Timber Notes that is deemed to have been exchanged for the New Timber Notes.

#### **(2) Indenture Trustee Plan.**

Under the Indenture Trustee Plan, a holder of an Allowed Claim will generally realize a gain or loss on the exchange under the Indenture Trustee Plan of his Allowed Claim for cash and other property in an amount equal to the difference between (i) the sum of the amount of any cash and the fair market value on the date of the exchange of any other property received by the holder (other than any consideration attributable to accrued but unpaid interest on the Allowed Claim), and (ii) the adjusted basis of the Allowed Claim exchanged therefore (other than basis attributable to accrued but unpaid interest previously included in the holder’s taxable income). Any gain recognized generally will be a capital gain (except to the extent the gain is attributable to accrued but unpaid interest or accrued market discount) if the Claim was a capital asset in the hand of an exchanging holder, and such gain would be a long-term capital gain if the holder’s holding period for the Claim surrendered exceeded one (1) year at the time of the exchange.

Any loss recognized by a holder of an Allowed Claim generally will be a capital loss if the Claim constitutes a “security” for federal income tax purposes or is otherwise held as a capital asset. For this purpose, a “security” is a debt instrument with interest coupons or in registered form.

Claimholders who receive any consideration under the Plan in respect of Allowed Claims for accrued but not previously taxed interest must treat the amount of that consideration as ordinary income. A Claimholder whose Allowed Claim for accrued and previously taxed interest is not fully satisfied generally may take an ordinary deduction for the unsatisfied portion of that Allowed Claim, even if the underlying claim is held as a capital asset. Claimholders should consult their own tax advisors about the proper allocation of consideration between principal and interest.

### (3) **Debtors Plan.**

Under the Debtors Plan, the tax treatment of Creditors holding Claims under the DIP Facility and the Palco Term Loan will depend upon whether the DIP Facility or the Palco Term Loan, as the case may be, constitute “securities” of Palco within the meaning of the tax law.

- If the indebtedness under the DIP Facility does not constitute a “security” of Palco within the meaning of the tax law, then the Creditor would realize gain or loss equal to the difference between the fair market value of the Reorganized Palco common stock received (other than amounts received which are attributable to accrued interest which has not previously been taken into income) and the Creditor’s adjusted tax basis in the indebtedness under the DIP Facility. If the indebtedness under the DIP Facility constitutes a “security” of Palco within the meaning of the tax law, then the Creditor would not recognize gain or loss on the receipt common stock of Reorganized Palco in exchange therefor.
- If the Palco Term Loan does not constitute a security for tax purposes, the Creditor would realize gain or loss equal to the difference between the sum of the fair market value of the Reorganized Palco common stock and Palco Town Assets received (other than amounts received which are attributable to accrued interest which has not previously been taken into income) and the Creditor’s adjusted tax basis in the Palco Term Loan. If the Palco Term Loan constitutes a security for tax purposes, the Creditor would not recognize any loss on the receipt of Reorganized Palco common stock and Palco Town Assets in exchange therefor, and the amount of gain recognized by the Creditor would equal the lesser of (i) the excess (if any) of the sum of the fair market value of the Reorganized Palco common stock and Palco Town Assets received (other than amounts received which are attributable to accrued interest which has not previously been taken into income), over the Creditor’s adjusted tax basis in the Palco Term Loan, or (ii) the fair market value of the Palco Town Assets received.

In general, a debt instrument with an original term of less than five (5) years will not constitute a “security” within the meaning of the tax law. However, there are exceptions to this rule depending upon the particular facts and circumstances surrounding the issuer of the debt and the terms of the debt. Moreover, if the Creditor realizes a loss under the foregoing rules, the Creditor’s ability to obtain a tax deduction for such loss may be limited under certain related party rules. Accordingly, Creditors holding Claims under the DIP Facility or the Palco Term Loan are urged to consult with their own tax advisors regarding the tax consequences to them of the exchange.

A Creditor who receives New Timber Notes, Scopac Class A Shares and Scopac Class B Shares in satisfaction of Scopac Timber Noteholder Claims will probably be deemed to have made (i) a taxable exchange of a portion of the Scopac Timber Notes for the New Timber Notes and (ii) a nontaxable contribution to Scopac of the remainder of the Scopac Timber Notes in exchange for the Scopac Class A Shares and Scopac Class B Shares. Such Creditor would realize gain or loss for tax purposes equal to the difference between the issue price of the New Timber Notes and the Creditor’s adjusted tax basis in the portion of the Scopac Timber Notes that is deemed to have been exchanged for the New Timber Notes.



