

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-K/A

Annual report pursuant to section 13 and 15(d) [amend]

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### FILER

#### **U S TIMBERLANDS KLAMATH FALLS LLC**

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Mailing Address  
*PO BOX 10  
6400 HIGHWAY 66  
KLAMATH FALLS OR 97601*

Business Address  
*625 MADISON AVENUE  
SUITE 10-B  
NEW YORK NY 10022  
5418842240*

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K /A

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

Commission File No.: 1-13573-01

1-13573

**INLAND FIBER GROUP, LLC**  
**FIBER FINANCE CORP.**

(Exact name of registrant as specified in its charter)

<b>DELAWARE</b>	<b>91-1217136</b>
<b>DELAWARE</b>	<b>91-1851612</b>
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

<b>625 Madison Avenue, Suite 10-B, New York, NY</b>	<b>10022</b>
(Address of principal executive offices)	(Zip code)

**Registrant's telephone number, including area code: 212-755-1100**

**Securities registered pursuant to Section 12(b) of the Act:**

None

**Securities registered pursuant to Section 12(g) of the Act:**

<b>Title of Each Class:</b>	<b>Name of Each Exchange on Which Registered:</b>
9-5/8% Senior Notes	New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during then preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to be the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes

No

Documents incorporated by reference: See item 15. Exhibit Index

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**INLAND FIBER GROUP, LLC**  
**FIBER FINANCE CORP.**

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**PART I**

**Item 1. Business.**

**General**

The business of Inland Fiber Group, LLC (formerly U.S. Timberlands Klamath Falls, L.L.C.), a Delaware limited liability company formed in 1996 (the “Company”), consists of the growing of trees, the sale of logs and standing timber and the sale of excess land. The Company owns approximately 272,000 fee acres of timberland and cutting rights on approximately 70,000 acres of timberland (collectively the “Timberlands”) containing total merchantable timber volume estimated as of January 1, 2004 to be approximately 0.7 billion board feet (“BBF”) in Oregon east of the Cascade Range. Logs harvested from the Timberlands are sold to unaffiliated domestic conversion facilities. These logs are processed for sale as lumber, plywood and other wood products, primarily for use in new residential home construction, home remodeling and repair and general industrial applications. The Company also owns and operates its own seed orchard and produces approximately four million conifer seedlings annually from its nursery, approximately 80% of which are used for its own internal reforestation programs, with the balance sold to other forest products companies.

The Timberlands’ merchantable timber consists of Ponderosa Pine (approximately 45%) and Douglas Fir (approximately 14%), species which have historically commanded premium prices over other softwood species, with the balance consisting of Lodgepole Pine, White Fir and other softwood species. The Timberlands have stands of varying ages and are unique in the forests east of the Cascade Range in Oregon in that approximately 104,000 acres are actively managed tree farms (the “Plantations”). The Plantations were first established by Weyerhaeuser Company (“Weyerhaeuser”) in the early 1960s and acreage has been planted each year since then. Currently, the Plantations contain age classes ranging generally from one to 43 years old. Initial thinning or harvesting of the Plantation stands is expected to begin within the next three years. The balance of the Timberlands is comprised of natural stands. For a more complete description of the Company’ s properties, see “Properties.”

The Company does not currently own any conversion facilities nor does it presently intend to own any such facilities on a long-term basis; consequently the Company’ s log sales are made to unaffiliated third parties. There are currently more than 18 primary conversion facilities located within a 150-mile radius of the Company’ s Timberlands.

In August 1996, the Company and an affiliate acquired approximately 604,000 fee acres of timberland (the “Klamath Falls Timberlands”), containing an estimated merchantable timber volume of approximately 1.9 BBF and related assets from Weyerhaeuser (the “Weyerhaeuser Acquisition”). In November 1997, the affiliate’ s portion of the Klamath Falls timberlands were transferred to the Company in a series of transactions. In July 1997, the Company acquired approximately 42,000 fee acres of timberland and cutting rights on approximately 3,000 acres of timberland (the “Ochoco Timberlands”), containing an estimated merchantable timber volume of approximately 280 million board feet (“MMBF”) from Ochoco Lumber Company (“Ochoco”) (the “Ochoco Acquisition”). At the date of acquisition, over 40% of the merchantable timber on the Ochoco Timberlands was at least 80 years old. As of December 31, 2000, the Company had harvested substantially all of the Old Growth timber on the Ochoco Timberlands. During the 4th quarter of 2002, the Company sold the Ochoco property to an affiliate. During October 1999, the first and second quarters of 2001, the third quarter of 2002 and the first half of 2003, the Company contributed primarily non-income producing, pre-merchantable pine plantation timberlands in exchange for an investment in the affiliate (See Item 13. Certain Relationships and Related Transactions, and Notes 3 and 9 to the Consolidated Financial Statements).

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**Formation of the Company**

On November 19, 1997, U.S. Timberlands Company, LP (now known as Pacific Fiber Company, LP), a limited partnership (the “MLP”), acquired substantially all of the equity interests in the Company and completed its initial public offering (the “MLP Offering”) of common units representing limited partner interests (“Common Units”). Upon the closing of the acquisition, U.S. Timberlands Services Company, L.L.C. (now known as Timber Resource Services, LLC) became the Company’s managing member (the “Manager”).

As a result of a series of transactions between the MLP and the Manager, the Company became the operating company for the MLP and the Manager owned an aggregate 2% interest in the MLP and the Company on a combined basis.

Concurrent with the closing of the MLP Offering, the Company and its wholly owned subsidiary, U.S. Timberlands Finance Corp. (“Finance Corp.,” now known as Fiber Finance Corp.), consummated the public offering (the “Public Note Offering”) of \$225.0 million aggregate principal amount of 9 5/8% unsecured senior notes due 2007 (the “Notes”). See *Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources.”*

Finance Corp., a Delaware corporation, was formed on August 18, 1997, and is a wholly-owned subsidiary of the Company. Finance Corp. serves as the co-obligor for the Notes. It has nominal assets and does not conduct any operations. Accordingly, a discussion of operations, liquidity and capital resources of Finance Corp. is not presented.

On October 17, 2002, the MLP announced that it had signed a definitive agreement to be acquired by an acquisition company formed by a group led by senior management (the “Privatization Transaction”). The definitive agreement contemplated a cash tender offer for 100% of the outstanding Common Units not already owned by the acquiring entity or its affiliates for \$3.00 per unit in cash, followed by a merger of the acquisition company with and into the MLP, pursuant to which each Common Unit not already owned by the acquiring entity or its affiliates would be converted into the right to receive \$3.00 per unit in cash. The tender offer commenced on November 19, 2002 and was completed on March 6, 2003. In connection with the tender offer, approximately 71% of the Company’s Common Units were tendered. The remaining Common Units held by non-affiliates that were not purchased in the tender offer were converted into the right to receive \$3.00 per Common Unit, in the merger that was completed on June 26, 2003.

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Subsequent to the Privatization Transaction, the interests in the Company originally held by the MLP were transferred in a series of transactions to a newly formed limited liability company, IFG Holdings, LLC. IFG Holdings, LLC is 99% owned by American Forest Resources, LLC (formerly known as U.S. Timberlands Yakima, LLC), in which the Company holds a preferred equity interest. As part of this reorganization of the ownership structure of the Company, a Board of Directors was formed for the Company to supervise its operations and a new management arrangement was established under which the Manager provides comprehensive timber management services to the Company pursuant to a fee-based management agreement.

**Company Structure and Management**

IFG Holdings, LLC owns a 98.9899% member interest in the Company and the Manager owns a 1.0101% non-voting member interest in the Company.

The Company's operations are managed by the Manager. Until September 1, 2003, the Manager did not receive any management fee or other compensation in connection with its management of the Company, but was reimbursed for all direct and indirect expenses incurred on behalf of the Company (including wages and salaries of employees, officers and directors of the Manager) and all other necessary or appropriate expenses allocable to the Company or otherwise reasonably incurred by the Manager in connection with the operation of the Company's business.

Effective September 1, 2003, the Company entered into a new management agreement with the Manager. The management agreement replaced the prior arrangement under which the Company reimbursed the Manager for expenses incurred on the Company's behalf, as described in the preceding paragraph. The management agreement provides for an annual fee of 2% of the agreed upon valuation of total timber and timberland assets under management, payable monthly and is comparable to other management agreements used in the industry where the manager receives a monthly fee based upon assets under management. In addition, the Company established its own Board of Directors to supervise the management of the Company. Expenses incurred for management of the Company by the Manager totaled \$3,529 and \$3,176, respectively, for the twelve months ended December 31, 2003 and 2002, including \$1,338 for the period from September 1 through December 31, 2003 under the management agreement.

Conflicts of interest may arise between the Company and its affiliates, including conflicts relating to the purchase and sale of timber and/or timber deeds. The Company's audit committee (the "Audit Committee"), consisting of a majority of independent members of its Board of Directors, is available at the Board's discretion to review matters involving conflicts of interest.

The principal executive offices of the Company are located at 625 Madison Avenue, Suite 10-B, New York, New York 10022. The telephone number at such offices is (212) 755-1100.

## **The Timberlands**

### *Timber Growth*

Timber growth rates reflect timberland productivity and the rate of return on a timber investment. Growth rate is an important factor in determining when to harvest timber and the harvest potential of timberlands over the long term. Merchantable timber is economically mature for harvesting when its current growth rate falls below the desired rate of return on the investment in the standing trees. The average growth rate from regeneration to economic maturity measures the capacity of the land for timber production. The Company's older and natural stands on the Timberlands that are expected to provide the near term harvest have a current average growth rate of approximately 150 board feet per acre per annum. The younger plantations, that presently have less merchantable volume, are growing at a rate that is expected to average at least 315 board feet per acre per annum to economic maturity in 50 to 60 years.

This growth rate is based on calculated volumes at the time of maturity. The Company has achieved higher growth rates on the Plantations by planting high quality seedlings, by eliminating competing non-timber growth from the Timberlands and by applying modern forestry practices to assist the growth of the timber. Currently, nearly all of the seedlings planted are grown from superior seed produced in the Company's seed orchard. Management does take action to enhance the growth rate in the natural stands as well. For example, selective harvesting in the slower growing natural stands opens up the timber stand allowing for more vigorous growth of the remaining trees. When it is no longer possible to maintain acceptable growth rates in these stands they will be harvested entirely and converted to faster growing plantations.

### *Harvest Plans*

The Company strives to manage all of its Timberlands, including the Plantations, in an economically prudent and environmentally sensitive manner in order to maximize their value over time. Integral to this management process are the Company's long-term harvest plans. The Company prepares its harvest plans annually based on analyses of the size, age, and class distribution of the Timberlands and the economic maturity of each harvest tract. The factors the Company considers in determining its long-term harvest plans include, among other things, current and expected market conditions, competition, customer requirements, the age, size and species distribution of the Company's timber, assumptions about timber growth rates (which are improving over time as a result of technological and biological advances that improve forest management practices), expected acquisitions and dispositions, access to the Timberlands, availability of contractors, sales contracts and environmental and regulatory constraints. The Company's harvest plans reflect the Company's expectations for each year's harvest, including the sites to be harvested, the manner of harvesting such sites, the volume of each species to be harvested, the prices expected to be received for the Company's timber, the amount of stumpage sales, logging and other costs, thinning operations and other relevant information. The Company has the flexibility to update its harvest plans during the year to take into consideration changes in these factors. The Company harvested or committed to harvest from log, stumpage and timber deed sales 111 million board feet (MMBF) in 2003 and plans to harvest, or commit to harvest, approximately 66 MMBF in 2004. The Company sold 53 MMBF through property sales in 2003. If current market conditions do not improve, the Company will be required to harvest its current Timberlands more aggressively over the next year. If market conditions improve future harvests could be expected to decline to a level which the Company considers to be more sustainable over the long term.

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Because harvest plans are based on certain assumptions, many of which are beyond the Company's control, there can be no assurance that the Company will be able to harvest the volumes projected in its harvest plans. Although the Company's Notes place certain limitations on the harvest plans which may limit the cash flow available for unrestricted use in the future, the Company believes that it generally has sufficient flexibility to permit modifications in response to fluctuations in the market for logs and lumber and the other factors described above. In 2002, because of accelerated harvesting during the fourth quarter of salvage timber resulting from the Toolbox Fire, the Company exceeded the allowable four year harvest levels by 6.9 MMBF and, as required under the indenture governing the Notes (the "Indenture"), had placed \$662 in a restricted account only to be used in ways prescribed in the Indentures. A balance of \$63 remained in the restricted account as of December 31, 2003. As of December 31, 2003, the Company was in compliance with the covenants contained in the Notes. See "Management's Discussion and Analysis of Financial Condition and Results of Operations." If the Company's current harvest plans are pursued unaltered for the next ten years, if it consummates the land sales contemplated by its strategic plan and if its other strategic assumptions prove to be accurate, the Company expects that its timber inventory will decline through 2010 and Ponderosa Pine volume will increase as a percentage of its total timber inventory by such date. The Company expects that its inventory would remain relatively stable thereafter. Long-term harvest plans, growth rates and forest inventory levels were reviewed during 2003. Such harvest plans, land sales and other strategic assumptions do not take into account any acquisition that the Company may consummate during such period.

*Access*

The Timberlands are accessible by a system of approximately 5,000 miles of established roadways or low maintenance roads owned by the Company or its affiliates. The Company uses third party road crews to conduct construction and maintenance on the Timberlands. The Company regularly enters into reciprocal road use agreements with the United States Department of Agriculture - Forest Service ("USFS") and the United States Department of Interior Bureau of Land Management ("BLM") and cooperates with such agencies in numerous cost-sharing arrangements regarding jointly used roads.

*Sales and Markets*

The Company sells its timber through log sales, stumpage sales and deed sales. Under a log sale, the Company identifies a block of timberland that is ready to be harvested and solicits offers from potential customers for delivery of logs. After a price and volume have been agreed among the parties, the Company contracts a third party to harvest the acreage and deliver to a roadside site on the Timberlands, where a contracted trucking company picks up the logs and delivers them to the customer. A stumpage sale is similar to a log sale in that the Company solicits offers from its customers for timber on a block of timberland that is ready to be harvested. However, under a stumpage contract, the Company sells the customer the right to harvest the timber, or stumpage, and the customer arranges to harvest and deliver the logs. Under a stumpage contract, revenue recognition occurs as the timber is harvested by the customer, as the Company retains the risk of loss until the timber is harvested. A timber deed sale is similar to a stumpage sale, except revenue recognition occurs when the contract is executed, as the Company passes the risk of loss to the customer when the contract is executed.

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The Company currently sells its sawlogs or stumpage principally to unaffiliated wood products manufacturers and sells its chips to unaffiliated pulp mills or hardboard plants. The percentage of logs which are sold as sawlogs/stumpage or pulp logs is dependent upon, among other things, the species mix and quality of the inventory harvested and the market dynamics affecting the region. Most of the timber on the Timberlands is softwood, which, due to its long fiber, strength, flexibility and other characteristics, is generally preferred over hardwood for construction lumber and plywood. Once processed, sawlogs are suitable for use as structural grade lumber, appearance grade boards, plywood and laminated veneer and can also be manufactured for such end uses as window trim, molding and door jambs. During 2003, sawlogs, stumpage sales and timber deed sales accounted for approximately 49%, 0% and 19%, respectively, of the Company's revenue. Chips, which can be used to make hardboard or pulp, and seedlings combined accounted for 5% of the Company's revenues in 2003. There were property sales in 2003 of \$10.1 million, compared to 2002 property sales of \$5.8 million.

