

BINDING TERM SHEET

ACQUISITION OF CERTAIN OF THE ASSETS OF
THE PACIFIC LUMBER COMPANY (the “Debtor” or “Palco”)

<p>Purpose</p>	<p>The acquisition (the “Palco Acquisition”) by Sierra Pacific Industries (“SPI” or “Buyer”) of the Palco Assets (defined below).</p> <p>The Palco Acquisition shall be effectuated pursuant to a Section 363 sale of the Palco Assets (“Section 363 Sale”) or through other mutually agreed-upon means, which excludes the Excluded Assets (as defined below), free and clear of all liens, claims and encumbrances of any type whatsoever except as expressly set forth herein. In the event of a Section 363 Sale, the Palco Acquisition shall be effectuated in accordance with bidding and auction procedures to be mutually agreed upon by the Debtor or a trustee appointed for the Debtor and the Buyer (the “Bid Procedures”). The Bid Procedures shall provide for the Buyer to serve as a “stalking horse” in exchange for the bidding protections outlined in the Bid Procedures, including without limitation the Breakup Fee (as defined below).</p> <p>SPI has owned and operated a sawmill in Arcata, CA continuously for over fifty years. Current employees at Arcata will be given the opportunity to work at the new facility to be constructed by SPI pursuant to this agreement.</p> <p>SPI expects to invest in excess of \$75 million to purchase, remodel, construct and operate the entire facility. After completion, the remodeled Scotia Mill and the new SPI facility will employ approximately 300 people and will bring much needed financial stability to Scotia, CA and the surrounding community.</p> <p>SPI will make this acquisition from the Palco estate whether it is represented by a Chapter 11 debtor-in-possession, or a trustee appointed under either Chapter 11 or Chapter 7 of the Bankruptcy Code.</p>
<p>Assets to be Sold</p>	<p>All assets and properties associated with Palco, except those specified under Excluded Assets, free and clear of all claims, liens, encumbrances and interests, including, without limitation, the following (the “Palco Assets”):</p> <p>All of the industrial property from the machine shop south and the log yard that lies generally east of highway 101.</p> <p>Scotia Mill – Sawmill and planning mill located in the town of Scotia,</p>

	<p>including all associated lumber marketing and distribution operations;</p> <p>Co-generation Plant – 32.5 MW Bio-Mass co-generation power plant located in the town of Scotia;</p> <p>All equipment as well as all supplies, spare parts and rolling stock related to the Scotia Mill and Co-generation Plant.</p> <p>Palco’s existing raw material, in-process and finished inventories and existing accounts receivable (the “Working Capital”).</p>
Excluded Assets	<p>“Excluded Assets,” which shall not be transferred to Buyer, and shall be retained by the estate of the Debtor or its affiliates shall include the residential, industrial and commercial property comprising the town of Scotia, including approximately 270 homes, located in the approximate 400-acre town of Scotia, California, the Debtor’s Fortuna, Carlotta, and Britt mill sites, as well as all other Palco property, real or personal, not associated with the Palco Assets or Working Capital.</p>
Section 363 Sale and Timing	<p>In the event of a Section 363 Sale, the Debtor, or a Trustee for the Debtor, shall file with the Court appropriate pleadings (the “363 Motion”) seeking the sale (the “Sale”) of the Palco Assets free and clear of all claims, liens, encumbrances and interests pursuant to section 363 of chapter 11 of title 11 of the Bankruptcy Code on or before a date not later than three (3) business days following entry of a final and non-appealable order confirming (the “Confirmation Order”) of the Plan of Reorganization (as amended, the “Plan”) proposed by The Bank of New York Trust Company, in its capacity as trustee and collateral agent under the Indenture with respect to the Timber Notes (the “Indenture Trustee”), which pleadings shall include a motion for expedited approval of the Bid Procedures (the “Bid Procedures Motion”). An order in form and substance acceptable to the Buyer approving the Bid Procedures, including the Breakup Fee, and otherwise granting the relief sought in the Bid Procedures Motion shall be entered no later than the earlier of (i) fifteen (15) business days after the date the Confirmation order becomes final and non-appealable and (ii) thirty (30) days following entry of the Confirmation Order. The Bid Procedures shall include, without limitation, a sale process, including a minimum initial overbid increment of \$1,320,000 and subsequent overbid increments of \$500,000, that shall be completed, including court approval of the sale by no later than two (2) months after entry of the Confirmation Order (the “Auction Period”).</p>
Consideration and Deposit	<p>SPI will pay \$27.5 million in consideration for the Palco Assets and in consideration for the Working Capital will pay an amount equal to 95%</p>