Where gain or loss is recognized by a Creditor under the foregoing rules, the character of such gain or loss as long-term or short-term capital gain or loss or as ordinary income or loss will be determined by a number of factors, including the tax status of the Creditor, whether the Claim constitutes a capital asset in the hands of the Creditor and how long it has been held, whether the Claim was acquired at a market discount and whether and to what extent the Creditor had previously claimed a bad debt deduction.

**(b) Market Discount.**

A creditor that purchased its claim from a prior holder at a market discount will be subject to the market discount rules of the Internal Revenue Code. Under those rules, assuming that the creditor has made no election to amortize the market discount into income on a current basis with respect to any market discount instrument, any gain recognized on the satisfaction of its claim (subject to a *de minimis* rule) generally would be characterized as ordinary income to the extent of the accrued market discount on such Claim as of the date of payment.

**(c) Information Reporting; Backup Withholding Tax.**

Distributions made pursuant to any of the Plans will generally be subject to applicable federal income tax information reporting and withholding. The Internal Revenue Code imposes backup withholding tax, currently at the rate of 28 percent, on certain payments, including payments of interest, if a taxpayer (a) fails to furnish its correct taxpayer identification number (generally on IRS Form W-9), (b) furnishes an incorrect taxpayer identification number, (c) is notified by the IRS that it has previously failed to report properly items subject to backup withholding tax, or (d) fails to certify, under penalty of perjury, that such taxpayer has furnished its correct taxpayer identification number and that the IRS has not notified such taxpayer that it is subject to backup withholding tax. However, taxpayers that are corporations generally are excluded from these information reporting and backup withholding tax rules. Backup withholding is not an additional federal income tax. Any amounts withheld under the backup withholding tax rules will be allowed as a credit against a taxpayer's federal income tax liability, if any, or will be refunded to the extent the amounts withheld exceed the taxpayer's actual tax liability, if such taxpayer furnishes required information to the IRS. A taxpayer that does not provide a correct taxpayer identification number may be subject to penalties imposed by the IRS. Each taxpayer should consult its own tax advisor regarding the information reporting and backup withholding tax rules.

#### **11.4 Federal Income Tax Consequences to the Debtors Under Alternative Plans.**

The following is a summary of the anticipated material federal income tax consequences of the implementation of the Alternative Plans to the Debtors or Creditors. The discussion that follows is based on the assumptions that New Palco will be treated as a corporation, and New Scopac will elect to be treated as a partnership, for U.S. federal income tax purposes.

As more particularly discussed below, it is not expected that the implementation of the Alternative Plans will create a federal tax liability<sup>15</sup> or a tax refund for the Debtors.

**(a) Cancellation of Indebtedness.**

Under the Internal Revenue Code, a taxpayer generally must include in gross income the amount of any cancellation of indebtedness income ("COD Income") realized during the taxable year. Section 108 of the Internal Revenue Code provides that a taxpayer does not realize COD Income from cancellation of indebtedness to the extent that payment of such indebtedness would have given rise to an income tax deduction. Section 108 of the Internal Revenue Code provides further that if (i) a cancellation occurs in a case under the Bankruptcy Code, (ii) the taxpayer is under the jurisdiction of a bankruptcy court, and (iii) the cancellation is granted by the court or is pursuant to a plan approved by the court, then the COD Income may be excluded from gross income but must be applied to reduce certain tax attributes of the taxpayer.

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<sup>15</sup> This conclusion is subject to confirmation that either (i) the amount of gain recognized by the Debtors under the Alternative Plans would not exceed their NOLs or (ii) if the gain would exceed available NOLs, the Debtors would not be required to reimburse MAXXAM for the tax paid by the MAXXAM consolidated group on such gain.

Under the Alternative Plans, Holders of all Claims, except for the Palco Term Loan Claim, the Scopac Timber Noteholder Claims, Scopac Claims, the Palco Claims, the Palco Non-Debtor Affiliate Claims, and the Scopac Non-Debtor Affiliate Claims will be paid the full amount of their Allowed Claims. Although the entire amount of the Scopac Claims, the Palco Claims, Palco Non-Debtor Affiliate Claims and Scopac Non-Debtor Affiliate Claims will be contributed to the capital of the Debtors, this should not give rise to COD Income. Accordingly, satisfaction of all Claims under the Alternative Plans, other than the Palco Term Loan Claims, and the Scopac Timber Noteholder Claims, should not give rise to COD Income to the Debtors (except to the extent that any interest previously accrued and deducted by the Debtors is not required to be paid) so as to bring into operation section 108 of the Internal Revenue Code with respect to those other Claims.