The Company's customers include numerous unaffiliated operators of conversion facilities. Since its acquisition of the Klamath Falls Timberlands in August 1996, the Company has sold logs and chips from such timberlands to over 25 different customers. In 2003, sales to Boise Cascade, Murphy Veneer, Timber Products, Scott Timber, and Columbia Plywood accounted for approximately 65% of the Company's revenue from log sales. No other single non-affiliated customer accounted for more than 4% of the Company's net revenues for 2003. Although the loss of one or more of such customers or other significant customers could have a material adverse effect on the Company's results of operations, the Company believes that the capacity for processing wood fiber in the Company's markets currently is in balance with the supply and that, therefore, such customers could be replaced with some additional freight costs. There are currently more than 18 primary conversion facilities located within a 150-mile radius of the Company's Timberlands.

*Seasonality*

Log and stumpage sales volumes are generally at their lowest levels in the first and second quarters of each year. Heavy snowfalls in higher elevations prevent access to many areas of the Company's timberlands in the first quarter. This limited access, along with spring break-up conditions in March or April (when warming weather thaws and softens roadbeds), restricts logging operations to lower elevations and areas with rockier soil types. The result of these constraints is that log sales volumes are typically at their lowest in the first quarter, improving in the second quarter and at their high during the third and fourth quarters. Most customers in the region react to this seasonality by carrying high log inventories at the end of the calendar year at a level that provides sufficient inventory to carry them to the second quarter of the following year.

Contributing to this seasonality of log volumes is the market demand for lumber and related products which is typically lower in the first or winter quarter when activity in the construction industry is slow, but increasing during the spring, summer and fall quarters. Log and stumpage prices generally increase in the spring with this build up of construction activity matching the timing of re-entry to all forested areas and increased logging activity.

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*Competition*

Due to transportation costs, domestic conversion facilities in the Pacific Northwest tend to purchase raw materials within relatively confined geographic areas, generally within a 200-mile radius. It is generally recognized that log suppliers such as the Company provide their market with a commodity product. The Company and its competitors all benefit from the same competitive advantages in the region--namely, close proximity to numerous mills, and positive demographic trends of the Pacific Northwest and the West Coast. Therefore, the Company and its competitors are currently able to sell all the logs they are able to produce at a market clearing price although this price has been adversely affected by international competition. Additional competitive factors within a market area generally will include species and grade, quality, ability to supply logs which consistently meet the customers' specifications and ability to meet delivery requirements. The Company believes that it has a reputation as a stable and consistent supplier of well merchandised, high-quality logs. The Company has no conversion facilities and therefore does not compete with its customers for logs. The Company believes that this gives it an advantage over certain of its competitors that also own conversion facilities.

The Company competes with numerous private land and timber owners in the northwestern United States and the state agencies of Oregon, as well as of foreign imports, primarily from Canada, Chile, and New Zealand. In recent years, the strength of the U.S. dollar combined with the much lower value of currencies in Canada, the Pacific Rim and South America have made international competition a larger factor in competitive pricing. In addition, the Company competes with the USFS, the BLM and the Bureau of Indian Affairs. Certain of the Company's competitors have significantly greater financial resources than the Company.

The Company believes that it is competitive in the timber business for the following reasons: (i) the Company has substantial holdings of timber properties which include approximately 0.7 BBF of merchantable, good quality timber, approximately 104,000 acres of plantation timberland and a full-scale seed orchard and nursery operation located in a region with a large number of conversion facilities; (ii) the Company focuses on owning timberlands rather than operating conversion facilities, which minimizes the Company's cost structure and capital expenditures, allows the Company to seek the most favorable markets for its timber rather than being committed to supply its own facilities, and ensures that the Company will not compete with its customers; and (iii) the Company's access to the Manager's computerized geographic information system ("GIS") enables the Company to evaluate the optimal timing and patterns of the harvest of its Timberlands and evaluate and integrate acquisitions of additional timberlands.

**Resource Management**

*Timber Resource Management*

All of the silvicultural activities on the Timberlands and the harvesting and delivery of logs are conducted by independent contractors. The Company's operations involve intensive timber management and harvesting operations, which include road construction and reforestation, as well as wildlife and watershed management, all of which are carefully monitored using the GIS. *See* "Geographic Information System." The Company employs a number of traditional and recently developed harvesting techniques on its lands based on site-specific characteristics and other resource considerations. The topography of the Timberlands allows over 95% of the Timberlands to be harvested using lower-cost mechanical methods as opposed to higher-cost cable systems.

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Harvesting on the Timberlands is conducted using both selective and regeneration harvesting. In selective harvesting, a partial harvest provides merchantable timber and opens up the stand for supplemental growth on the remaining stand. Harvest entries are separated by approximately 1 to 15 years and each entry is prescribed for volume to be removed, spacing to be provided, and diameter limits to be harvested. In regeneration harvesting, which is used to harvest approximately 60% of the Company's timber, all merchantable volume is removed in a single harvest. After an area has been regeneration harvested, the Company employs a reforestation contractor to plant two-year-old seedlings at an optimal density of approximately 300 trees per acre. The Company also attempts to protect and maintain the ecosystem within the Timberlands while providing for a reasonable harvest. For example, the Company typically leaves a mix of green and dead trees at the harvest site, including some large trees, snags and downed logs to provide habitats for a variety of wildlife species while enriching the soil for successive generations of trees.

Particular forestry practices vary by geographic region and depend upon factors such as soil productivity, weather, terrain, tree size, age and stocking. The climate, site and soil conditions on the east side of the Cascade Range, for example, permit management to harvest on an optimal rotation, or harvest cycle, of 50 to 60 years. Forest stands are thinned periodically to improve growth and stand quality until harvested. The Company actively utilizes commercial thinning as a timber management practice. Pre-commercial thinning, which occurs only in the Plantation stands, is utilized when the timber harvested is not merchantable. The Company believes that such thinning improves the overall productivity of the Timberlands by enhancing the growth of the remaining trees. Occasionally, revenues are generated from pre-merchantable thinning due to strong markets for wood chips.

The Company's policy is to ensure that every acre harvested is reforested in order to enhance the long-term value of its timberlands. Based on the geographic and climatic conditions of a given harvest site, harvested areas may be regenerated naturally, by leaving mature trees to reseed the area, or replanted with seedlings. Natural regeneration methods are widely used on approximately 70% of the Company's harvested land. Approximately 38% of the Timberlands acreage currently consists of Plantations. The Company expects to convert an average of 7,000 acres of natural stands per year over the next three years to Plantations. The seed orchard produces seed from trees selected because they were the best genotype in their respective environments. During 2003, the Company planted approximately 3.0 million seedlings and expects to plant 1.6 million seedlings in 2004. The Company uses the seed collected from its orchard (representing approximately 90% of seedlings planted) to grow trees with desirable traits such as superior growth characteristics, good form and disease resistance, resulting in greater wood volume over a rotation than that generated by naturally regenerated seedlings. The seedlings are grown in the Company's nursery, which uses seeds from the Company's seed orchard, which was established by Weyerhaeuser in 1973.

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*Geographic Information System (“GIS”)*

The GIS is a computer software program that was acquired from Weyerhaeuser as part of the Weyerhaeuser Acquisition. The GIS data, which has been compiled over a period of at least five years, includes detailed topographical field maps for every stand within the Timberlands, setting forth the characteristics, including age, species, size and other characteristics for the timber growing on each stand. Using the data in the GIS, the Company can use a computer model to “grow” the timber over time, enabling it to generate long-term harvest plans and to update its inventory annually. To maintain the integrity of the data in the GIS, the Company performs a detailed ground survey of the remaining timber inventory on a tract after each harvest and updates the data in the GIS for that tract. With the aid of the GIS, the Company is able to actively manage the Timberlands, track its inventory and develop site-specific harvest plans on multiple scales, adding additional layers of detail, such as the location of roadways or wildlife nesting areas, as required. The GIS also permits the Company to analyze the impact that new legislation may have on its Timberlands by inputting the proposed constraints imposed by such legislation in light of the particular field characteristics of its Timberlands. The Company believes the GIS may be used to the Company’s advantage to evaluate potential acquisition opportunities.

**Federal and State Regulation**

*Endangered Species*

The Federal Endangered Species Act and counterpart state legislation protect species threatened with possible extinction. Protection of endangered species may include restrictions on timber harvesting, road building and other silvicultural activities in areas containing the affected species. A number of species indigenous to the Pacific Northwest have been protected under the Endangered Species Act, including the northern spotted owl, marbled murrelet, Columbian white-tail deer, mountain caribou, grizzly bear, bald eagle and various anadromous fish species. Currently, the Company has identified several spotted owl and bald eagle nesting areas affecting the Timberlands and the presence of bull trout in certain of its streams, which may affect harvesting on approximately 27,000 acres.

The United States Fish and Wildlife Service (the “USFWS”) listed the american bald eagle in 1976 and the northern spotted owl in 1990 as threatened species throughout its range in Washington, Oregon and California. The Oregon Forest Practices Act and related regulations also protect endangered species and has specific provisions governing habitat protection for the spotted owl, the bald eagle and other threatened species.

Based on the 2003 survey year, there were approximately 73 bald eagle sites on the Timberlands. The Company observes harvesting restrictions around the eagle sites. Due in part to efforts of the Company and its predecessor, the bald eagle was recently removed from the endangered species list; although the Company continues to observe its past operating practices in the affected areas.

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In addition, the Company conducts surveys to determine the presence of northern spotted owls. The surveys have been conducted every year in order to (i) meet the regulatory requirements for timber harvest and other management activities, (ii) monitor existing sites and determine the current status of such sites, (iii) determine if areas identified as containing suitable habitat are supporting owls and (iv) investigate other spotted owl or other species sightings. The most recent of such surveys was completed in August 2003, and identified approximately 24 northern spotted owl sites affecting the Timberlands, three of which are located, totally, on the Timberlands.

The Company believes that it is managing its harvesting operations in the areas affected by protected species in substantial compliance with applicable federal and state regulations. Based on certain consultants' reports, and on management's knowledge of the Timberlands, the Company does not believe that there are any species protected under the Endangered Species Act or similar state laws that, under current regulations and Court interpretation, would have a material adverse effect on the Company's ability to harvest the Timberlands in accordance with current harvest plans. There can be no assurance, however, that species within the Timberlands may not subsequently receive protected status under the Endangered Species Act or that currently protected species may not be discovered in significant numbers within the Timberlands. Additionally, there can be no assurance that future legislative, administrative or judicial activities related to protected species will not adversely affect the Company or its ability to continue its activities and operations.

*Timberlands*

The operation of the Timberlands is subject to specialized statutes and regulations in the State of Oregon, which has enacted laws which regulate forestry operations, including the Forest Practices Act, which addresses many growing, harvesting and processing activities on forest lands. Among other requirements, these laws restrict the size and spacing of regeneration harvest units, and impose certain reforestation obligations on the owners of forest lands. The State of Oregon requires a company to provide prior notification before beginning harvesting activity. The Forest Practices Act and other state laws and regulations control timber slash burning, operations during fire hazard periods, logging activities which may affect water courses or in proximity to certain ocean and inland shore lines, water protection and enhancement and certain grading and road construction activities. The Company believes it is in substantial compliance with these regulations.

*Environmental Laws*

The Company's operations are subject to federal, state and local environmental laws and regulations relating to the protection of the environment. Although the Company believes that it is in material compliance with these requirements, there can be no assurance that significant costs, civil and criminal penalties, and liabilities will not be incurred, including those relating to claims for damages to property or natural resources resulting from the Company's operations.

Environmental laws and regulations have changed substantially and rapidly over the last 20 years, and the Company anticipates there will be continuing changes. The trend in environmental regulations is to place more restrictions and limitations on activities that may affect the environment, such as emissions of pollutants and the generation and disposal of wastes.

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Increasingly strict environmental restrictions and limitations have resulted in increased operating costs for the Company and it is possible that the costs of compliance with environmental laws and regulations will continue to increase.

*Access to Timberlands May be Limited by Federal Regulation*

A substantial portion of the Timberlands consists of sections of land that are intermingled with or adjacent to sections of federal land managed by the USFS and the BLM. Removal of trees from those portions of the Timberlands requires transportation of the logs by truck across logging and general purpose roads. The Company has entered into road use agreements with the USFS and the BLM. The majority of the Company's timberland management activities include the transportation of timber products across federal land and roads fall under such agreements, which describe the Company's exclusive rights to transport timber products across federal lands and roads without USFWS consultation. In many cases, access is only, or most economically, achieved through a road or roads built across adjacent federal land pursuant to a reciprocal right-of-way ("RROW"). Removal of federal timber often requires similar access across the Timberlands. Recent litigation (not involving the Company) before the United States Court of Appeals for the Ninth Circuit held that the BLM was not required to consult with the USFWS, which administers the Endangered Species Act, prior to approving a private landowner's proposal to build an access road across federal land pursuant to an existing RROW entered into prior to the enactment of the Endangered Species Act. A reversal on appeal or a rehearing of that case, or future federal law or regulation requiring the BLM to consult with the USFWS in connection with an RROW, could materially adversely affect the Company's ability to harvest the affected portion of the Timberlands. Certain of the Company's RROW agreements contain provisions that require compliance with state and federal environmental laws and regulations. To the extent that the Company acquires new Timberlands that require access through federal lands, the Company may enter into new RROW agreements with the BLM or other federal agencies which would require consultation with the USFWS. In addition, the BLM has published advance notice of its intent to revise regulations governing RROW agreements entered into the future to, among other things, expand the BLM's consideration of environmental and cultural factors in granting, issuing or renewing rights-of-way, provide the BLM with regulatory authority to object to the location of roads because of potential effects on threatened or endangered species and allow for the abandonment of rights-of-way under certain circumstances.

*Safety and Health*

The operations of the Timberlands are subject to the requirements of the Federal Occupational Safety and Health Act ("OSHA") and comparable state statutes relating to the health and safety of employees. The Company believes that it is in compliance with OSHA regulations, including general industry standards, permissible exposure levels for toxic chemicals and record-keeping requirements.

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**Employees**

As of March 15, 2004, the Company had no employees, and relies upon the employees of the Manager to manage the operations of the Company. All of the silvicultural activities on the Timberlands and the harvesting and delivery of logs are conducted by independent contractors who are not employees of the Company or the Manager.

## **Item 2. Properties**

### **Timber Inventory**

The Company currently owns and manages approximately 272,000 fee acres of timberland and cutting rights on approximately 70,000 acres of timberland containing total merchantable timber volume estimated as of January 1, 2004 to be approximately 0.7 BBF in Oregon east of the Cascade Range. A merchantable tree is a tree of sufficient size that will produce a sound log 16 feet in length and at least 4.6 inches in diameter, inside bark, at the small end. The Company's merchantable timber inventory consists of a substantial percentage of premium species of softwood, consisting of Ponderosa Pine and Douglas Fir, species which have historically commanded premium prices over other softwood species, as well as Lodgepole Pine, White Fir and other species. The Company believes that the Timberlands are suitable for current operations.