	<p>of the Debtor’s current accounts receivable at the time of closing and 90% of the fair market value of the Debtor’s raw material, in-process and finished inventories at the time of closing (collectively, the “Palco Consideration”), subject to Buyer’s overbid protections described below and pursuant to the terms of the Bid Procedures.</p> <p>As additional consideration and as a condition of the sale, SPI agrees that, after closing, it will remodel the Debtors’ existing facilities to specialize in the manufacture of redwood, white wood and Douglas-fir lumber from small logs with a diameter of 24" and smaller as well as large logs of the same species. SPI will create two separate mills, one large log and one small log plant, utilizing some existing equipment and some new equipment. SPI will: change the flow of boards through the mills; scrap the existing dry kilns; construct new modern, computerized, state of the art dry kilns in a different location more conducive to flow; improve the fuel handling system in the boiler house; develop a more efficient means of moving hog fuel to the cogeneration plant; black top the log yard to allow recovery of fuel for the boiler and to reduce silt runoff; improve the storm water runoff system for environmental effectiveness reducing the silt transported into the Eel River; black top all lumber yards, and make numerous other improvements. This reconstructed facility will replace SPI's existing mill in Arcata CA. It is expected the investment by SPI in the Scotia mill to exceed \$70,000,000.00. Upon acceptance of this Term Sheet by the Debtors and relevant approval by the Court, Buyer will, within five (5) business days, deliver a cash deposit equal to \$7,500,000.00 of the Palco Consideration (the “Deposit”) to an escrow agent to be identified by the Debtors and acceptable to Buyer.</p> <p>Contingencies to the transaction shall be limited to title and environmental due diligence as well as the execution of the Log Supply Agreement (defined below) mutually acceptable to SPI and the Plan Agent appointed under the Plan, the terms of which shall be binding on any acquirer of Scotia Pacific Company LLC’s timberlands for the term of the Agreement.</p> <p>Other than the MAE Provision (defined below) and agreement on the definitive Acquisition Documents, the closing of the purchase of the Palco Assets and Working Capital and payment and delivery of the Palco Consideration are not subject to any other contingency.</p>
<p>Pre- and Post-Sale Liquidity</p>	<p>Any liquidity requirements related to the Palco Assets pre-sale shall be paid for by the Debtor or its secured lender(s). In the event the Debtor and its secured lenders do not provide such pre-sale liquidity, the Deposit shall be used to fund liquidity requirements during the Auction period; <u>provided, however</u>, that any such use of the Deposit will be a dollar-for-dollar reduction of the purchase price to be paid by the Buyer</p>