The Debtors would realize COD Income with respect to the satisfaction of the Palco Term Loan Claims and the Scopac Timber Noteholder Claims if and to the extent that:

- The fair market value of the Palco Mill and Palco Town Assets paid in satisfaction of the Palco Term Loan Claim is less than the adjusted issue price of the indebtedness represented by the Palco Term Loan; and
- The fair market value of the Commercial Timberlands paid in satisfaction of the Scopac Timber Noteholder Claims, is less than the adjusted issue price of the indebtedness represented by the Scopac Timber Notes.

Any COD Income recognized by the Debtors under the foregoing provisions will be excluded from taxable income. The Debtors will, however, be required to reduce their net operating loss carryovers (“NOLs”) by such COD Income.

**(b) Tax Treatment of Mergers.**

The mergers of Salmon Creek and Scotia Development with and into Palco will not constitute a taxable transaction for federal tax purposes because Salmon Creek and Scotia Development are disregarded entities for federal tax purposes. The mergers of Britt and Scotia Inn with and into Palco would not constitute a taxable transaction for federal tax purposes if the value of the assets of Britt and Scotia, as the case may be, exceeds the amount of their respective liabilities. Otherwise, such mergers of Britt and Scotia Inn with and into Palco could constitute a taxable transaction for federal tax purposes.

**(c) Impact on Debtors’ NOLs.**

**(1) Section 382 Limitation on NOLs**

In general, if a taxpayer has NOLs, it may carry such NOLs back to the 2 previous taxable years and forward to the next 20 taxable years. If the taxpayer paid income taxes in a carryback year, it may be entitled to a refund of those taxes. An NOL carryforward, on the other hand, will generally reduce or eliminate the taxes payable in one or more carryforward years. Section 382 of the Internal Revenue Code, however, limits a corporate taxpayer’s utilization of an NOL following a Section 382 Ownership Change. A Section 382 Ownership Change occurs when the percentage of stock (determined on the basis of value) owned by one or more holders of at least 5% of such stock increases by more than 50 percentage points (in relationship to the corporation’s total stock considered to be outstanding for this purpose) from the lowest percentage of stock that was owned by such 5% shareholders at any time during the applicable “testing period.” The testing period is ordinarily the shorter of (i) the three-year period preceding the date of testing or (ii) the period of time since the most recent ownership change of the corporation. In general, for purposes of determining stock ownership under section 382 of the Internal Revenue Code, stock owned by an entity is deemed owned proportionately by its owners and, with certain exceptions, all persons holding less than 5% of the value of the corporation’s stock are treated as a single 5% shareholder.

When the limitation under section 382 (the “Section 382 Limitation”) applies, the maximum amount of Pre-Section 382 Ownership Change NOLs that may be utilized by the corporate taxpayer to offset taxable income in taxable years following the Section 382 Ownership Change is limited to an annual amount generally equal to the

product of (i) the applicable federal long-term exempt rate in effect on the date of the ownership change and (ii) the value of the corporation's equity immediately prior to the Section 382 Ownership Change (the "Annual Limitation"). Any unused Annual Limitation may be carried forward to increase the amount of income that may be offset by the NOL in subsequent years. However, special rules apply in cases where a Section 382 Ownership Change occurs in bankruptcy.

**(2) Effects of the Implementation of the Alternative Plans on Debtors' NOLs**

*Reduction of NOLs Due to COD Income Realization and Gain Recognition.* As indicated in "Cancellation of Indebtedness" above, the Debtors may realize COD Income from the satisfaction of the Claims under the Palco Term Loan and the Scopac Timber Notes under the Alternative Plans. The Debtors' NOLs will be reduced by the amount of such COD Income. Moreover, the transfers of the Palco Town Assets, Palco Mill, and Commercial Timberlands will generate taxable gain to the Debtors, which will also reduce the NOLs of the Debtors.

*Limitation on Remaining NOLs Due to Section 382 Ownership Change.* No Palco stock will be issued or transferred in connection with the Alternative Plans. Accordingly, the Alternative Plans themselves will not result in a Section 382 Ownership Change of Palco. The rules regarding Section 382 Ownership Changes are complex, however. There can be no assurance that transactions involving the stock of Palco's ultimate parent either prior to or subsequent to the effectiveness of the Alternative Plans, or transactions involving the stock of Palco subsequent to the effectiveness of the Alternative Plans, will not cause a Section 382 Ownership Change of Palco.