The Timberlands have stands of varying sizes and ages and are unique in the forests east of the Cascade Range in Oregon in that approximately 104,000 acres of the 272,000 acre total consist of actively managed Pine Plantations with stands ranging in age from one to 43 years. The Plantations are stocked with high quality Ponderosa Pine (approximately 78%) and Lodgepole Pine (approximately 22%). Initial thinning of the Plantation stands, including the thinning of commercial quantities of merchantable timber, is expected to begin within the next three years. See "Item 1. Business - The Timberlands--Harvest Plans."

#### *Merchantable Timber Inventory by Species*

The Company maintains data regarding the estimated merchantable timber inventory by species within the Timberlands. All volume estimates are based on information developed by the Manager. As of January 1, 2004, the total timber inventory amounted to 0.7 BBF. The Company's combined timber inventory by MMBF and percentage is Ponderosa Pine (319 (45%)), Lodgepole Pine (132 (19%)), White Fir (123 (18%)), Douglas Fir (99 (14%)) and other species (29 (4%)). Other species include Cedar, Sugar Pine, Western Larch and Grand Fir.

#### *Size and Species Distribution of Merchantable Timber*

The Timberlands are diversified by species mix and, to a lesser extent, by size distribution. Timber on the Timberlands generally reaches merchantable size between 40 and 50 years in natural stands and between 25 and 35 years in the Plantations. The Company maintains data as to the estimated volume distribution of merchantable timber on the Timberlands by species and by diameter at breast-height ("DBH"). As of January 1, 2004, approximately 175 MMBF, or 25%, of the merchantable timber, had a DBH of 16 or more inches.

#### *Acreage Distribution by Age Class on Plantations*

The Company also maintains data as to the acreage distribution of timber on the Plantations by age class. As of January 1, 2004, the Plantations totaled 104,000 acres. Of the total acreage, 60,000 acres range from 1 to 15 years of age, 20,000 acres range from 16 to 25 years of age, and 24,000 acres are 26 years of age or older.

**Item 3. *Legal Proceedings***

On June 21, 2002, the Company was notified that it was named in a lawsuit filed in State Court in Oregon as a codefendant seeking medical expenses and up to \$12.0 million in damages for injuries sustained by the minor child of an employee of the Manager while riding on equipment owned by the Manager. At the time, liability insurance was in place, however, the insurance underwriter has since gone bankrupt and coverage is limited and is being administered by the Oregon Guarantee Insurance Association. Effective April 5, 2004 this case was dismissed with prejudice.

On December 19, 2003, an action was brought in the Court of Chancery of the State of Delaware in and for New Castle County by the trustee under the Indenture against the Company, Finance Corp., the Manager, American Forest Resources, LLC, Cascade Resource Holdings Group, LLC, and all of the directors of the Manager as of January 1, 2003 (collectively, the "Defendants"). The complaint alleges that the Company violated the provisions of the Indenture by transferring certain assets to its affiliates, the directors of the Company violated their fiduciary duty to the Company and that the transfers of the assets were fraudulent conveyances and subject to rescission. The trustee seeks a declaration that the Company has violated the terms of the Indenture, an injunction against the transfer of additional assets out of the ordinary course of business, damages and the imposition of a construction trust on the assets transferred by the Company to its affiliates. In January 2004, the plaintiff's motion to schedule a preliminary injunction hearing with respect to further transfers to affiliates and for expedited discovery was denied. In connection with the denial of the plaintiff's motion, the Company agreed that, through the earlier of December 31, 2004 and the resolution of the lawsuit, it would provide at least thirty days' notice before entering into any transfer of assets to affiliates, other than payment of management fees. Discovery began in January 2004 and is ongoing. On February 6, 2004, the Defendants filed a motion to dismiss. In May 2004, A hearing was held with respect to defendants' motion to dismiss. The defendants expect a decision regarding their motion to dismiss within a few months. Subsequent to the hearing, the Company received a Notice of Default from the Trustee covering certain of the allegations in the complaint. On March 26, 2004 a motion to stay discovery pending the outcome of the Defendant's motion to dismiss was denied. The Company and its legal counsel believe the litigation to be without merit and intend to vigorously defend itself in the lawsuit.

**Item 4. *Submission of Matters to a Vote of Security Holders***

There were no matters submitted to a vote of the Company's noteholders during the fourth quarter of 2003.

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**PART II**

**Item 5. Market for Registrant's Common Equity and Related Security Holder Matters**

The Company's equity securities are owned 98.99 % by Timber Resource Holdings Group, LLC, indirectly, and 1.01% by the Manager.

**Item 6: Selected Financial Data**

The financial information set forth below for each of the indicated years is derived from the Company's audited consolidated financial statements. This information should be read in conjunction with the consolidated financial statements and related notes included with this report and previously filed with the Securities and Exchange Commission.

	<b>Inland Fiber Group, LLC</b>				
	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
<b>CASH FLOWS AND OTHER DATA</b>					
<b>(IN MILLIONS):</b>					
Modified EBITDDA <sup>(1)</sup>	0.4	12.8	\$ 23.2	\$ 49.3	\$ 50.6
Additions to timber and timberlands	2.0	3.1	5.6	2.3	1.0
Cash flow from operating activities	1.3	3.2	9.2	28.9	25.5
Cash flow (used in) investing activities	(2.0)	(3.3)	(4.7)	(2.3)	(1.3)
Cash flow from (used in) financing activities	1.2	-	(6.6)	(26.2)	(26.2)
<b>OPERATING STATEMENT DATA</b>					
<b>(IN MILLIONS EXCEPT PER UNIT AMOUNTS):</b>					
Revenues <sup>(2)</sup>	37.1	49.5	54.6	75.6	77.0
Depreciation, depletion and road amortization	15.6	27.5	37.3	28.8	23.3
Fire loss	0.0	0.6	-	-	-
Cost of timber and property sales	10.0	7.3	-	2.6	-
Operating income (loss)	(25.1)	(21.9)	(14.6)	17.9	27.2
Income (loss) before extraordinary items	(47.3)	(44.1)	(37.0)	(4.1)	6.4
Net income (loss)	(47.3)	(44.1)	(37.0)	(4.1)	6.4
<b>BALANCE SHEET DATA (AT PERIOD END, IN MILLIONS):</b>					
Working capital (deficiency)	(6.5)	(1.6)	(1.7)	2.0	2.4
Total assets	168.7	211.0	254.4	300.9	327.7
Long-term debt <sup>(3)</sup>	225.0	225.0	225.0	225.0	225.0
Equity (deficiency)	(65.5)	(19.4)	24.4	67.1	97.2
<b>OPERATING DATA (UNAUDITED):</b>					

Log, stumpage and timber deed sales volumes (MMBF)	110.8	204.8	250.7	243.7	187.3
Property sales volumes (MMBF)	53.3	3.5	-	13.6	-

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- (1) Modified EBITDDA is defined as operating income plus depreciation, depletion, and road amortization and cost of timber and property sales. The Company considers Modified EBITDDA to be a relevant and meaningful indicator of earnings performance commonly used by investors, financial analysts and others in evaluating companies in its industry and, as such, has provided this information in addition to the generally accepted accounting principles-based presentation of net income or loss  
In addition, Modified EBITDDA does not necessarily represent funds available for management's discretionary use as it is calculated prior to debt service obligations and capital expenditures. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."
- (2) Revenues in 2003 consist of \$25.0 million of log, stumpage and deed sales, \$10.1 of timber and property sales and \$2.0 million of by-products and other sales. Revenues in 2002 consist of \$42.3 million of log, stumpage and deed sales, \$5.8 of timber and property sales and \$1.5 million of by-products and other sales. Revenues in 2001 consist of \$54.1 million of log, stumpage and deed sales, \$0.0 million of timber and property sales and \$0.4 million of by-products and other sales. Revenues in 2000 consist of \$72.3 million of log, stumpage and deed sales, \$2.8 million of timber and property sales and \$0.6 million of by-products and other sales. Revenues in 1999 consist of \$76.6 million of log and stumpage sales and \$0.4 million of by-products and other sales.
- (3) See discussion of long-term debt at Note 7 of the Notes to Consolidated Financial Statements.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Statements**

Certain information contained in this report may constitute forward-looking statements within the meaning of the federal securities laws. Although the Company believes that expectations reflected in such forward-looking statements are based upon reasonable assumptions, it can give no assurance that its expectations will be achieved. Forward-looking information is subject to certain risks, trends and uncertainties that could cause actual results to differ materially from those projected. Such risks, trends and uncertainties include the highly cyclical nature of the forest products industry, general economic conditions, competition, price conditions or trends for the Company's products, the possibility that timber supply could be affected if governmental, environmental or endangered species policies change, and limitations on the Company's ability to harvest its timber due to adverse natural conditions or increased governmental restrictions. The results of the Company's operations depend upon a number of factors, many of which are beyond its control. These factors include general economic and industry conditions, domestic and export prices, supply and demand for logs, seasonality, government regulations affecting the manner in which timber may be harvested, and competition from other supplying regions and substitute products. These and other risks are described in the Company's other reports and registration statements, which are available from the United States Securities and Exchange Commission.

**General**

The Company's primary business is the growing and harvesting of timber (see Item 1. Business).

The Company's results of operations are affected by various factors, many of which are beyond its control, including general industry conditions, domestic and international prices and supply and demand for logs, lumber and other wood products, seasonality and competition from other domestic and international supplying regions and substitute products.

## **Supply and Demand Factors**

### *Supply*

The supply of logs available for purchase has been most affected in recent years by significant reductions in timber harvested from public timberlands, principally as a result of efforts to preserve the habitat of certain endangered species, as well as a change in the emphasis of government policy toward habitat preservation, conservation and recreation and away from timber management. Since the early 1970s, environmental and other similar concerns and governmental policies have substantially reduced the volume of timber under contract to be harvested from public lands. The pace of regulatory activity accelerated in the late 1980s. The resulting supply decrease caused prices for logs to increase significantly, reaching peak levels during 1993. Prior to 1998, the low supply of timber from public lands, which is expected to continue for the foreseeable future, benefited private timber holders such as the Company through higher stumpage and log prices. Since 1998, the strength of the U.S. dollar has decreased exports and increased imports and has disrupted the equilibrium of the supply and demand equation and contributed to the general downward trend of prices. Certain market conditions for finished products have also negatively impacted stumpage and log prices in 2003.

Industry participants do not expect environmental restrictions to ease materially within any reasonable planning horizon. Consequently, many producers of lumber and wood products are attempting to adapt to the new supply environment by increasing their emphasis on raw material yields, entering into long-term timber supply arrangements and value added manufacturing, and accessing previously untapped supplies (such as private wood lot owners, timber with difficult access, alternative species and imports). These factors have tended to maintain supply of domestic produced logs and have kept prices from increasing.

In response to an increase in domestic timber prices in the early 1990s and the strengthening US dollar against Pacific Rim currencies, especially, imports of logs and lumber from abroad (from countries such as Canada and New Zealand) increased. These imports, however, only partially offset the lost volume of timber from public timberlands and did not replace the mature, high-quality timber found in greater quantities on public timberlands. Imports did however tend to dampen upward price movements. Imports are likely to remain a factor over the next few years and could significantly affect the raw material supplies and prices in the domestic lumber and wood products industry.

### *Demand*

Changes in general economic and demographic factors, including the strength of the economy, unemployment rates, interest rates for home mortgages and construction loans have historically caused fluctuations in housing starts and, in turn, demand and prices for lumber and commodity wood products. Over the last five to ten years, the relative strength of the dollar against the currencies of other wood producing nations has reduced the competitiveness of domestic logs in export markets and increased the competitiveness of imported logs in our domestic markets. United States housing starts for 2003 were up slightly from 2002 levels, however log prices have declined slightly or remained flat in 2003 over 2002 as a consequence of increases in imported logs and lumber. As a result of the growth of the home center distribution business, the repair and remodeling markets have become a significant factor in terms of the demand for lumber and commodity wood products and have tended to dampen the wide fluctuations that occurred when new housing starts were the primary factor.

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Prices for Pine species, primarily Ponderosa Pine, reached a peak in the spring of 1993 and as a result attracted imports of Radiata Pine from New Zealand and Chile. Given the strong growth of the housing market during the past several years, domestic markets have been able to absorb the increasing quantities of imported Radiata Pine lumber and logs which has limited the benefit of the strong housing market. With the continuing strength of the dollar, the level of imports has had a negative impact on pricing for Pine lumber. The Company believes that recent declining value of the dollar should allow the price trend to become more positive. The demand for logs in the United States is also affected by the level of lumber imports. In response to increasing lumber imports from Canada, the United States and Canada signed an agreement in 1996 which restricted the availability of Canadian softwood lumber in the United States. The Company believes that this agreement, which expired on March 31, 2001, has not had a material impact on the price or demand for logs in the United States. The United States and Canada are presently negotiating a new softwood lumber agreement even though a 30% tariff has been imposed on Canadian softwood lumber. The long term effect of not having an agreement or having a new agreement is uncertain.

Due to transportation costs, domestic conversion facilities in the Pacific Northwest tend to purchase raw materials within relatively confined geographic areas, generally within a 200-mile radius. The conversion facilities in the vicinity of the Timberlands need more wood supply to run at capacity than can be produced by nearby timberlands. As a result, the demand from this region is relatively steady, although prices have generally declined with market conditions and increased imports.

**Application of Critical Accounting Policies**

The Company's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Certain accounting policies have a significant impact on amounts reported in the financial statements. A summary of those significant accounting policies can be found in Note 1 to the Company's financial statements included herein.

The Company has not adopted any new accounting policies during the year ended December 31, 2003 that significantly impact its financial statements.

Among the significant judgments made by management in the preparation of the Company's financial statements are the determination of the allowance for doubtful accounts and the rates of depletion applicable to the Company's merchantable timber. These determinations are made periodically in the ordinary course of accounting.

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**Current Market Conditions**

Log prices in the first quarter of 2003 were down by 3.4% from the fourth quarter of 2002. During the second quarter prices improved slightly and after a slight decline in the third quarter, improved again in the fourth quarter of 2003. Log prices in the fourth quarter of 2003 and 2002 were virtually equal. The average log price in 2003 was \$316/MBF compared to \$330/MBF in 2002. Even with the lower average price on a year to year basis, the downward trend in log prices that has been in effect for the past several years appears to have stopped and the Company expects prices of logs to trend slowly upwards in 2004.

In June 2003, a major customer and competitor of the Company, Crown Pacific, filed for relief under Chapter 11 of the Bankruptcy Code. There was no direct financial impact to the Company. It is not known at this time how this bankruptcy will impact the forest products industry in which the Company operates, although it may lead to increased timber supply in the market.

