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Humboldt Redwood
COMPANY, LLC

October 22, 2010

To All Employees:

As you may be aware, HRC was mentioned in both the LA Times and the Eureka Times Standard 2 weeks ago regarding a Humboldt Redwood Co. tax issue (see news on the website). Legislation has since been enacted representing an important and constructive remedy to an adverse situation. I thought you would like to know the history and the facts.

HRC was formed on July 31, 2008 after its PALCO predecessor had spent 18 months in bankruptcy court in Texas. The bankruptcy process was a difficult time for many, including employees and members of the community. The plan of reorganization that formed HRC offered strong benefits for employees, environmental stakeholders, regulators and the community. HRC's formation was strongly supported by the State of California, including regulatory agencies and, ultimately, in writing by Governor Schwarzenegger himself.

The support that built around our plan of reorganization was based on promises – promises to maintain operations in Scotia, to do a substantially better job for the environment, and to reduce the debt on the company so that it could be operated sustainably going forward. Over the last two years we have met or beaten our promises, even in the face of tough economic times.

Two months after HRC was formed, California was at the tail end of the last budget crisis. As part of that budget deal, on September 30, 2008, California retroactively changed its tax code for companies in a manner that was intended to make companies pay higher taxes for a 2 year period (since extended to four years), and then pay lower taxes by a like amount in subsequent years. This tax rule change, after-the-fact, had the unintended and unfair consequence on HRC of imposing a large one-time unrecoverable tax.

This retroactively applied tax (an asserted tax of approximately $20 million, along with asserted interest and penalties of another $10 million) was a potentially catastrophic financial hit. The old PALCO entity was dissolved as part of our reorganization plan. For HRC, as the new surviving company, the tax would be a one-time unrecoverable event. Had we known of such a tax in advance of our reorganization being completed, we would have had to abandon our effort.

When we first learned of the possible large one-time tax at the end of 2009, we felt that the State of California did not intend to uniquely tax us for dramatically improving forestry practices on the former PALCO lands, saving more than 200 jobs, and assuming an underfunded pension plan (among other components of our plan). In the spring of this year, we visited with a number of legislators in Sacramento and found them receptive to legislation that would address this unintended consequence of the 2008 budget deal. Our Sacramento discussions led to the four legislative leaders and the Governor agreeing to address the issue in the 2010 budget.

In the midst of all the issues and problems facing California this year, the Governor and Legislature found a way to honorably address the issue of unintended unfairness in the 2008 budget deal (that was made 60 days after the formation of HRC).

This is the way government is supposed to work in California, and so it has. The people of Humboldt County and the forests are the real winners here.

Sincerely,

Sandy Dean
Chairman