**11.5 Federal Income Tax Consequences to Creditors Under Alternative Plans.**

**(a) Distributions in Satisfaction of Claims.**

To the extent that any amount received by a Creditor is received in satisfaction of accrued interest or accrued original issue discount during the Creditor's holding period, such amount will be taxable to the Creditor as interest income (but only to the extent not previously included in the Creditor's gross income) regardless of whether the Creditor otherwise recognizes a loss as a result of the overall transaction. In addition, Creditors may realize gain or loss as more particularly described below.

In general, each Creditor who receives solely Cash in satisfaction of its Claims will recognize gain or loss in an amount equal to the difference between (a) the amount of any Cash received by such Creditor in satisfaction of such Claim (other than amounts attributable to accrued interest which has not previously been taken into income) and (b) the Creditor's adjusted tax basis in such Claim.

A Creditor who receives Palco Town Assets in satisfaction of Palco Term Loan Claims will recognize gain or loss on the receipt of the Palco Town Assets in an amount equal to the difference between the fair market value of the Palco Town Assets received (other than amounts received which are attributable to accrued interest which has not previously been taken into income) and the Creditor's adjusted tax basis in the Palco Term Loan.

A Creditor who receives Commercial Timberlands in satisfaction of Scopac Timber Noteholder Claims will recognize gain or loss equal to the difference between the fair market value of the Commercial Timberlands received and the Creditor's adjusted tax basis in the Scopac Timber Notes.

Where gain or loss is recognized by a Creditor under the foregoing rules, the character of such gain or loss as long-term or short-term capital gain or loss or as ordinary income or loss will be determined by a number of factors, including the tax status of the Creditor, whether the Claim constitutes a capital asset in the hands of the Creditor and how long it has been held, whether the Claim was acquired at a market discount and whether and to what extent the Creditor had previously claimed a bad debt deduction.

**(b) Market Discount.**

A Creditor that purchased its Claim from a prior Holder at a market discount will be subject to the market discount rules of the Internal Revenue Code. Under those rules, assuming that the Creditor has made no election to

amortize the market discount into income on a current basis with respect to any market discount instrument, any gain recognized on the satisfaction of its Claim (subject to a *de minimis* rule) generally would be characterized as ordinary income to the extent of the accrued market discount on such Claim as of the date of payment.

**(c) Information Reporting; Backup Withholding Tax.**

Distributions made pursuant to the Alternative Plans will generally be subject to applicable federal income tax information reporting and withholding. The Internal Revenue Code imposes backup withholding tax, currently at the rate of 28 percent, on certain payments, including payments of interest, if a taxpayer (a) fails to furnish its correct taxpayer identification number (generally on IRS Form W-9), (b) furnishes an incorrect taxpayer identification number, (c) is notified by the IRS that it has previously failed to report properly items subject to backup withholding tax, or (d) fails to certify, under penalty of perjury, that such taxpayer has furnished its correct taxpayer identification number and that the IRS has not notified such taxpayer that it is subject to backup withholding tax. However, taxpayers that are corporations generally are excluded from these information reporting and backup withholding tax rules. Backup withholding is not an additional federal income tax. Any amounts withheld under the backup withholding tax rules will be allowed as a credit against a taxpayer's federal income tax liability, if any, or will be refunded to the extent the amounts withheld exceed the taxpayer's actual tax liability, if such taxpayer furnishes required information to the IRS. A taxpayer that does not provide a correct taxpayer identification number may be subject to penalties imposed by the IRS. Each taxpayer should consult its own tax advisor regarding the information reporting and backup withholding tax rules.

**11.6 Importance of Obtaining Professional Tax Assistance.**

This discussion is intended only as a summary of certain federal income tax consequences of each of the Plans, and is not a substitute for careful tax planning with a tax professional. The tax consequences are in many cases uncertain and may vary depending on a creditor's individual circumstances. Accordingly, creditors are urged to consult with their tax advisors about the federal, state, local, and foreign tax consequences of the proposed Plans.

**SECTION 12.**

**SOURCES OF INFORMATION PROVIDED AND THE ACCOUNTING METHOD USED**

**12.1 Sources of Information.**

The information set forth in this Joint Disclosure Statement and the attached exhibits was provided by the Plan Proponents and their professionals.