**Results of Operations**

The following table sets forth sales volume for each of 2003, 2002 and 2001 from the sale of logs, stumpage and timber deeds by thousand board feet ("MBF") and price per thousand board feet and the sales of property:

Period	Sales Volume (MBF)			Price Realization (MBF)			Timberland Sales (\$000)
	Logs	Stumpage	Timber Deeds	Logs	Stumpage	Timber Deeds	
<b>2003</b>							
Year ended 12/31	57,048	–	53,719	\$ 316	– \$	130 \$	10,129
4th Quarter	12,803	–	38,860	\$ 325	– \$	120 \$	1,185
3rd Quarter	12,833	–	1,104	\$ 306	– \$	135	10
2nd Quarter	14,314	–	10,869	\$ 320	– \$	136	8,334
1st Quarter	17,098	–	2,886	\$ 313	– \$	236	600
<b>2002</b>							
Year ended 12/31	74,612	–	130,161	\$ 330	– \$	135 \$	5,763
4th Quarter	31,015	–	19,159	\$ 324	– \$	174 \$	4,700
3rd Quarter	23,998	–	20,189	\$ 329	– \$	186	1,063
2nd Quarter	14,575	–	88,480	\$ 341	– \$	114	–
1st Quarter	5,024	–	2,333	\$ 349	– \$	169	–
<b>2001</b>							
Year ended 12/31	74,640	–	176,105	\$ 349	– \$	160	
4th Quarter	15,827	–	48,838	\$ 361	– \$	158	
3rd Quarter	27,984	–	83,899	\$ 347	– \$	173	
2nd Quarter	9,890	–	28,624	\$ 313	– \$	138	
1st Quarter	20,939	–	14,744	\$ 357	– \$	133	

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*Year Ended December 31, 2003 Compared to Year Ended December 31, 2002*

*Revenues.* Revenues decreased \$12.4 million, or 25%, from \$49.5 million in 2002 to \$37.1 million in 2003. The decrease is primarily attributable to a decrease in log sales of \$6.7 million and a \$10.6 million decrease in stumpage sales and deed sales. These decreases were offset by property sales in 2003 of \$10.1 million, compared to \$5.8 million in 2002. Chip and by-product revenues were also higher by \$0.5 million in 2003 compared to 2002. To meet its working capital requirements, the Company harvested and sold logs and timber deeds in 2003 at rates in excess of the estimated current annual board footage growth on the Timberlands.

Log sales for 2003 were \$18.0 million on volumes of 57,048 MBF, compared to log sales of \$24.7 million on volumes of 74,612 in 2002. The average log sales price for 2003 was \$316 compared to an average log sales price of \$330 in 2002, a 4% decrease, reflecting weaker markets for the Company's log sales

Timber deed sales for 2003 were \$7.0 million on volumes of 53,719 MBF, compared to timber deed revenue of \$17.6 million on volumes of 130,161 MBF in 2002. The average timber deed sales price per MBF for 2003 was \$130 compared to an average timber deed sales price of \$135 in 2002, a 4% decrease. The decrease in timber deed sales realization is due to overall declines in market conditions, as well as a change in the timber mix being sold in timber sales.

There were no stumpage sales for 2003 and 2002. The reduction in stumpage volumes is a result of the Company's strategic decision to utilize log sales and timber deed sales as its primary source of revenue.

The Company had revenue from timber and property sales in 2003 of \$10.1 million, compared to \$5.8 million in revenue from timber and property sales during 2002.

*Gross Loss.* Gross loss decreased by \$1.7 million from \$3.3 million in 2002 to \$1.6 million in 2003 and gross margin improved from negative 7% in 2002 to negative 4% in 2003. The improvement in gross margin was due to several factors including lower contracted log and haul costs on a per MBF basis during 2003 as compared to 2002, a fire loss of \$0.6 million in 2002, reduction in silviculture spending by \$0.4 million in 2003 compared to 2002, and reduction in harvest taxes by \$0.2 million during 2003 compared to 2002. Depletion, road amortization, and depreciation were lower by \$11.9 million during 2003 compared to 2002 as a result of lower log, timber deed, and timberland sales, but on a per cent basis there was no change between the years and therefore no impact on the gross loss.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$6.4 million in 2003, compared to selling, general and administrative expenses of \$7.5 million in 2002, a decrease of \$1.1 million. Within selling, general and administrative, many categories of expenses were down as a result of a new management fee agreement and a change in allocation of expenses between the Company and its affiliates. Until September 1, 2003, the Manager did not receive any management fee or other compensation in connection with its management of the Company, but was reimbursed for all direct and indirect expenses incurred on behalf of the Company (including wages and salaries of employees, officers and directors of the Manager) and all other necessary or appropriate expenses allocable to the Company or otherwise reasonably incurred by the Manager in connection with the operation of the Company's business.

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Effective September 1, 2003, the Company entered into a management agreement with the Manager. The management agreement replaced the prior arrangement under which the Company reimbursed the Manager for expenses incurred on the Company's behalf, as described in the preceding paragraph. The management agreement, which provides for an annual fee of 2% of the agreed upon valuation of total timber and timberland assets under management, payable monthly, is comparable to other management agreements used in the industry where the manager receives a monthly fee based upon assets managed.

The lower selling, general and administrative expenses were primarily reflected in salaries, wages and benefits, down \$0.7 million, professional services were down \$0.4 million, property taxes were down \$0.1 million, and MLP related expenses were down \$0.8 million. These expense reductions were offset by the management fee of \$1.3 million of the Company paid with respect to the period September 1, 2003 through December 31, 2003.

*Equity in Net Income (Loss) of Affiliate.* The equity in net loss of affiliate was \$17.0 million during 2003 as compared to equity in net loss of affiliate of \$11.0 million in 2002. The losses in 2003 and 2002 reflect the Company's share of losses absorbed from its preferred equity investment in American Forest Resources, LLC. See "Investment in Affiliate" included in Note 9 of the Financial Statements for an explanation of the preferred equity investment in American Forest Resources, LLC.

*Interest Expense.* Interest expense was \$21.7 million in 2003 and 2002, consisting primarily of interest expense on the Company's \$225.0 million of Senior Notes.

*Other Income (Expense), net.* Other income, net, was \$0.2 million in 2003 and 2002 and consisted of income derived from the cattle leases, and other mineral and grazing rights granted.

*Year Ended December 31, 2002 Compared to Year Ended December 31, 2001*

*Revenues.* Revenues decreased \$5.1 million, or 9%, from \$54.6 million in 2001 to \$49.5 million in 2002. The decrease was primarily attributable to a decrease in log sales of \$1.4 million and a \$10.5 million decrease in stumpage sales and deed sales. These decreases were offset by property sales in 2002 of \$5.8 million, compared to \$0.0 million in 2001. Chip and by-product revenues were also higher by \$1.0 million in 2002 compared to 2001. To meet its working capital requirements, the Company harvested and sold logs and timber deeds in 2002 at rates in excess of the estimated current annual board footage growth on the Timberlands.

Log sales for 2002 were \$24.7 million on volumes of 74,612 MBF, compared to log sales of \$26.0 million on volumes of 74,640 in 2001. The average log sales price for 2002 was \$330 compared to an average log sales price of \$349 in 2001, a 5% decrease, reflecting weaker markets for the Company's log sales.

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Timber deed sales for 2002 were \$17.6 million on volumes of 130,162 MBF, compared to timber deed revenue of \$28.1 million on volumes of 176,105 MBF in 2001. The average timber deed sales price per MBF for 2002 was \$135 compared to an average timber deed sales price of \$160 in 2001, a 16% decrease. The significant decrease in timber deed sales realization is due to overall declines in market conditions, as well as a change in the timber mix being sold in timber sales.

There were no stumpage sales for 2002 and 2001. The reduction in stumpage volumes is a result of the Company's strategic decision to utilize log sales and timber deed sales as its primary source of revenue.

The Company had revenue from two property sales in 2002 of \$5.8 million, compared to \$0.0 million in revenue from timber and property sales during 2001.

*Gross Profit.* Gross profit decreased along with revenues by \$3.9 million from \$0.6 million in 2001 to negative \$3.3 million in 2002 and gross margin decreased from 1.0% in 2001 to negative 7.0% in 2002. The decrease in gross margin was primarily from four factors. First, contracted log and haul costs on a per MBF basis were higher during 2002 as compared to 2001 due to longer hauls for delivered logs. Second, the Company's timber deed sales were composed of a different value grade mix as compared to 2001. Third, in 2002 the Company incurred a fire loss of \$0.6 million. Finally, continued declines in the timber markets resulted in lower realizations on delivered log and stumpage values. Depletion, depreciation and road amortization decreased from \$37.3 million in 2001 to \$27.5 million in 2002 due primarily to decreased volume of timber sales.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$7.5 million in 2002, compared to selling, general and administrative expenses of \$8.3 million in 2001. Within selling, general and administrative, most categories of expenses were down. Salaries, wages and benefits were down \$0.3 million due to positions that were vacant for a portion of the year and professional services were down \$0.2 million compared to 2001. Those decreases were partly offset by increases in insurance expense of \$0.1 million.

*Equity in Net Income (Loss) of Affiliate.* The equity in net loss of affiliate was \$11.0 million during 2002 as compared to equity in net loss of affiliate of \$6.9 million in 2001. The losses in 2002 and 2001 reflect the Company's share of losses absorbed from its preferred equity investment in American Forest Resources, LLC. See "Investment in Affiliate" included in Note 9 of the Financial Statements for an explanation of the preferred equity investment in American Forest Resources, LLC.

*Interest Expense.* Interest expense was \$21.7 million in 2002 and \$22.0 million in 2001 consisting primarily of interest expense on the Company's \$225.0 million of Senior Notes.

*Other Income (Expense), net.* Other income, net, was \$0.2 million for 2002, compared to \$0.1 million for 2001, representing an increase in income of \$0.1 million.

## **Liquidity and Capital Resources**

The Company's primary sources of liquidity have been cash provided by operating activities as well as debt and equity financings. As of December 31, 2003, the Company had a cash balance of \$1.4 million and a \$6.5 million working capital deficit that included \$5.0 of deferred revenue relating to the prepayment of a log sale contract entered into in December 2003.

*Operating Activities.* Cash flows provided by operating activities in 2003 were \$1.3 million, compared to cash flows provided by operating activities of \$3.2 million in 2002.

*Investing Activities.* Cash flows used in investing activities were \$2.0 million in 2003, as compared to cash flows used in investing activities of \$3.3 million during 2002 principally for reforestation, timber acquisitions and road additions in each year.

*Financing Activities.* Cash flows provided by financing activities were \$1.2 and \$0.0 million in 2003 and 2002, respectively. In May 2003, U.S. Timberlands Acquisition Co., LLC reimbursed the Company for certain expenses aggregating \$1,238 incurred in connection with the Privatization Transaction. These expenses consisted principally of legal expenses of the Company and the Special Committee and a fairness opinion fee to an investment banking firm retained by the Special Committee. The reimbursement has been recorded as a contribution to the capital of the Company. Beginning in the second quarter of 2001, the Company ceased making distributions to its equityholders. Accordingly, during 2003 and 2002, the Company paid no distributions to members.

*Notes.* On November 14, 1997, the Company issued \$225.0 million aggregate principal amount of Notes representing unsecured general obligations of the Company which bear interest at 9 5/8% per annum, payable semiannually in arrears on May 15 and November 15. The Notes mature on November 15, 2007 unless previously redeemed. The Notes do not require any mandatory redemption or sinking fund payments prior to maturity and are redeemable at the option of the Company in whole or in part, on or after November 15, 2002, at predetermined redemption prices plus accrued interest to the redemption date. Upon the occurrence of certain events constituting a "change of control" (as defined in the Indenture), the Company must offer to purchase the Notes, at a purchase price equal to 101% of the principal amount thereof, plus accrued and unpaid interest to the date of purchase. There can be no assurance that the Company will have access to sufficient funds to repurchase the Notes in the event of a change in control.

The Indenture contains various affirmative and restrictive covenants applicable to the Company and its subsidiaries, including limitations on the ability of the Company and its subsidiaries to, among other things, (i) incur additional indebtedness (other than certain permitted indebtedness) unless the Company's Consolidated Fixed Charge Coverage Ratio (as defined in the Indenture) is greater than 2.25 to 1.00, and (ii) make distributions to members, make investments (other than permitted investments) in any person, create liens, engage in transactions with affiliates, suffer to exist any restrictions on the ability of a subsidiary to make distributions or repay indebtedness to members, engage in sale and leaseback transactions, enter into a merger, consolidation or sale of all or substantially all of its assets, sell assets or harvest timber in excess of certain limitations or engage in a different line of business.

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The Indenture also contains restrictions on the amount of timber that may be harvested based on a limit of 150%, 140%, 130% and 120% of 125 MMBF, adjusted for various acquisitions, dispositions and adjustments, averaged over a one, two, three and four year period, respectively. In 2002, because of the accelerated harvesting during the fourth quarter 2002 of salvage timber resulting from the Toolbox Fire, the Company exceeded the allowable four year harvest by 6.9 MMBF and, as required under the Indenture, placed \$662 in a restricted account only to be used in ways prescribed in the Indenture. A balance of \$63 remains in the restricted account as of December 31, 2003. As of December 31, 2003, the Company was in compliance with the covenants contained in the Notes. (See Item 3: Legal Proceedings for a discussion of certain litigation initiated against the Company among others relating to the Notes.).

The Company made its required interest payment, due on November 17, 2003, on its Notes, within the 30 day grace period provided therefore. (See Item 3. Legal Proceedings for a discussion of certain litigation initiated against the Company among others relating to the Notes.).

*Affiliate Credit Facility*

The Company had a credit facility with an affiliate of the Manager (the "Affiliate Credit Facility") consisting of a revolving line of credit of up to \$12.0 million. Borrowings under the Affiliate Credit Facility bore interest at the prime lending rate as published in the Wall Street Journal plus applicable margin, which was based on the Company's leverage ratio. The Affiliate Credit Facility expired, by its terms, at the end of April 2002. The Company sought to replace the Affiliate Credit Facility with a working capital facility from an unaffiliated third party but has been unable to obtain a working capital credit facility in amounts sufficient to fund its working capital needs from a traditional commercial lender. While the Company continues to seek a credit facility from an unaffiliated source, affiliated lenders have made short term advances to the Company, payable on demand, at an annual interest rate of 10%. The affiliate has made no commitment to continue lending funds to the Company, and each request is reviewed on a case by case basis. During 2003, the maximum amount outstanding under such loans was \$424 all of which had been repaid as of December 31, 2003.

*Capital Expenditures/Cash Distributions*

Capital expenditures in 2003 totaled \$2.0 million. The Company purchased timber cutting rights from its affiliate for approximately 5.1 MMBF of timber for \$0.8 million. The remaining \$1.2 million in capital expenditures were mainly in the nature of land management/silviculture costs. Capital expenditures were financed through cash flow generated by operations. As the Company does not currently own and does not plan to own manufacturing facilities, and all logging is subcontracted to third parties, it is anticipated that capital expenditures in the future will not be significant and will consist mainly of land management/silviculture expenditures. It is currently anticipated that the Company will not maintain significant log inventories, although small log inventories may be maintained for a short period of time, or incur material capital expenditures for machinery and equipment. The Company anticipates that capital expenditures will be approximately \$0.5 million in 2004 consisting primarily of capitalized silviculture costs and miscellaneous equipment purchases.

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Cash required to meet the Company's debt service will be significant. To meet its working capital requirements, the Company has been selling logs and making timber sales at a rate in excess of the Manager's estimate of the current annual board footage growth on the Company's timberlands. Although the Company has been approached recently regarding certain debt restructuring scenarios, discussions have been very preliminary and it is premature to assess the likelihood of pursuing any such scenario or other material transaction. (See Item 3. Legal Proceedings for a discussion of certain litigation initiated against the Company among others relating to the Notes.).