	<p>and, in the event Buyer is not the successful bidder for the Palco Assets, Buyer shall be refunded in cash its Deposit immediately out of the winning bidder's purchase price.</p> <p>In the event the Buyer is the successful bidder for the Palco Assets, the Buyer shall maintain an existing revolving credit facility, providing more than adequate working capital and other liquidity needs of the Palco Assets subsequent to closing its acquisition.</p>
Remaining Due Diligence	<p>The Debtor shall use good faith efforts to cause Buyer to be provided with (a) reasonable access to all pertinent financial, legal and operational documents and information pertaining to the Palco Assets, and (b) reasonable access to all Palco property and personnel.</p> <p>Buyer shall complete its due diligence within 30 days after the execution of this Term Sheet; however, except as specifically provided in the MAE Provision below, nothing discovered in due diligence shall relieve Buyer of its obligations under this Term Sheet or be sufficient justification for Buyer to reduce the Palco Consideration or alter any other term of this Term Sheet.</p>
MAE Provision	<p><u>"Material Adverse Effect"</u> means any change, occurrence or development occurring after May 7, 2008, that either individually or in the aggregate (i) is materially adverse to the business, results of operation, assets and properties, taken as a whole, (ii) would prevent or impair the ability of the Debtor to perform its obligations under any of the Acquisition Documents to which it is a party, or (iii) would prevent or materially impede, interfere with, hinder, or delay the consummation of the transactions contemplated by this Term Sheet or any of the Acquisition Documents, in each case, as a direct or indirect result of damage to the Palco Assets due to fire, earthquake or similar natural disaster.</p>
Overbid Protections	<p>In the event of a Section 363 Sale, the Bid Procedures shall include a break-up fee (the "Break-up Fee") in the amount of \$550,000, payable to Buyer in cash, if (a) Buyer has not previously defaulted under the terms of the Acquisition Documents, and (b) any party other than the Buyer effectuates any transaction, sale, merger, recapitalization, plan of reorganization or any other disposition of any material portion of the Palco Assets, including the consummation of any plan of reorganization whereby existing secured and/or unsecured creditors convert their claims into equity. The Breakup Fee shall be paid in cash directly to the Buyer by the Successful Bidder at the time of the closing of the Acquisition by the Successful Bidder, and the Breakup Fee shall be deemed to be an expense of the kind specified in sections 503(b) and 507(b) of the Bankruptcy Code (a "Super-Priority Claim"). If the Buyer is not the Successful Bidder, the Successful Bidder's cash deposit, required under the Bid Procedures, shall not be released or</p>

	<p>applied until the Breakup Fee has been paid in full to the Buyer. If the Acquisition is effectuated through a Plan, including any plan of reorganization whereby existing secured and/or unsecured creditors convert their claims into equity, the Breakup Fee shall be paid to Buyer in cash on the effective date of such Plan. For the avoidance of doubt, Buyer will not be entitled to reimbursement of Buyer's expenses.</p>
Credit Bid	<p>Buyer acknowledges that the Bid Procedures will provide that Marathon may credit bid in an amount up to the maximum amount of its claims pursuant to section 363(k) of the Bankruptcy Code.</p>
Log Supply Agreement	<p>Log Supply Agreement – Pursuant to a mutually acceptable log supply agreement, buyer to have right to purchase 100% of harvest from Scotia Pacific Company LLC (“Scopac”) timberlands for at least 15 years at market terms.</p>
Confidentiality	<p>Until the earlier of (i) the date on which the Debtor and the Buyer have reached agreement on the form of the agreement by which the Palco Assets will be sold to Buyer (the “Acquisition Agreement”) and related documents (collectively the “Acquisition Documents”), and (ii) 2008 (such period being the “Buyer Documentation Period”), (A) the Debtor, Indenture Trustee and Buyer will negotiate in good faith to complete the Acquisition Documents, (B) the Debtor agrees not to negotiate or execute any other documents with any party other than the Buyer related to any competing or alternative Acquisition Proposal except after giving notice to Buyer; provided that the Debtor shall conduct a marketing process during such period in an effort to solicit competing Bids in connection with which they shall have the right to provide any and all Potential Bidders who have submitted an appropriate Potential Bid Package with any and all information reasonably necessary or appropriate to enable them to formulate a competing Bid, other than the information described in (C), below, and (C) neither the Debtor nor the Indenture Trustee may discuss or disclose to any third party any details related to the negotiation or status of negotiation of the Acquisition Agreement, Plan of Reorganization or any related documents with the Buyer.</p>
Offer Expiration	<p>This offer will expire on June 30, 2008, unless on or before such date: (i) the Indenture Trustee's Plan is confirmed; and (ii) the Buyer has been selected as the stalking horse bidder for the Palco Assets in accordance with the terms and conditions provided herein or the parties have agreed upon other means to effect the acquisition.</p>