**12.2 Accounting Method.**

The Debtors maintain their books and records in accordance with generally accepted accounting principles used in the United States.

**SECTION 13.**

**REQUIREMENTS FOR CONFIRMATION OF COMPETING PLANS AND VOTING PROCEDURES**

**13.1 Acceptance or Rejection of the Plans.**

**(a) Requirements of 11 U.S.C. § 1124.**

Under the Bankruptcy Code, only classes of claims and interests that are impaired under a plan of reorganization can vote to accept or reject that plan. Under section 1124 of the Bankruptcy Code, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest in that class, that plan:

(1) leaves unaltered the legal, equitable, and contractual rights to which that claim or interest entitles its holder; or

(2) notwithstanding any contractual provision or applicable law that entitles the holder of that claim or interest to demand or receive accelerated payment of that claim or interest after the occurrence of a default occurs:

A. cures that default, if other than a default of a kind specified in section 365(b)(2) of the Bankruptcy Code or of a kind that section 365(b)(2) expressly does not require to be cured;

B. reinstates the maturity of that claim or interest as it existed prior to that default;

C. compensates the holder of that claim or interest for any damages that holder incurs as a result of that holder's reasonable reliance on that contractual provision or law;

D. if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for the any pecuniary loss incurred by such holder as a result of such failure; and

E. does not otherwise alter the legal, equitable, or contractual rights to which that claim or interest entitles its holder.

Under the MRC/Marathon Plan, Classes 1 and 2 are unimpaired; therefore, the Holders of Claims in such Classes are conclusively presumed under section 1126(f) of the Bankruptcy Code to have accepted the MRC/Marathon Plan. MRC and Marathon are not soliciting acceptances from these Classes.

Under the Indenture Trustee Plan, Claims in Class 1 and Class 2(a) are unimpaired; therefore, the Holders of Claims in such Classes are conclusively presumed under section 1126(f) of the Bankruptcy Code to have accepted the Indenture Trustee Plan. The Indenture Trustee is not soliciting acceptances from these Classes.

Under the Debtors Plan, Palco Class 1 and Scopac Class 1 are unimpaired; therefore, the Holders of Claims in such Classes are conclusively presumed under section 1126(f) of the Bankruptcy Code to have accepted the Debtors Plan. The Debtors are not soliciting acceptances from these Classes. Under the Alternative Plans, Palco Classes 1, 2, 4,, and 9 and Scopac Classes 1, 2, 5,, and 9 are unimpaired; therefore, the Holders of Claims or Interests in such Classes are conclusively presumed under section 1126(f) of the Bankruptcy Code to have accepted the Alternative Plans. The Debtors are not soliciting acceptances from these Classes.

**(b) Acceptance by Impaired Classes of Claims.**

Pursuant to section 1126(c) of the Bankruptcy Code and except as otherwise provided in section 1126(e) of the Bankruptcy Code, an Impaired Class of Claims has accepted the Plan if the Holders of at least two-thirds in dollar amount and more than one-half in number of the Allowed Claims in such Class actually voting have voted to accept the Plan.

Under the MRC/Marathon Plan, Claims in Classes 3, 4, 5, 6, 7, 8 and 9 are impaired and, accordingly, the Holders of Claims in those Classes are the only Holders of Claims entitled to vote to accept or reject the MRC/Marathon Plan.

Under the Indenture Trustee Plan, Claims in Classes 2(b)(1), 2(b)(2), 2(b)(3), 2(c), 3 and 4 are impaired under the Indenture Trustee Plan and are entitled to vote to accept or reject the Indenture Trustee Plan.

Under the Debtors Plan and the Alternative Plans, the Holders of Claims in Palco Classes 2, 3, 4, 5, 6, 7, 8 and 9 and Scopac Classes 2, 3, 4, 5, 6, 7, 8, and 9 under the Debtors Plan, and Palco Classes 3, 4, 5, 6, 7 and 8 and Scopac Classes 3, 4, 5, 6, 7 and 8 under the Alternative Plans, are the only Holders of Claims or Interests entitled to vote to accept or reject the Debtors Plan, the Palco Alternative Plan and the Scopac Alternative Plan.

(c) **Tabulation of Votes.**

Ballots will be tabulated in accordance with the voting procedures approved by the Bankruptcy Court. If no impaired class accepts a particular Plan, the proponents of such Plan may modify the Plan to appropriately address the rights of the Holders of Allowed Claims.