*Effects of Inflation*

Prices for the Company's stumpage and logs may be subject to sharp cyclical fluctuations due to market or other economic conditions, including the level of construction activity, but generally do not directly follow inflationary trends. Costs of forest operations and general and administrative expenses generally reflect inflationary trends.

*Recent Accounting Standards*

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" as an amendment to SFAS No. 123 by introducing two additional conversion methods when converting to the fair value based method from the intrinsic value method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income (loss) of an entity's accounting policy decisions with respect to stock based employee compensation and amends APB Opinion No. 28 to require disclosure about those effects in interim financial information. The disclosure provisions are effective for fiscal years ending after December 15, 2002 and for interim periods beginning after December 15, 2002.

Prior to the Privatization Transaction, when the Company was deemed to have provided stock-based compensation in connection with the MLP's Unit Option Plan, the Company had elected to follow the intrinsic value method of accounting for stock-based employee compensation.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46) "Consolidation of Variable Interest Entities" which is an interpretation of Accounting Research Bulletin No. 51 "Consolidated Financial Statements". In December 2003 the FASB modified FIN 46 to make certain technical corrections and address certain administration issues that had arisen. FIN 46 requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. Previously, entities were generally consolidated by an enterprise when it had a controlling financial interest through ownership of a majority voting interest in the entity.

The provisions of FIN 46 as revised are required to be applied by the Company no later than March 31, 2004. The Company has considered the applicability of FIN 46 to its investment in its parent company, American Forest Resources, LLC, and has concluded that American Forest Resources, LLC is not a variable interest entity and therefore its financial statements are not required to be consolidated with those of the Company pursuant to the provisions of FIN 46.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

Not applicable

**Item 8. *Financial Statements***

The information required hereunder is included in this report as set forth in the “Index to Financial Statements” on Page F-1.

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

**Item 9A. *Disclosure Controls and Procedures***

The Company’s management maintains an adequate system of disclosure controls and procedures to promote the timely identification and reporting of material, relevant information. The Company’s President and Chief Executive Officer and its Vice President and Chief Financial Officer meet regularly with members of senior management of the Manager to discuss significant transactions and events affecting the Company’s operations and consider whether topics discussed represent information that should be disclosed under the rules of the SEC. The Company established a Board of Directors in July 2003 and it includes an Audit Committee. The Audit Committee reviews all reports on Form 10-Q and 10-K prior to their filing. The Audit Committee is responsible for hiring the Company’s external auditors and meets with those auditors.

The Company’s President and Chief Executive Officer and its Vice President and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures. They have designed such controls to ensure that others make all material information known to them within the organization.

As of the end of the period covered by this annual report, the Company’s executive officers completed an evaluation of the disclosure controls and procedures and has determined them to be functioning properly and effectively. They did not discover any significant deficiencies or material weaknesses within the controls and procedures that required modifications. Since the completion of that evaluation, there have been no significant changes in internal control over financial reporting or in other factors that could significantly affect internal control over financial reporting.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

**Directors and Executive Officers of the Company**

The following table sets forth certain information with respect to the members of the Board of Directors of the Company and its executive officers. Executive officers and directors are elected for one-year terms.

<u>Name</u>	<u>Age</u>	<u>Position with Manager</u>
John M. Rudey	60	Chairman, Chief Executive Officer, President and Director
Laurie G. Rudey	56	Director
George R. Hornig	49	Director <sup>(1)</sup>
John D. Layton	42	Director <sup>(1)</sup>
Mel A. Sachs	58	Director <sup>(1)</sup>
Suzanne M. Hay	32	Director <sup>(2)</sup>
Carrie L. Tillman	32	Director <sup>(2)</sup>
Thomas C. Ludlow	57	Vice President, Secretary and Treasurer

(1) Member of the Audit Committee.

(2) These directors are “Independent Directors” under the Company’s operating agreement and have the powers and duties of directors of the Company only with respect to the Company’s entering into certain significant transactions, including, but not limited to, a merger, sale of substantially all of the assets or the institution of bankruptcy proceedings with respect to the Company and in other limited circumstances.

John M. Rudey has served as Chairman and President of the Company since its reorganization in July 2003. He also serves as Chairman, Chief Executive Officer and President of the Manager, having been elected to the Board of Directors of the Manager in September 1996.

Laurie G. Rudey has served as a director of the Company since its reorganization in July 2003. She also served as a director of the Manager. Mrs. Rudey has been a Psychotherapist since 1998. John M. Rudey, Chairman and President of the Company, is Mrs. Rudey’s husband

George R. Hornig has served as a Director of the Company since its reorganization in July 2003. He also serves a Director of the Manager, having been elected to the Board of Directors of the Manager in September 1996. Since 1999, Mr. Hornig has been Managing Director and Chief Operating Officer of Credit Suisse First Boston’s Private Equity Division. From 1993 to 1999, Mr. Hornig was an Executive Vice President of Deutsche Bank Americas Holdings, Inc. (the United States arm of Deutsche Bank, a German banking concern) and affiliated predecessor entities.. Mr. Hornig is also a director of Unity Mutual Life Insurance Company and Forrester Research, Inc.



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John D. Layton has served as a director of the Company since its reorganization in July 2003. He also serves as a director of the Manager, having been elected to the Board of Directors of the Manager in June 2003. For the past five years, Mr. Layton has been a Manager with HRH Construction, LLC, in New York City.

Mel A. Sachs has served as a director of the Company since its reorganization in July 2003. He also serves as a director of the Manager, having been elected to the Board of Directors of the Manager in June 2003. For the past five years Mr. Sachs has been a trial lawyer. Mr. Sachs has lectured practicing lawyers at the National College of Criminal Defense and has taught at Cornell University Law School, Emory University Law School, University of Colorado Law School and Hofstra University School of Law.

Suzanne M. Hay has served as a director of the Company since its reorganization in July 2003. Since 1995, Ms. Hay has served in various positions with Entity Services Group, LLC, which provides independent directors and other services to companies, and currently serves as Vice President, Client Development.

Carrie L. Tillman has served as a director of the Company since its reorganization in July 2003. Since 1998, Ms. Tillman has served as an administrative manager with Entity Services Group, LLC. Prior to 1998, Ms. Tillman was Assistant to the Coordinator of Special Services for Corporation Service Company, a leading corporate services company that provides incorporation, registered agent, filing, merger and other corporate governance services.

Thomas C. Ludlow became Vice President, Chief Financial Officer, Secretary and Treasurer of the Company in July 2003. He has served as Vice President and Chief Financial Officer of the Manager since July 2000. From 1998 to 2000, Mr. Ludlow was Chief Financial Officer of Forest Systems, LLC, a Boston based timber investment management company. From 1995 to 1998, Mr. Ludlow was Director and head of North American Forest Products for Deutsche Morgan Grenfell, an international investment bank.

The Board of Directors of the Company has determined that George R. Hornig is an “audit committee financial expert” as defined in Item 401(h) of Regulation S-K.

The Company does not have a code of ethics as it does not have any employees. The Company’s principal executive officer and principal financial officer provide services to the Company primarily in their capacities as the executive officers of the Manager, and are bound by the provisions of the Manager’s employee handbook and other regulations established by the Manager.

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**Item 11. Executive Compensation**

Under the terms of the Company's previous management arrangement, the Company was required to reimburse the Manager for expenses relating to the operation of the Company, including salaries and bonuses of employees employed on behalf of the Company, as well as the costs of providing benefits to such persons under employee benefit plans and for the costs of health and life insurance. Accordingly, the Company reimbursed the Manager for the salaries and bonuses paid to its executive officers and other employees. Under the management agreement entered into with the Manager, the Company pays the Manager an annual fee of 2% of the agreed upon valuation of total timber and timberland assets under management for its management services. The compensation of the Manager's executive officers is subject to separate arrangements between the Manager and the executive officers. The Company's executive officers are not paid by the Company for their services as executives officers of the Company. The table below sets forth annual salary, bonus and all other compensation awards and payouts earned by the Manager's chief executive officer and chief financial officer for services rendered through August 31, 2003 which were reimbursed by the Company:

**SUMMARY COMPENSATION TABLE**

Name and Principal Position	Fiscal Year	Annual Compensation		Long-Term Compensation	All Other Compensation
		Salary (\$)	Bonus (\$)	Awards	
				Securities Underlying Options/SARs(#)	
John M. Rudey Chairman and Chief Executive Officer	2003	309,000 <sup>(1)</sup>	—	—	—
	2002	463,500	—	—	—
	2001	463,500	—	—	—
Thomas C. Ludlow Vice President and Chief Financial Officer	2003	150,000 <sup>(1)</sup>	—	—	—
	2002	225,000	—	—	—
	2001	225,000	—	—	—

**(1) reflects salary payments up to August 31, 2003.**

**Compensation of Directors**

Directors of the Company, other than Mr. Rudey, Ms. Hay and Ms. Tillman, currently receive annual compensation of \$25,000 for their service on the Board of Directors of the Company. The Company pays \$1,100 annually to the Entity Services Group, LLC for the services of each of Ms. Hay and Ms. Tillman. The independent directors of the Company's Manager received \$50,000 to \$100,000 on an annual basis through June 2003. For their remuneration, the independent directors (other than Ms. Hay and Ms. Tillman) each agreed to participate in four regular meetings of the Board of Directors and four Audit Committee meeting and the non-employee director agrees to participate in four regular meetings of the Board of Directors. Each non-employee director will receive \$1,250 for each additional meeting in which he or she participates. In addition, each non-employee director will be reimbursed for his or her out-of-pocket expenses in connection with attending meetings of the Board of Directors or committees thereof. Each director will be fully indemnified by the Company for his or her actions associated with being a director to the extent permitted under Delaware law.



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Through June 2003, the Manager and Aubrey Cole Associates (a consulting firm affiliated with Aubrey Cole, a director of the Company through June 2003), Robert F. Wright Associates, Inc. (a consulting firm affiliated with Robert F. Wright, a director of the Company through June 2003) and Mr. Hornig were parties to consulting agreements pursuant to which each such person or firm provided consulting services to the Manager. Each such agreement provided for an annual retainer of \$25,000, plus \$150 per hour (with a maximum per diem of \$1,200) for services rendered at the request of the Manager. In addition, for the first half of 2002, the Manager entered into a consulting agreement with Mr. Wyman that provided for an annual retainer of \$50,000 for services rendered at the request of the Manager. As of July 1, 2002, Mr. Wyman's consulting fees were reduced to zero and were offset by increased director fees. Pursuant to the management arrangement in effect at the time, the Company reimbursed the Manager for the payment of approximately \$56,000, \$112,000, and \$98,000 to the Directors of the Manager for consulting services during 2003, 2002 and 2001, respectively. The consulting agreements were discontinued in July 2003.

**Committee Interlocks and Insider Participation in Compensation Decisions**

As the Company does not have any employees, the Company does not have a compensation committee. Under the prior management arrangement, pursuant to which the Manager was reimbursed by the Company for compensation paid to the employees of the Manager, the Compensation Committee of the Manager was composed of Messrs. Rudey, Abramson, Wyman, Hornig and Cole. Mr. Rudey also served as Chairman of the Manager. Other than Mr. Rudey and Mr. Hornig, none of the members of the Company's Board of Directors are officers or employees of the Company or the Manager. The Manager currently does not have a compensation committee.

**Item 12. Security Ownership of Certain Beneficial Owners and Management**

None.

**Item 13. Certain Relationships and Related Party Transactions**

The Company is managed by the Manager pursuant to a management agreement between the Company and the Manager. Under the management agreement, the Manager is entitled to an annual fee of 2% of the agreed upon valuation of total timber and timberland assets under management. Substantially all of the ownership interests in the Manager are owned by John M. Rudey and entities affiliated with Mr. Rudey. Mr. Rudey is the Chairman and President of the Company. In 2003, \$1,338 in fees were paid by the Company pursuant to the management agreement.

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**Consulting Agreements**

Through June 2003, the Manager and each of Aubrey Cole Associates (a consulting firm affiliated with Mr. Cole), Robert F. Wright Associates, Inc. (a consulting firm affiliated with Mr. Wright) and Mr. Hornig were parties to consulting agreements pursuant to which each such person or firm provided consulting services to the Manager. Each such agreement provided for an annual retainer of \$25,000, plus \$150 per hour (with a maximum per diem of \$1,200) for services rendered at the request of the Manager. In addition, for the first half of 2002, the Manager entered into a consulting agreement with Mr. Wyman that provided for an annual retainer of \$50,000 for services rendered at the request of the Manager. Such fees were reimbursed to the Manager by the Company. See also Compensation of Directors included in Item 11.

**Investments in and Transactions with Affiliate**

Since October 1999, the Company has owned a redeemable preferred membership interest (“Preferred LLC Interest”) in American Forest Resources, LLC (formerly U.S. Timberlands Yakima, LLC) (“AFR”), an affiliate, accounted for under the equity method. As described in Note 1 to the Financial Statements, in July 2003 the Company became an indirect subsidiary of AFR as a result of a series of transactions culminating in the contribution to a subsidiary of AFR of the 99% non-managing member’s interest in the Company previously owned by the MLP.

In October 1999, the Company made an investment in AFR. AFR, a then newly formed entity organized to acquire timber properties located in Central Washington and Central Oregon, is engaged in the growing of trees and sale of logs and standing timber to third party wood processors. The MLP contributed to AFR \$294 of cash for 49% of AFR’s common interests (the “Common LLC Interests”). The remaining Common LLC Interests were acquired for \$306 in cash by Cascade Resource Holdings Group, LLC (formerly U.S. Timberlands Holding Group, L.L.C., a Delaware limited liability company (“Holdings Group”) in which John Rudey, the Chairman of the Board of the Company holds a controlling interest. The Company also acquired all of the senior preferred membership interests in AFR (the “Senior or Preferred LLC Interests”) for its contribution to AFR of timberlands consisting primarily of non-income producing, pre-merchantable pine plantations having an agreed upon value of \$22,000. The Company recorded its investment in the Senior LLC interest at its \$18,850 cost basis for the contributed timberlands. Terms of the Preferred LLC Interests include a cumulative annual guaranteed return of 5% until December 31, 2001 and 6% thereafter of the \$22,000 agreed upon value of the contributed timberlands. The Preferred LLC Interests are redeemable at AFR’s option for a redemption price equal to the agreed upon value of the Preferred LLC Interests, either in cash or timberlands, plus any portion of the guaranteed return not received by the Company prior to the redemption date. Generally, AFR’s net income or losses are allocated to the Common LLC Interests. However, net losses exceeding the account balances of the Common LLC Interests are allocated to the Preferred LLC Interest. The Company accounts for the Preferred LLC Interest at cost plus accrued dividends to the extent earned, reduced by losses, if any, in excess of the Common LLC Interests.

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On September 14, 2001, management of AFR was taken over by American Forest Services, LLC (“American Forest Services,” formerly U.S. Timberlands Services Yakima, LLC), a wholly owned subsidiary of the Manager of the Company. American Forest Services is paid a fee equal to 2% of the agreed upon valuation of the assets under management. Prior thereto, the Manager provided management services for a fee equal to 2% of AFR’s earnings before interest, taxes, depletion, depreciation and amortization. Such fees charged to operations by AFR amounted to \$3,033 in 2003, \$2,555 in 2002, and \$1,137 in 2001.

