



February 8, 2008

To All Employees:

In December, through a filing made in the US Bankruptcy Court in Corpus Christi, Texas by Marathon Structured Fund L.P. (a large creditor of Palco), we made public our support for a plan of reorganization for Palco. Approximately 200 pages of plan details were submitted to the court late January 30th, as were two competing plans from others. We are attaching a summary of highlights from our court filings, competing plans that were filed, and an explanation of next steps.

Early next week we will begin meeting with you to answer questions, and share what we can about the prospects of this opportunity. In anticipation, we thought it might be helpful to answer the big question; "What does all of this mean to me and others?"

Our employees:

An additional supply of FSC certified lumber products available for the markets we serve. We believe this will be a long-term benefit to our business and our customers, and enhance job security during difficult economic times. New job opportunities will become available as we continue to become a larger overall collection of companies.

Palco employees:

Our reorganization plan, once successfully implemented, will protect approximately 250 jobs associated with the mill and forest operations. Marathon will also employ additional folks directly or indirectly in conjunction with their ownership of the town of Scotia and the Cogen plant.

Scotia town and residents:

A chance to own their homes and or business, as well as a continued thriving community largely supported by the mill and forestland operations.

Palco/ScoPac timberlands:

Implementation of the forest practices that have been successful at MRC, and the immediate pursuit of FSC certification of the timberlands.

State of California:

Enforcement and protection of the Habitat Conservation Plan associated with the Headwaters Agreement, and a movement away from forest practices meeting regulatory minimums to the pursuit of exemplary forest management standards. Maintaining these lands as working forests that provide jobs and tax revenue is good for all Californians.

Creditors to Palco:

Court approved settlements of their claims. The majority in number of these creditors are local small businesses that will benefit significantly if Palco emerges from bankruptcy as successful and ongoing operation.

Our investors:

The Fisher family views owning forestland and related operations as a good *long-term* investment, and as an opportunity to advance ecological objectives with the efficiency of a business. If we are successful in the proposed reorganization of Palco, the Fisher family will be able to increase their commitment to redwood forests and related operations.

A number of folks worked seven days per week through the month of January to complete the plans that were filed with the court January 30th. Our thanks for their efforts, and as always our thanks for what all of you have done to allow us to be in a position to consider expanding our activities.

When new developments occur, we will send you another update. This is a very exciting, although lengthy and detailed, process for all of us.

Sincerely,

Richard Higgenbottom
CEO
Mendocino Redwood Company, LLC

Sandy L. Dean
Chairman
Mendocino Redwood Company, LLC

Update on MRC's Support for the Reorganization of PALCO
February 7, 2008

Late on January 30th, we filed a detailed plan with the court which is posted on our website www.mrc.com. Look under "Court Filings" in the PALCO section of the site. The most important document we filed was the 100 page Disclosure Statement. Pages 23 to 28 and 54 to 70 of the Disclosure Statement is where you will find what we wrote about our plans for the PALCO business.

Here are important highlights from the more detailed plans we thought might be of particular interest to you:

1. Overall, we would look to reposition Palco as a successful integrated producer and distributor of redwood lumber and complementary forest products.
2. Our plan would reduce the existing debt of Palco by approximately \$675 million through the bankruptcy process, including an investment of \$225 million of new equity, to make sure that a reorganized Palco has a more manageable level of debt.
3. We have determined an initial harvest rate for the lands for the short-term, and would conduct a 2 year process to re-inventory the lands and determine a long-term harvest plan in a public process (the harvest rate can not be made public until Maxxam gives us their approval or the court tells us we can share publicly).
4. In the first six or eight months of operation, we would invest as much as \$7.5 million in capital into the Scotia Sawmill, to position the mill for success for the long-term. A successful Scotia sawmill is an essential element of our plan of reorganization.
5. Although still being finalized, our estimates are that we would employ about 250 people for the long-term in Humboldt County in conjunction with the plans outlined in our court documents. Marathon will also employ additional folks directly or indirectly in conjunction with their ownership of the town of Scotia and the Cogen plant.
6. We would share the distribution infrastructure of MFP and affiliates with a reorganized Palco to generate higher overall returns from the redwood lumber produced by Scotia. We believe the financial benefits of sharing our distribution infrastructure would be significant for the reorganized Palco.
7. Subject to availability of logs and people, we would run a second shift at the Ukiah sawmill for a few months while we implement capital improvements to the Scotia mill, and would offer Scotia mill workers the chance to staff the second shift (along with a per diem to pay for transportation, meals and lodging). We would temporarily run a second shift at Ukiah mostly to reduce the burden of downtime required to improve the Scotia sawmill.
8. Our equity investment of \$225 million, our management team, and our operating plans are ready to go if and when the Judge and the creditors decide they want to move ahead.

There are currently two other competing plans in court -

Maxxam's plan is still centered around developing 22,000 acres of forestland for high end residential use. It appears that lack of creditor support and lack of new investment capital from Maxxam makes this a tough sell to the court.

The Bondholders (who are owed about \$800 million) continue to be interested in auctioning off the trees in an effort to maximize recovery for their \$800 mm of debt. The weakness in this strategy is that, to survive, the Scotia mill needs a *dedicated long-term supply of logs*, and we think a buyer of only the land will be hard pressed to provide such a commitment to the Scotia mill.

What is next?

The court will allow people to refine their plans between now and the end of February. The month of March will be taken up with creditors receiving a large package of information and being provided the opportunity to vote on whatever plan they like the most. To the extent the creditors do not all unify behind one plan of reorganization, the Judge will hold a "confirmation trial" in early April, and will determine the fate of the company at that time.

We recognize that the employees of Pacific Lumber Co are affected the most in this process. All paths ahead will mean change for employees of Pacific Lumber Company. We believe that our plan will have the highest odds of the best long-term outcome for the employees of Palco. The benefits we bring to a reorganized Palco (more widely accepted forest practices, a track record of success in our sawmill and related lumber distribution business, a long-term horizon for measuring success, and a management team and board with substantial experience in the redwood region), are the key ingredients to the company's future success and prosperity.

More information -

Please visit www.mrc.com to learn more about our plans. There is much information available there. You may direct questions to Marty Olhiser, although in the short-term we will probably refer you to information on the website due to the legal nature of the bankruptcy process.