**13.2 Confirmation Hearing.**

Section 1128(a) of the Bankruptcy Code requires the Bankruptcy Court, after notice, to hold a hearing on confirmation of a proposed plan. The Confirmation Hearing has been scheduled for **April 8, 2008, at 9:00 a.m.**, before the Honorable Richard S. Schmidt, United States Bankruptcy Judge for the Southern District of Texas, in his courtroom located at 1133 N. Shoreline Blvd., Second Floor, Corpus Christi, Texas. The Bankruptcy Court may adjourn the Confirmation Hearing from time to time without further notice except for an announcement of the adjourned date made at the Confirmation Hearing or any subsequent adjourned Confirmation Hearing.

Section 1128(b) of the Bankruptcy Code provides that any party in interest may object to confirmation of a plan. Unless otherwise directed or permitted by the Bankruptcy Court, any objection to Confirmation of any of the Plans must (1) be in writing, (2) conform to the Bankruptcy Rules, (3) set forth the name of the objecting party, (4) identify the nature of Claims or Interests held or asserted by the objector against the Debtors' Estates or property, (5) state the basis for the objection and the specific grounds therefore, (6) be filed with the clerk of the Bankruptcy Court, together with proof of service, and served upon each of the following so as to be received in the offices of each such Persons no later than March 25, 2008 at 4:00 p.m., prevailing Central Time: (a) Jack L. Kinzie, Baker Botts L.L.P., 2001 Ross Avenue, Dallas, Texas 75201-2980; (b) Shelby A. Jordan, Jordan, Hyden, Womble, Culbreth, & Holzer, P.C., Suite 900, Bank of America, 500 North Shoreline, Corpus Christi, Texas 78471; (c) Kathryn A. Coleman, Gibson, Dunn & Crutcher LLP, 200 Park Ave, 47th Floor, New York, NY 10166-0193; (d) Kyung S. Lee, Diamond McCarthy LLP, 909 Fannin, Suite 1500, Houston, Texas 77002; (d) David Neier, Winston & Strawn LLP, 200 Park Avenue, New York, New York 10166-4193; (e) John D. Penn, Haynes and Boone, LLP, 201 Main Street, Suite 2200, Fort Worth, Texas 76102; (f) Kenneth M. Crane, Perkins Coie LLP, 131 South Dearborn Street, Suite 1700, Chicago, Illinois 60603; (g) Allan S. Brilliant, Goodwin Procter LLP, 599 Lexington Avenue, New York, New York 10022; (h) Zack A. Clement, Fulbright & Jaworski L.L.P., 1301 McKinney, Suite 5100, Houston, Texas 77010; (i) Toby L. Gerber, Fulbright & Jaworski L.L.P., 2200 Ross Avenue, Suite 2800, Dallas, Texas 75201-2784; (j) Evan M. Jones, O'Melveny & Myers LLP, 400 South Hope Street, Los Angeles, CA 90071-2899; and (k) John D. Fiero, Pachulski Stang Ziehl & Jones LLP, 150 California Street, 15th floor, San Francisco, CA 94111-4500.

**13.3 Requirements for Confirmation.**

(a) **Confirmation Under Section 1129(a) of the Bankruptcy Code.**

At the Confirmation Hearing, the Bankruptcy Court will be asked to determine whether the requirements of section 1129(a) of the Bankruptcy Code have been satisfied for each Plan. These requirements include, among others, judicial findings that:

- the Plan complies with applicable provisions of the Bankruptcy Code;
- the Plan Proponents have complied with the applicable provisions of the Bankruptcy Code;
- the Plan has been proposed in good faith and not by any means forbidden by law;
- any payment made or promised by the Plan Proponents to any person for services, costs, or expenses in connection with the Debtors' cases or the Plan has been approved by, or is subject to the approval of, the Bankruptcy Court as reasonable;