In June 2000, the Company purchased timber cutting rights for approximately 4.2 million board feet from AFR for \$1,300. These timber cutting rights expired in June 2003.

In December 2000, the Company sold approximately 8,000 acres of timberland located in Central Oregon to AFR for \$2,900.

During 2001, the Company contributed cutting rights and timberland located in Central Oregon to AFR. The contributions have an aggregate agreed upon value of \$18.5 million and were added to the Company’s Preferred LLC Interest in AFR. Terms of the additional senior Preferred LLC Interest acquired are the same terms as the senior Preferred LLC Interest previously issued to the Company. The Company recorded its additional Preferred LLC Interest at its cost for the cutting rights and timberland of approximately \$16,300. All property that has been contributed for the Company’s Preferred LLC Interest in AFR has been pledged as collateral by AFR under its credit facility with its lender.

In March 2001, the Company purchased timber cutting rights for approximately 17.2 million board feet from AFR for \$4,500. These timber cutting rights expired in March 2004.

In September 2001, the Company sold timber cutting rights for approximately 80.6 million board feet to AFR for \$12,000. These timber cutting rights expire in August 2004.

In November 2001, the Company sold timber cutting rights for approximately 44.8 million board feet to AFR for \$7,000. These timber cutting rights expire in October 2004.

In June 2002, the Company sold timber cutting rights for approximately 87.3 million board feet to AFR for \$9,900. These timber cutting rights expire in May 2005.

As a result of the Toolbox Fire in August 2002, the Company purchased salvage timber cutting rights for approximately 12.0 million board feet from AFR for \$1,300 to gain certain operating efficiencies. All of the timber was harvested before these timber cutting rights expired in August 2003.

In November 2002, the Company sold timberland to AFR for \$4,700.

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During 2002, the Company contributed timberland located in Central Oregon to AFR. The contributions have an aggregate agreed upon value of \$18,500 and were added to the liquidation preference of the Company's Preferred LLC Interest in AFR. Terms of the additional Preferred Interest acquired are the same terms as the Preferred Interest previously issued to the Company. The Company recorded its additional Preferred Interest at its cost for the timberland of approximately \$18,300. All property that has been contributed for the Preferred Interest in AFR has been pledged as collateral by AFR under its credit facility with its lender.

In addition to the preceding, in July 2002, the Company purchased timber cutting rights for approximately 5.1 million board feet from AFR Services for \$500. These timber cutting rights expire in July 2005.

During 2003, the Company contributed timberlands located in Central Oregon to AFR. The contributions have an aggregate agreed upon value of \$12,900 and were added to the liquidation preference of the Company's Preferred LLC Interest in AFR. Terms of the additional Preferred LLC Interest acquired are the same terms as the Preferred LLC Interest previously issued to the Company. The Company recorded its additional Preferred LLC Interests at its aggregate costs for the timberlands of approximately \$10.5 million.

In addition to the preceding, in May of 2003, the Company sold approximately 21,000 acres to American Forest Services, LLC (AFS) for \$8,300.

In December of 2003, the Company sold approximately 1,000 acres to AFS for \$1,900.

In December 2003, the Company sold timber cutting rights for approximately 34,965 million board feet to AFS for \$4,756. These timber cutting rights expire in December 2004.

Also, In December 2003, the Company sold seedlings to AFR for \$300.

Gross profits realized on the Company's sales of timber cutting rights to AFR, to the extent of the Company's ownership interest in AFR, have been eliminated and are recognized in operations upon AFR's sale of the timber to third parties with corresponding adjustments to the carrying value of the investment in AFR. In addition, the Company's equity in net income (loss) of affiliate has been adjusted to eliminate its share of gross profits realized by AFR on sales of timber cutting rights to the Company, until the Company sells the timber to third parties.

**Affiliate Credit Facility**

See the description of the Affiliate Credit Facility included in the *Liquidity and Capital Resources* section of *Item 7*.

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**Item 14. *Principal Accounting Fees and Services***

The Following chart shows the aggregate fees billed to the Company by Eisner LLP for professional services in the named categories for the years ended December 31, 2003 and December 31, 2002.

	<u>2003</u>	<u>2002</u>
Audit Fees <sup>(1)</sup>	\$449	\$281
Audit Related Fees <sup>(2)</sup>	3	-
Tax Fees <sup>(3)</sup>	100	70
Other Fees <sup>(4)</sup>	-	-
Total Fees	\$552	\$351

- (1) Audit fees consists of professional services rendered in connection with the audit of the company' s annual financial statements, reviews of the Company' s annuals reports on Form 10-K, reviews of the financial statements included in the Company' s quarterly reports on Form 10-Q, statutory audits and reviews of documents filed with the SEC.
- (2) Separately billed annual tax planning and IT audit work.
- (3) Preparation on annual tax returns
- (4) Other miscellaneous assignments as assigned by the Board of Directors.

Consistent with policies of the Securities and Exchange Commission regarding auditor independence and the Audit Committee charter, the Audit Committee has responsibility for appointing, setting compensation and overseeing the work of the independent auditor. The Audit Committee' s policy is to pre-approve all audit and permissible non-audit services provided by the independent accountants. The Audit Committee may also pre-approve particular services on a case-by-case basis.

**PART IV**

**Item 15. Exhibits, Financial Statements, and Reports on Form 8-K**

**(a) (1) and (2) Financial Statements**

See "Index to Financial Statements" set forth on page F-1.

**(a) (3) Exhibits**

- 3.3 - [Third Amended and Restated Operating Agreement of U.S. Timberlands Klamath Falls, LLC](#)
- † 10.2 - Indenture among U.S. Timberlands Klamath Falls, LLC, U.S. Timberlands Finance Corp. and State Street Bank and Trust Company, as trustee
- ++10.12- Amended and Restated Operating Agreement of U.S. Timberlands Yakima, LLC (now known as American Forest Resources, LLC)
- # 10.13 - Management Agreement by and among U.S. Timberlands Klamath Falls, LLC Dated as of July 25, 2003
- \*21.1 - List of Subsidiaries
- 31.1 - [§ 302 Certification of CEO pursuant to Rule 13a-14\(a\) or Rule 15d-14\(a\) under the Exchange Act](#)
- 31.2 - [§ 302 Certification of CFO pursuant to Rule 13a-14\(a\) or Rule 15d-14\(a\) under the Exchange Act](#)
- 32.1 - [Certification of CEO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2 - [Certification of CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002.](#)

\* *Incorporated by reference to the same numbered Exhibit to the Registrant's Registration Statement on Form S-1 filed November 13, 1997.*

† *Incorporated by reference to the same numbered Exhibit to the Registrant's Current Report on Form 8-K filed January 15, 1998.*

++ *Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q filed on August 14, 2003*

# *Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q filed on November 19, 2003*

**(b.) Reports on Form 8-K**

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 17th day of May, 2004.

INLAND FIBER GROUP, LLC

By: /s/ John M. Rudey  
John M. Rudey, Chairman and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities and on the dates indicated.

/s/ John M. Rudey John M. Rudey	Chairman, President, and Director (Principal Executive Officer)	May 17, 2004
/s/ Thomas C. Ludlow Thomas C. Ludlow	Vice President, Treasurer (Principal Financial Officer)	May 17, 2004
/s/ Laurie G. Rudey Laurie G. Rudey	Director	May 17, 2004
/s/ George R. Hornig George R. Hornig	Director	May 17, 2004
/s/ John D. Layton John D. Layton	Director	May 17, 2004
/s/ Mel A. Sachs Mel A. Sachs	Director	May 17, 2004

**INLAND FIBER GROUP, LLC AND SUBSIDIARY  
(formerly U.S. Timberlands Klamath Falls, LLC)**

**C O N S O L I D A T E D   F I N A N C I A L   S T A T E M E N T S**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Members of  
Inland Fiber Group, LLC

We have audited the accompanying consolidated balance sheets of Inland Fiber Group, LLC (formerly U.S. Timberlands Klamath Falls, LLC) and subsidiary as of December 31, 2003 and 2002, and the related consolidated statements of operations, changes in members' equity (deficiency) and cash flows for each of the years in the three-year period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Inland Fiber Group, LLC and subsidiary as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, in December 2003 litigation was instituted against the Company and others by the trustee under the note indenture which alleges, among other matters, that the Company violated certain provisions of the indenture governing the \$225,000,000 of Senior Notes due in 2007 and in May 2004, the Trustee issued a Notice of Default. As described in Note 14, the Company and its legal counsel believe the litigation to be without merit and have filed a motion to dismiss the complaint. If the trustee were to succeed on its claims, and any potential appeals therefrom, and the Company were unable to cure or obtain waivers with respect to any then outstanding events of default under the indenture, the holders of the requisite percentage of the Notes, and the trustee therefor, would then have the right to accelerate the maturity of the Notes, which raises substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Eisner, LLP

New York, New York

January 30, 2004

With respect to Note 14

May 17, 2004

**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**Consolidated Balance Sheets**

(in thousands)

	December 31,	
	2003	2002
	_____	_____
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	1,447	965
Accounts receivable	530	1,028
Due from general partner	-	6
Other receivables	332	211
Notes receivable	103	1,344
Prepaid expenses and other current assets	220	331
	_____	_____
Total current assets	2,632	3,885
Timber and timberlands, net	129,002	163,980
Investment in affiliate	33,414	38,881
Property, plant and equipment, net	833	905
Notes receivable, less current portion	10	10
Restricted cash	154	82
Deferred financing fees, net	2,623	3,298
	_____	_____
Total assets	\$ 168,668	\$ 211,041
	_____	_____
<b>LIABILITIES AND MEMBER' S DEFICIENCY</b>		
Current liabilities:		
Accounts payable	525	1,454
Accrued liabilities	749	1,238
Accrued bond interest	2,830	2,752
Customer Deposit	5,000	-
Payable to managing member and affiliates	46	-
	_____	_____
Total current liabilities	9,150	5,444
	_____	_____
Long-term debt	225,000	225,000
	_____	_____
Members' deficiency:		
Managing member' s interest	(674)	(196)
Nonmanaging member' s interest	(64,808)	(19,207)
	_____	_____
	(65,482)	(19,403)
	_____	_____
Total liabilities and members' deficiency	\$ 168,668	\$ 211,041

See notes to consolidated financial statements

**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**In thousands**

**Consolidated Statements of Operations**

	Year Ended December 31,		
	2003	2002	2001
	_____	_____	_____
Revenues:			
Log, timber deed and stumpage sales, including \$4,200 (2003), \$9,900 (2002), and \$19,015 (2001) to an affiliate	\$ 25,000	\$ 42,256	\$ 54,128
Timber and property sales including \$9,519 in 2003 and \$4,700 in 2002 to an affiliate	10,129	5,763	-
By-products and other	2,001	1,455	436
	_____	_____	_____
	37,130	49,474	54,564
	_____	_____	_____
Cost of products sold:			
Cost of timber harvested	(13,252)	(17,477)	(16,652)
Cost of timber and property sales	(9,952)	(7,273)	-
Fire loss	-	(591)	-
Depletion, depreciation and road amortization	(15,557)	(27,476)	(37,287)
	_____	_____	_____
	(38,761)	(52,817)	(53,939)
	_____	_____	_____
Gross profit (loss)	(1,631)	(3,343)	625
Selling, general and administrative expenses	(6,438)	(7,518)	(8,340)
Equity in net loss of affiliate	(17,039)	(11,046)	(6,885)
	_____	_____	_____
Operating loss	(25,108)	(21,907)	(14,600)
Interest expense	(21,736)	(21,657)	(21,993)
Amortization of deferred financing fees	(675)	(675)	(675)
Interest income	12	13	101
Other income, net	190	158	131
	_____	_____	_____
Net loss	\$ (47,317)	\$ (44,068)	\$ (37,036)
	_____	_____	_____

See notes to consolidated financial statements



**INLAND FIBER GROUP, LLC AND SUBSIDIARY**

**(formerly U.S. Timberlands Klamath Falls, LLC)**

**In thousands**

**Consolidated Statements of Changes in Members' Equity (Deficiency)**

	Managing Member's Interest	Nonmanaging Member Interest	Total Members' Equity (Deficiency)
<b>Balance, December 31, 2000</b>	\$ 683	\$ 67,579	\$ 68,262
Distributions to members	(65)	(6,496)	(6,561)
Net loss	(371)	(36,665)	(37,036)
	-----	-----	-----
<b>Balance, December 31, 2001</b>	247	24,418	24,665
Net loss	(443)	(43,625)	(44,068)
	-----	-----	-----
<b>Balance, December 31, 2002</b>	<b>(196)</b>	<b>(19,207)</b>	<b>(19,403)</b>
Capital contribution	0	1,238	1,238
Net loss	(478)	(46,839)	(47,317)
	-----	-----	-----
<b>Balance, December 31, 2003</b>	<b>\$ (674)</b>	<b>\$ (64,808)</b>	<b>\$ (65,482)</b>
	-----	-----	-----

See notes to consolidated financial statements

**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**In thousands**

**Consolidated Statements of Cash Flows**

	Year Ended December 31,		
	2003	2002	2001
<b>Cash flows from operating activities:</b>			
Net loss	\$ (47,317)	\$ (44,068)	\$ (37,036)
Adjustments to reconcile net (loss) to net cash provided by operating activities:			
Depreciation, depletion, amortization and cost of timber and property sold	25,509	34,749	37,287
Fire loss	-	574	-
Gain on disposal of assets	(19)	-	(2)
Amortization of deferred financing fees	675	675	675
Equity in net loss of affiliate	17,039	11,046	6,885
Other non-cash items	-	173	233
Changes in assets and liabilities:			
Accounts receivable	498	(717)	4,119
Other receivables	(121)	69	(120)
Notes receivable	1,241	227	704
Prepaid expenses and other current assets	111	(106)	(190)
Accounts payable	(929)	120	112
Accrued liabilities	(410)	659	5
Customer deposit	5,000	-	(1,474)
Payable to general partner and affiliate	(3)	(168)	(2,024)
	<hr/>	<hr/>	<hr/>
Net cash provided by operating activities	1,274	3,233	9,174
	<hr/>	<hr/>	<hr/>
<b>Cash flows from investing activities:</b>			
Purchase of property, plant and equipment - net	-	(160)	-
Proceeds from sale of assets	26	-	904
Timber, timberlands and road additions	(1,984)	(3,096)	(5,615)
Restricted cash	(72)	(82)	-
	<hr/>	<hr/>	<hr/>
Net cash used in investing activities	(2,030)	(3,338)	(4,711)
	<hr/>	<hr/>	<hr/>
<b>Cash flows from financing activities:</b>			
Distributions to members	-	-	(6,561)
Capital contributions	1,238	-	-
	<hr/>	<hr/>	<hr/>
Net cash provided by (used in) financing activities	1,238	-	(6,561)
	<hr/>	<hr/>	<hr/>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>482</b>	<b>(105)</b>	<b>(2,098)</b>

Cash and cash equivalents, beginning of period	<b>965</b>	1,070	3,168
	_____	_____	_____
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1,447</b>	\$ 965	\$ 1,070
	_____	_____	_____
<b>Supplemental cash flow information:</b>			
Cash paid for interest expense	<b>\$ 21,658</b>	\$ 21,657	\$ 22,033
<b>Noncash activities:</b>			
Contribution of timberlands for investment in affiliate	<b>\$ 11,572</b>	\$ 18,317	\$ 16,289
See notes to consolidated financial statements			

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amounts in thousands, except per unit amounts or otherwise noted)**

**1. Business and Significant Accounting Policies:**

**Business**

The accompanying consolidated financial statements include the accounts of Inland Fiber Group, LLC (the "Company") (formerly, U.S. Timberlands Klamath Falls, LLC), a Delaware limited liability company, and its wholly owned subsidiary, Fiber Finance Corp. ("Finance Corp.")(formerly, U.S. Timberlands Finance Corp.), collectively referred to hereafter as the Company. The Company changed names in December 2003. Finance Corp. serves as the co-obligor for the Company's Notes (defined below). It has nominal assets and does not conduct operations. All intercompany transactions have been eliminated in consolidation. An investment in an affiliate is carried at cost, plus accrued dividends to the extent earned, reduced by losses in excess of the common members' interest in the investee.

The primary activities of the Company are the growing of trees and the sale of logs and standing timber to third party wood processors and the sale of excess land. The Company's timber is located principally in Oregon, east of the Cascade Range. Logs harvested from the timberlands are sold to unaffiliated domestic conversion facilities. These logs are processed for sale as lumber, plywood and other wood products, primarily for use in new residential home construction, home remodeling and repair and general industrial applications.

Prior to July 2003, Pacific Fiber Company, LP, a master limited partnership (the "MLP") (formerly U.S. Timberlands Company, L.P.), owned a 99% non-managing member interest in the Company. The MLP was formed on June 27, 1997 to acquire and own substantially all of the equity interests in the Company. U.S. Timberlands Management Company, LLC (now known as Timber Resource Services, LLC and formerly known as U.S. Timberlands Services Company, LLC, the "Manager") manages the business of the Company and owns a 1% non-voting membership interest in the Company

**Basis of Presentation**

The accompanying consolidated statements have been prepared assuming that the Company will continue as a going concern. As more fully described in Note 14, in December 2003, the trustee under the indenture governing the Company's \$225,000 of Senior Notes, which mature in 2007, commenced litigation against the Company and others alleging, among other matters, that the Company has violated certain covenants contained in the Indenture. The Company has denied all of the allegations and made a motion to dismiss the complaint. In May 2004, the Company received a Notice of Default from the Trustee covering certain of the allegations in the complaint. In the event the trustee prevails in the litigation, the Trustee will have the right to demand repayment and accelerate the maturity of the notes. If such event occurs, and the Company is unable to effect an amendment or a restructuring of the notes, the Company's ability to continue as a going concern would be in substantial doubt. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**Going Private Transaction**

On October 17, 2002, the MLP announced that it had signed a definitive agreement to be acquired by an acquisition company formed by a group led by senior management (the "Privatization Transaction"). The group beneficially owned 36.4% of the combined outstanding limited partnership units of the MLP consisting of 16% of the common units and 98% of the subordinated units. The definitive agreement contemplated a cash tender offer for 100% of the outstanding common limited partnership units not already owned by the acquiring entity or its affiliates for \$3.00 per unit in cash, followed by a merger of the acquisition company with and into the MLP, pursuant to which each common limited partnership unit not already owned by the acquiring entity or its affiliates would be converted into the right to receive \$3.00 per unit in cash. The tender offer commenced on November 19, 2002 and was completed on March 6, 2003. In connection with the tender offer, approximately 71% of the MLP's common units were tendered. The remaining common units held by non-affiliates not

purchased in the tender offer were converted into the right to receive \$3.00 per common unit, in the merger which was completed on June 26, 2003.

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**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amounts in thousands, except per unit amounts or otherwise noted)**

Subsequent to the Privatization Transaction, the 99% interest in the Company originally held by the MLP was transferred in a series of transactions to a newly-formed limited liability company, IFG Holdings, LLC. IFG Holdings, LLC is wholly owned by American Forest Resources, LLC (“AFR”) (formerly known as US Timberlands Yakima), in which the Company holds a preferred equity interest. As part of this reorganization of the ownership structure of the Company, a Board of Directors was elected for the Company to supervise its operations and a new management arrangement was established under which the Manager, whose interest was converted into a 1% nonvoting interest in the Company, provides comprehensive timber management services to the Company pursuant to a fee-based management agreement.

As a result of the Privatization Transaction described above, the Company is an indirect 99% owned subsidiary of American Forest resources, LLC.

Because of the publicly-owned long-term debt which remains outstanding, the Company did not elect to adopt “push-down” accounting for the Privatization Transaction described above, pursuant to which the purchase price paid by the group for the 63.6% indirect interest in the Company would be reflected in the Company’s financial statements.

#### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### **Revenue Recognition**

Revenue on delivered log sales is recognized upon delivery to the customer. Revenue on timber deeds and timber and property sales is generally recognized upon closing. Revenue from timber sold under stumpage contracts (i.e., the customer arranges to harvest and deliver the logs) is recognized when the timber is harvested.

#### **Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of trade accounts and notes receivable. The majority of the Company’s trade accounts and notes receivable are derived from sales to third party wood processors. The Company’s five largest, non-affiliated customers accounted for approximately 19%, 13%, 11%, 11%, and 11% of the Company’s aggregate net revenues from log, stumpage and timber deed sales for the year ended December 31, 2003. In 2002, three customers represented approximately 25%, 10%, and 10% respectively, of aggregate net revenues from log, stumpage and deed sales. In 2001, one customer accounted for approximately 22% of aggregate net revenues from log, stumpage and deed sales. No other single customer accounted for more than 10% of aggregate net revenues from log, stumpage and timber deed sales in those years. Credit risk on trade receivables is mitigated by control procedures to monitor the credit worthiness of customers. The Company mitigates credit risk related to notes receivable by obtaining asset lien rights or performing credit worthiness procedures or both.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amounts in thousands, except per unit amounts or otherwise noted)**

The Company periodically reviews its allowance for doubtful accounts and reserves an estimated amount for such accounts, if required. As of December 31, 2003 and 2002 no allowance for doubtful accounts was required.

**Cash and Cash Equivalents**

Cash equivalents consist of highly liquid investments with maturities at date of purchase of 90 days or less.

**Timber and Timberlands**

Timber and timberlands is comprised of timber, timberlands, logging roads, and seed stock and nursery stock.

*Timber, timberland and roads*

Timber, timberlands and roads are stated at cost less depletion and road amortization for timber previously harvested. The cost of the timber harvested (including logging roads) is determined based on the volume of timber harvested in relation to the amount of estimated net merchantable volume, primarily utilizing a single composite pool. The Company estimates its timber inventory using statistical information and data obtained from physical measurements, site maps, photo types and other information gathering techniques. These estimates are updated annually and may result in adjustments of timber volumes and depletion rates, which are recognized prospectively. Changes in these estimates have no effect on the Company's cash flow.

*Seed orchard and nursery stock*

The Company operates and maintains a seed orchard and nursery. Cost incurred by the orchard and nursery to produce seed and seedlings utilized in the reforestation of the Company's timberlands are capitalized to seed orchard and nursery stock in the accompanying balance sheets. A certain amount of seed and seedling stock is sold to unaffiliated customers and is reflected as a component of by-products and other revenues in the accompanying statements of operations.

**Property, Plant and Equipment**

Property, plant and equipment, including significant improvements thereto, are stated at cost less accumulated depreciation and amortization. Cost includes expenditures for major improvements and replacements. Maintenance and repairs are charged to expense as incurred. When assets are sold, retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in income.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amounts in thousands, except per unit amounts or otherwise noted)**

The cost of property, plant and equipment is depreciated using the straight-line method over the estimated useful lives of the related assets. Buildings and improvements are generally depreciated over 40 years and equipment is depreciated over 3 to 5 years. Leasehold improvements are amortized under the straight-line method based on the shorter of the lease periods or the estimated useful lives of the improvements.

**Deferred Financing Fees**

Deferred financing fees consist of fees incurred in connection with obtaining the related debt financing. The Company amortizes deferred financing fees over the terms of the related debt. The Company presents deferred financing fees net of accumulated amortization. The accumulated amortization of deferred financing fees as of December 31, 2003 and 2002 was \$4,127 and \$3,452, respectively.

**Income Taxes**

The Company is a limited liability company. Accordingly, the Company is not liable for federal or state income taxes since the Company's income or loss is reported on the separate tax returns of the members. Accordingly, no provision for current or deferred income taxes has been reflected in the accompanying financial statements.

**Unit-Based Compensation Plans**

Prior to the Privatization Transaction, the MLP had a Unit Option Plan which is described more fully in Note 10. As permitted under SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure", which was issued in December 2002 and amended SFAS No. 123, "Accounting for Stock-Based Compensation", the Company had elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements as defined by Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees", and related interpretations. The following table illustrates the effect on net loss if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

	Year Ended December 31,		
	2003	2002	2001
Net loss as reported	\$ (47,317)	\$ (44,068)	\$(37,036)
Unit-based employee compensation determined under the fair value method	\$ -	\$ 320	323
Net loss pro forma	(47,317)	(44,388)	(37,359 )

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amount s in thousands, except per unit amounts or otherwise noted)**

For purposes of the pro forma disclosures, the estimated fair value of the unit options is amortized to expense over their estimated exercise period, which corresponds to the assumed conversion period of the then outstanding subordinated limited partnership interests in the MLP.

In connection with the Privatization Transaction, each outstanding unit option granted under the Unit Option Plan was converted into an option to receive, upon exercise, including payment of the exercise price, the \$3.00 per unit merger consideration. Because the exercise price for each option was greater than the merger consideration, the Company does not expect any options to be exercised in the future.

No options were granted in 2003, 2002, or 2001.

**Recent Accounting Standards**

In January 2003, the FASB issued Interpretation No. 46 (FIN 46) "Consolidation of Variable Interest Entities" which is an interpretation of Accounting Research Bulletin No. 51 "Consolidated Financial Statements." In December 2003 the FASB modified FIN 46 to make certain technical corrections and address certain implementation issues that had arisen. FIN 46 requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. Previously, entities were generally consolidated by an enterprise when it had a controlling financial interest through ownership of a majority voting interest in the entity.

The provisions of FIN 46 as revised are required to be applied by the Company no later than March 31, 2004. The Company has considered the applicability of FIN 46 to its investment in its indirect parent company, American Forest Resources, LLC (formerly U.S. Timberlands Yakima, LLC) and has concluded that American Forest Resources, LLC is not a variable interest entity and therefore its financial statements are not required to be consolidated with those of the Company pursuant to the provisions of FIN 46.

**2. Timber and Timberlands:**

Timber and timberlands consisted of the following at December 31:

	<u>2003</u>	<u>2002</u>
Timber and logging roads	\$ 281,367	\$ 294,208
Timberlands	19,269	26,043
Seed orchard and nursery stock	1,451	1,375
	<u>302,087</u>	<u>321,626</u>
Less accumulated depletion and road amortization	<u>173,085</u>	<u>157,646</u>
	<u>\$ 129,002</u>	<u>\$ 163,980</u>

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amount s in thousands, except per unit amounts or otherwise noted)**

**3. Investment in Affiliate:**

Since October 1999, the Company has owned a redeemable preferred member interest (“Preferred LLC Interest”) in American Forest Resources, LLC (formerly U.S. Timberlands Yakima, LLC), (“AFR”), an affiliate accounted for under the equity method (see Note 9).

As described in Note 1, in July 2003 the Company became an indirect subsidiary of AFR, as the result of a contribution to AFR of the 99% non-managing member’ s interest in the Company previously owned by the MLP.

The following summarized financial information for AFR is presented without consolidation of the Company’ s asset, liabilities and results of operations to avoid duplication which would otherwise occur. AFR’ s investment in the Company is accounted for by the equity method. The carrying amount of the investment reflects the purchase price paid by the investor group for the 63.6% acquired interest in the Privatization Transaction and the investor group’ s carryover basis for the 36.4% interest owned prior to the transaction.

Following is summarized financial information for AFR as of and for the years ended December 31:

	2003	2002	2001
Current assets	\$ 754	\$ 2,091	\$ 5,779
Noncurrent assets, principally timber and timberlands	136,227	142,884	116,558
Investment in Inland Fiber Group, LLC	(12,272)		
Current liabilities	5,886	9,811	1,883
Noncurrent liabilities - long-term debt	121,383	96,053	88,435
Redeemable preferred member interest (owned by the Company)	50,683 <sup>(2)</sup>	39,111	32,019
Common member deficiency	(53,243)		
Net sales	27,624	22,018	13,574
Gross profit (loss)	580	(1,449)	3,121
Loss before equity in the Company’ s loss	(9,926)	(11,225)	(5,329)
Equity in the Company’ s loss <sup>(1)</sup>	(33,407)		
Net Loss	\$ (43,333)	\$ (11,225)	\$ (5,329)

(1) Reflects (a) charges of \$7,152 related to the amortization of \$43,287 excess of cost over deficiency in net assets attributable to 63.6% acquired interest and (b) benefit of \$3,984 representing share of the Company’ s net loss for 2003 attributable to 63.6% acquired interest, prior to acquisition.

(2) Represents balance at beginning of year increased by \$11,572 contribution of timberlands by the Company during 2003.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

(dollar amounts in thousands, except per unit amounts or otherwise noted)

**4. Property, Plant and Equipment:**

Property, plant and equipment consisted of the following at December 31:

	2003	2002
Equipment	\$ 545	\$ 654
Buildings and improvements	995	995
	1,540	1,649
Less accumulated depreciation and amortization	707	744
	\$ 833	\$ 905

**5. Accrued Liabilities:**

Accrued liabilities consisted of the following at December 31:

	2003	2002
Legal fees pursuant to settlement	-	375
Other	511	863
	\$ 511	\$ 1,238

**6. Affiliate Credit Facility:**

The Company had a credit facility with an affiliate of the Manager (the "Affiliate Credit Facility") consisting of a revolving line of credit up to \$12.0 million. Borrowings under the Affiliate Credit Facility bore interest at the prime lending rate as published in the Wall Street Journal plus applicable margin, which was based on the Company's leverage ratio. The Affiliate Credit Facility expired, by its terms, at the end of April 2002. The Company had sought to replace the Affiliate Credit Facility with a working capital facility from an unaffiliated third party, but has been unable to obtain a working capital credit facility in amounts to fund its working capital needs from a traditional commercial lender. While the Company continues to seek a credit facility from an unaffiliated source, affiliated lenders have agreed to make short term advances to the Company, payable on demand to the affiliates, at an annual interest rate of 10%. During 2003, the maximum amount outstanding was \$424, all of which had been repaid as of December 31, 2003. The affiliate has made no commitment to continue to lend funds to the Company, and each request is considered on a case by case basis.

There were no outstanding borrowings under the Affiliate Credit Facility at December 31, 2003 and 2002. Peak borrowings were \$424 and \$1,325 under the Affiliate Credit Facility during 2002 and 2001, respectively. Total interest and commitment fees paid to the affiliate were \$0 and \$0 respectively in 2002 and 2003, and \$330 and \$75 in 2001.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amount s in thousands, except per unit amounts or otherwise noted)**

**7. Long-Term Debt:**

The \$225,000 of Senior Notes (the "Notes"), which were issued in 1997, were issued jointly and severally by the Company and Fiber Corp. a wholly owned subsidiary of the Company (collectively, the "Issuers"). The Issuers serve as co-obligors of the Notes. The Notes represent unsecured general obligations of the Issuers and bear interest at 9-5/8% payable semiannually in arrears on May 15 and November 15, and mature on November 15, 2007 unless previously redeemed. The Notes are redeemable at the option of the Issuers in whole or in part at predetermined redemption prices plus accrued interest to the redemption date.