- the Plan Proponents have disclosed the identity and affiliations of any individual proposed to serve as an officer, director, or manager of the reorganized Debtors after confirmation of the Plan and that the appointment to, or continuance in, such office by such individual is consistent with the interests of holders of claims and interests and with public policy;
- except to the extent the Plan meets the “Nonconsensual Confirmation” standards discussed below, each class of claims or interests has either accepted the Plan or is not impaired under the Plan;
- except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the Plan provides that administrative expenses and priority claims will be paid in full on the effective date and that priority tax claims will be either paid in full on the effective date or will receive on account of such Claims deferred cash payments, over a period not exceeding five years after the date of assessment of such claims, of a value, as of the effective date, equal to the allowed amount of such claims;
- at least one impaired and non-insider class of claims has accepted the Plan;
- that the Plan is feasible; that is, confirmation is not likely to be followed by the liquidation or the need for further reorganization of the Debtors, unless such liquidation or reorganization is proposed in the Plan;
- all fees payable under section 1930 of title 28 of the United States Code have been paid on or prior to the effective date;
- the Plan provides for the continuation after the effective date of payment of all retiree benefits, as that term is defined in section 1114 of the Bankruptcy Code, at the level established pursuant to section 1114(e)(1)(B) or (g), at any time prior to confirmation of the Plan, for the duration of the period the Debtors have obligated themselves to provide such benefits; and
- the Plan is in the best interests of the holders of claims and interests, as discussed in more depth below.

The Plan Proponents believe that each of their respective Plans satisfy all applicable requirements of section 1129(a) of the Bankruptcy Code.

**(b) Best Interests Test.**

Under the best interests test, a plan is confirmable if, with respect to each impaired class of claims or interests, each holder of a claim or interest in that class either:

- has accepted the plan; or
- will receive or retain under the plan, on account of its claim or interest, property of a value, as of the effective date, that is not less than the amount that holder would receive or retain if the debtors were to be liquidated under chapter 7 of the Bankruptcy Code.

The Plan Proponents believe that each of their respective Plans will produce a greater recovery for holders of allowed claims and interests than would be achieved in a liquidation pursuant to chapter 7 of the Bankruptcy Code (as discussed in greater detail above), and is in the best interests of creditors and interest holders. The Debtors have prepared a Liquidation Analysis and a valuation analysis to assist holders of claims and interests in determining whether to accept or reject each Plan.

(c) **Feasibility of the Plans.**

In order for a plan to be confirmed, the bankruptcy court also must determine that the plan is feasible—that is, that the need for further reorganization or a subsequent liquidation of the debtors (unless provided for in the Plan) is not likely to result following confirmation of the plan. In determining whether a plan of reorganization is feasible, a court will consider:

- the adequacy of the proposed capital structure of the reorganized entity;
- the earning power of that entity;
- the overall economic conditions in which that entity will operate;
- the capability of its management;
- the continuity of its management; and
- any other factors the court deems relevant to the successful operation of the reorganized entity to perform the provisions of the plan of reorganization.

The Plan Proponents believe that each of their respective Plans are feasible for the reasons set forth in this Joint Disclosure Statement and based on the financial projections incorporated herein.

(d) **Nonconsensual Confirmation under Section 1129(b) of the Bankruptcy Code.**

Although section 1129(a)(8) of the Bankruptcy Code requires that a plan be accepted by each class that is impaired by such plan, section 1129(b) of the Bankruptcy Code provides that the bankruptcy court may still confirm a plan at the request of the plan proponent if all requirements of section 1129(a) (except section 1129(a)(8)) are met and if, with respect to each class of claims or interests that is impaired under the plan and has not voted to accept the plan, the plan “does not discriminate unfairly” and is “fair and equitable.” A plan confirmed on the basis of this provision is commonly referred to as a “cramdown” plan.

In the event an impaired class of claims or interests does not accept a particular proposed Plan, each of the Plan Proponents may seek cramdown confirmation of that Plan with respect to any such non-accepting class. With the exception of the Debtors Plan which Debtors have admitted cannot be crammed down, the Plan Proponents believe that their respective Plans, with respect to such classes, meet the requirements of section 1129(b) of the Bankruptcy Code.

(1) **Unfair Discrimination.** A plan of reorganization does not discriminate unfairly if no class receives more than it is legally entitled to receive for its claims or equity interests.

(2) **Fair and Equitable Test.** “Fair and equitable” has meanings for Secured Claims, Unsecured Claims, and Interests.

With respect to a Secured Claim, “fair and equitable” means that a Plan provides either:

(a) that the Holder of a Secured Claim in an impaired class retains the liens securing such claim, whether the property subject to such liens is retained by the Debtor or transferred to another entity, to the extent of the amount of such allowed claim, and that the holder of such claim receives on account of such claim deferred cash payments totaling at least the amount of such allowed claim, of a value, as of the effective date, of at least the value of such holder’s interest in the estate’s interest in such property;

(b) for the sale, subject to section 363(k) of the Bankruptcy Code, of any property that is subject to the liens securing such claim, free and clear of such liens, with such liens to



attach to the proceeds of such sale, and the treatment of such Liens on proceeds under subsections (a) or (b) hereof; or

(c) the realization by such holder of the “indubitable equivalent” of such claim.

With respect to an Unsecured Claim, “fair and equitable” means either (a) a Plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (b) the holder of any claim or interest that is junior to the claims of such class will not receive or retain any property under the plan on account of such junior claim or interest.

With respect to an Interest, “fair and equitable” means either (a) each holder of an interest in an impaired class receives or retains property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or (b) the holder of any interest that is junior to the interests of such class will not receive or retain any property under the plan on account of such junior interest.

With the exception of the Debtors Plan which Debtors have admitted cannot be crammed down, the Plan Proponents believe that each of their respective Plans does not unfairly discriminate as to any class of claims or interests and will meet the fair and equitable test if a class of claims does not accept such Plan.

#### **13.4 Conditions to Effectiveness.**

In addition to the requirements for Confirmation of each Plan, the terms of each Plan provide that each Plan may not become effective unless certain contingencies are met, as set forth in each respective Plan.

#### **13.5 Effect of Confirmation and Effectiveness.**

If a Plan is confirmed and becomes effective, it will be binding upon the Debtors, all holders of claims and interests, and all other parties in interest, regardless of whether they have accepted or rejected such Plan.

### **RECOMMENDATION AND CONCLUSION**

MRC and Marathon recommend that all Holders of Claims in Classes 3, 4, 5, 6, 7, 8 and 9 vote to accept the MRC/Marathon Plan.

The Indenture Trustee recommends that Holders of Claims in Classes 2(b)(1), 2(b)(2), 2(b)(3), 2(c), 3 and 4 vote to accept the Indenture Trustee Plan.

As to the Debtors Plan, the Debtors strongly recommend that all Holders of Claims in Palco Classes 2, 3, 4, and 8 and Scopac Classes 2, 3, 4, 5 and 8 vote to accept the Debtors Plan.

As to the Alternative Plans, the Debtors strongly recommend that all Holders of Claims or Interests in Palco Classes 3 and 8 and Scopac Classes 3, 4, and 8 vote to accept each Alternative Plan.

The Debtors ask you to vote for both the Debtors Plan and the Alternative Plans.

The undersigned have executed this Joint Disclosure Statement as of the 29th day of February 2008.

Respectfully submitted,

**FOR THE MRC/MARATHON PLAN:**

<p>Mendocino Redwood Company, LLC, as Plan Proponent</p> <p>By: _____ /s/ _____ Alexander L. Dean, Jr. Chairman of the Board of Directors</p>	<p>Marathon Structured Finance Fund L.P., as Plan Proponent</p> <p>By: _____ /s/ _____ Louis T. Hanover Chief Investment Officer</p>
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**FOR THE INDENTURE TRUSTEE PLAN:**

<p>The Bank of New York Trust Company, N.A., Indenture Trustee for the Timber Notes</p> <p>By: _____ /s/ _____ J. Chris Matthews Vice President</p>	
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**FOR THE DEBTORS PLAN AND ALTERNATIVE PLANS:**

<p>The Pacific Lumber Company, a Delaware Corporation</p> <p>By: _____ George A. O'Brien President and Chief Executive Officer</p> <p>Britt Lumber Co., Inc., a California Corporation</p> <p>By: _____ George A. O'Brien Chief Executive Officer</p> <p>Salmon Creek LLC, a Delaware limited liability company</p> <p>By: _____ George A. O'Brien Executive Vice President</p> <p>Scotia Development LLC, a Texas limited liability company</p> <p>By: _____ George A. O'Brien Executive Vice President</p> <p>Scotia Inn Inc., a Delaware Corporation</p> <p>By: _____ George A. O'Brien President and Chief Executive Officer</p> <p>Scotia Pacific Company LLC, a Delaware limited liability company</p> <p>By: _____ Jeffrey C. Barrett Vice President</p>	<p>MAXXAM Inc., a Delaware Corporation</p> <p>By: _____ M. Emily Madison Vice President, Finance</p> <p>MAXXAM Group Holdings Inc., a Delaware Corporation</p> <p>By: _____ M. Emily Madison Vice President, Finance</p> <p>MAXXAM Group Inc., a Delaware Corporation</p> <p>By: _____ M. Emily Madison Vice President, Finance</p>
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