The Notes contain certain restrictive covenants, including limiting the ability of the Company and its subsidiaries to make cash distributions, incur additional indebtedness, sell assets or harvest timber in excess of certain limitations. Under certain restrictive covenants, during 2003 and 2002, the Company was and presently is prohibited from making distributions to its members. In 2002, because of the accelerated harvesting during the fourth quarter 2002 of salvage timber resulting from the Toolbox Fire, the Company exceeded the allowable four year harvest by 6.9 MMBF and, as required under the Indenture, had placed \$662 in a restricted account during the first quarter of 2003 only to be used in ways prescribed in the Indenture. A balance of \$63 remained in the restricted account as of December 31, 2003. As of December 31, 2003, the Company was in compliance with the covenants contained in the Notes, however, the trustee under the indenture has alleged that the company has violated certain covenants and has commenced litigation as described in Note 14.

The Company made its required interest payment, due on November 17, 2003, on its Notes during the 30 day grace period provided therefore.

**8. Members' Equity:**

**Allocation of Income (Loss)**

As provided in the Company' s Operating Agreement, income and losses are allocated 99% to the IFG Holdings, LLC and 1% to the Manager.

**9. Certain Relationships and Related Party Transactions:**

**Manager**

The Manager manages the timber operations of the Company.

Until September 1, 2003, the Manager did not receive any management fee or other compensation in connection with its management of the Company, but was reimbursed for all direct and indirect expenses incurred on behalf of the Company (including wages and salaries of employees, officers and directors of the Manager) and all other necessary or appropriate expenses allocable to the Company or otherwise reasonably incurred by the Manager in connection with the operation of the Company' s business.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amounts in thousands, except per unit amounts or otherwise noted)**

On September 1, 2003, the Company completed a management agreement with the Manager. The new management agreement replaced the prior arrangement under which the Company reimbursed the Manager for expenses incurred on the Company's behalf. The new management agreement, provides for an annual fee of 2% of the agreed upon valuation of total timber and timberland assets under management, payable monthly. For the period September 1 through December 31, 2003, fees of \$1,138 were incurred under the management agreement.

As of December 31, 2003 and 2002, the Company had a payable to the Manager of \$46 and \$0, respectively. During 2003, 2002, and 2001 expenses allocated to and reimbursed by the Company totaled \$2,191, \$3,323, and \$6,760, respectively.

### **Consulting Agreements**

Through June 2003, the Manager had consulting agreements with affiliates of certain persons who were directors of the Manager during the terms of such consulting agreements, pursuant to which each such person or firm had provided consulting services to the Manager. The agreements provided for an annual retainer of \$25, plus an hourly rate for services rendered at the request of the Manager. Payments by the Manager related to consulting agreements in 2003, 2002, and 2001 amounted to \$56, \$112, and \$98, respectively. Such fees were reimbursed to the Manager by the Company. The consulting agreements were discontinued in July 2003.

### **Investments in and Transactions with Affiliates**

In October 1999, the Company made an investment in AFR, an unconsolidated affiliate. AFR, a then newly formed entity organized to acquire timber properties located in Central Washington and Central Oregon, is engaged in the growing of trees and sale of logs and standing timber to third party wood processors. The MLP contributed to AFR \$294 of cash for 49% of AFR's common interests (the "Common LLC Interests"). The remaining Common LLC Interests were acquired for \$306 in cash by Cascade Resource Holdings Group, LLC (formerly U.S. Timberlands Holdings Group, LLC) ("Holdings Group"), a Delaware limited liability company in which John Rudey the Chairman of the Board of the Company, holds a controlling interest. The Company also acquired all of the senior preferred interests in AFR (the "Senior or Preferred LLC Interests") for its contribution to AFR of timberlands consisting primarily of non-income producing, pre-merchantable pine plantations having an agreed upon value of \$22,000. The Company recorded its investment in the Senior LLC interest at its \$18,850 cost basis for the contributed timberlands. Terms of the Preferred LLC Interests include a cumulative annual guaranteed return of 5% until December 31, 2001 and 6% thereafter of the \$22,000 agreed upon value of the contributed timberlands. The Preferred LLC Interests are redeemable at AFR's option for a redemption price equal to the agreed upon value of the Preferred LLC Interests, either in cash or by returning the contributed timberlands, plus any portion of the guaranteed return not received by the Company prior to the redemption date. Generally, AFR's net income or losses are allocated to the Common LLC Interests. However, net losses exceeding the account balances of the Common LLC Interests are allocated to the Preferred LLC Interest. The Company accounts for the Preferred LLC Interest at cost plus accrued dividends to the extent earned, reduced by losses, if any, in excess of the Common LLC Interests.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amount s in thousands, except per unit amounts or otherwise noted)**

On September 14, 2001, management of AFR was taken over by American Forest Services, LLC (formerly, U.S. Timberlands Services Yakima, LLC) (“American Forest Services,”) a wholly owned subsidiary of the Manager of the Company. American Forest Services is paid a fee equal to 2% of the agreed upon valuation of the total timber and timberland assets under management. Prior thereto, the Manager provided management services for a fee equal to 2% of AFR’ s earnings before interest, taxes, depletion, depreciation and amortization. Such fees charged to operations by AFR amounted to \$3,033 in 2003, \$2,555 in 2002 and \$1,137 in 2001. The MLP and the Company granted Holdings Group an irrevocable proxy to vote its Common and Preferred LLC Interests.

In June 2000, the Company purchased timber cutting rights for approximately 4.2 million board feet from AFR for \$1,300. These timber cutting rights expired in June 2003.

In December 2000, the Company sold approximately 8,000 acres of timberland located in Central Oregon to AFR for \$2,900.

During 2001, the Company contributed cutting rights and timberlands located in Central Oregon to AFR. The contributions have an aggregate agreed upon value of \$18,500 and were added to the Company’ s Preferred LLC Interest in AFR. Terms of the additional Preferred LLC Interest acquired are the same terms as the Preferred LLC Interest previously issued to the Company. The Company recorded its additional Preferred LLC Interest at its cost for the cutting rights and timberland of approximately \$16,300.

In March of 2001, the Company purchased timber cutting rights for approximately 17.2 million board feet from AFR for \$4,500. These timber cutting rights expired in March 2004.

In September 2001, the Company sold timber cutting rights for approximately 80.6 million board feet to AFR for \$12,000. These timber cutting rights expire in August 2004.

In November 2001, the Company sold timber cutting rights for approximately 44.8 million board feet to AFR for \$7,000. These timber cutting rights expire in October 2004.

In June 2002, the Company sold timber cutting rights for approximately 87.3 million board feet to AFR for \$9,900. These timber cutting rights expire in May 2005.

In August 2002, the Company purchased timber cutting rights for approximately 12.0 million board feet from AFR for \$1,300. These timber cutting rights expired in August 2003.

In November 2002, the Company sold timberland to AFR for \$4,700.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amounts in thousands, except per unit amounts or otherwise noted)**

During 2002, the Company contributed timberland located in Central Oregon to AFR. The contributions have an aggregate agreed upon value of \$18,500 and were added to the Company's Preferred LLC Interest in AFR. Terms of the additional Preferred LLC Interest acquired are the same terms as the Preferred LLC Interest previously issued to the Company. The Company recorded its additional Preferred LLC Interest at its cost for the timberland of approximately \$18,300.

In addition to the preceding, in July 2002, the Company purchased timber cutting rights for approximately 5.1 million board feet from AFR Services for \$500. These timber cutting rights expire in July 2005.

During 2003, the Company contributed timberlands located in Central Oregon to AFR. The contributions have an aggregate agreed upon value of \$12,900 and were added to the liquidation preference of the Company's Preferred LLC Interest in AFR. Terms of the additional Preferred LLC Interest acquired are the same terms as the Preferred LLC Interest previously issued to the Company. The Company recorded its additional Preferred LLC Interests at its aggregate costs for the timberlands of approximately \$11,600.

In addition to the preceding, in May of 2003, the Company sold approximately 21,000 acres to American Forest Services, LLC (AFS) for \$8,300.

In December of 2003, the Company sold approximately 1,000 acres to American Forest Services, LLC (AFS) for \$1,900.

In December 2003, the Company sold timber cutting rights for approximately 34,965 million board feet to American Forest Services, LLC (AFS) for \$4,756. These timber cutting rights expire in December 2004.

Also, in December 2003, the Company sold seedlings to AFR for \$300.

Gross profits realized on the Company's sales of timber cutting rights to AFR, to the extent of the Company's ownership interest in AFR, have been eliminated and are recognized in operations upon AFR's sale of the timber to third parties with corresponding adjustments to the carrying value of the investment in AFR. In addition, the Company's equity in net income (loss) of affiliate has been adjusted to eliminate its share of gross profits realized by AFR on sales of timber cutting rights to the Company, until the Company sells the timber to third parties, with corresponding adjustments to the carrying value of timber and timberlands.

All property that has been contributed for the Company's Preferred LLC Interest in AFR has been pledged as collateral by AFR under its credit facility with its lender.

#### **Payments to Affiliate**

See Note 6 regarding interest and commitment fees paid to an affiliate of the Manager under the Affiliate Credit Facility.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

(dollar amount s in thousands, except per unit amounts or otherwise noted)

**10. Management Incentive Plans:**

**Unit Option Plans**

The MLP maintained a Unit Option Plan, which provided for the granting of options (the "Unit Options") to employees and directors of the Manager who performed services for the Company. The plan permitted the grant of Unit Options covering 857,749 of the MLP' s Common Units. Unit Options granted under the MLP' s Unit Option Plan were determined by the Long-Term Incentive Plan Committee of the MLP' s Board of Directors (the "LTIP Committee") and were granted at fair market value at the date of the grant. There were no Unit Options granted in 2001, 2002 and 2003. The Unit Options granted expire ten years from the date of grant and become exercisable automatically upon and in the same proportion as the conversion of Subordinated Units to Common Units provided that the minimum quarterly distributions (as defined in the MLP Agreement) has been made. Although the performance criteria were met for the years ended December 31, 2000 and 1999, and 25% of the outstanding units of subordinated limited partnership interest of the MLP were converted into units of common limited partnership interests in February 2001, no compensation expense was recorded during such years, as the market price of the units was less than the exercise price during the years. As indicated in Note 7, distributions have been suspended and accordingly the performance criteria had not been met for the years ended December 31, 2003, 2002 and 2001.

The following table summarizes the activity related to unit options for three years ended December 31, 2003:

	Number of Units	Weighted Average Exercise Price
	_____	_____
<b>Outstanding, December 31, 2000</b>	<b>757,627</b>	<b>13.75</b>
Unit options cancelled	(70,620)	13.22
	_____	
<b>Outstanding, December 31, 2001</b>	<b>687,007</b>	<b>13.78</b>
Unit options cancelled	(4,000)	12.69
	_____	
<b>Outstanding, December 31, 2002</b>	<b>683,007</b>	<b>13.77</b>
Unit options cancelled	(102,000)	13.34
Unit options effectively cancelled with the Privatization Transaction	(581,007)	13.85
	_____	
<b>Outstanding, December 31, 2003</b>	-	-
	_____	_____

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amounts in thousands, except per unit amounts or otherwise noted)**

As of December 31, 2003, exercise prices for options outstanding were between \$5.84 and \$14.75 with a weighted average exercise price of \$13.85 per unit. The weighted average remaining contractual life of the options was 5 years. There were no options exercisable at December 31, 2000. Options for 276,741, 170,752 and 171,752 units were exercisable at December 31, 2003, 2002 and 2001 respectively, with a weighted average exercise price of \$13.85, \$13.76 and \$13.78 per unit, respectively. On June 26, 2003, as part of the merger, these options were converted into the right to receive \$3.00 per unit which is below even the lowest exercise price. The Company has no expectation that any of the options will be exercised, and they have effectively been cancelled.

**11. Fair Value of Financial Instruments:**

A summary of the fair value of the Company's significant financial instruments and the methods and significant assumptions used to estimate those values is as follows:

- a. Short-term financial instruments - The fair value of short-term financial instruments, including cash and cash equivalents, trade and other receivables, notes receivable, trade accounts payable and certain accrued liabilities, approximates the carrying amounts in the financial statements due to the short maturities of such items.
- b. Long-term debt - The estimated fair value of the Company's long-term debt was approximately \$117,000 and \$139,500 at December 31, 2003 and 2002, respectively, based on published market quotations.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

(dollar amounts in thousands, except per unit amounts or otherwise noted)

**12. Quarterly Results (Unaudited):**

	Quarter Ended				
	December 31	September 30	June 30	March 31	Total Year
<b>2003</b>					
Revenues	\$ 10,826	\$ 4,746	\$ 14,727	\$ 6,831	\$ 37,130
Gross profit (loss)	(629)	(553)	(455)	6	(1,631)
Net (loss)	(12,587)	(12,345)	(12,274)	(10,111)	(47,317)
<b>2002</b>					
Revenues	\$ 18,536	\$ 13,323	\$ 15,460	\$ 2,155	\$ 49,474
Gross profit (loss)	(1,868)	204	(1,731)	52	(3,343)
Net (loss)	(13,071)	(9,658)	(12,176)	(9,163)	(44,068)

**13. 401(K) Defined Contribution Plan:**

The Manager sponsors a 401(K) defined contribution plan which covers substantially all of its full-time employees the allocable costs of which were reimbursed by the Company through August 30, 2003. The amounts which were reimbursed by the Company pursuant to the management arrangement totaled \$27 in 2003, \$45 in 2002 and \$56 in 2001.

**14. Commitments, Contingencies and Other:**

**Fire Loss Risk**

In accordance with industry practice, the Company self-insures for fire loss.

**Litigation**

On June 21, 2002, the Company was notified that it was named in a lawsuit filed in the State Court in Oregon as a codefendant seeking medical expenses and up to \$12.0 million in damages for injuries sustained by the minor child of an employee of the Manager while riding on equipment owned by the Manager. At the time, liability insurance was in place, however, the insurance underwriter has since gone bankrupt and the coverage is limited and is being administered by the Oregon Guarantee Insurance Association. Effective April 5, 2004 this case was dismissed with prejudice.

**Notes to Consolidated Financial Statements**  
**INLAND FIBER GROUP, LLC AND SUBSIDIARY**  
**(formerly U.S. Timberlands Klamath Falls, LLC)**

**(dollar amount s in thousands, except per unit amounts or otherwise noted)**

On December 19, 2003, an action was brought in the Court of Chancery of the State of Delaware in and for New Castle County by the trustee under the Indenture against the Company, Finance Corp., the Manager, American Forest Resources, LLC, Cascade Resource Holdings Group, LLC, and all of the directors of the Manager as of January 1, 2003 (collectively, the “Defendants”). The complaint alleges that the Company violated the provisions of the Indenture by transferring certain assets to its affiliates, the directors of the Company violated their fiduciary duty to the Company and that the transfers of the assets were fraudulent conveyances and subject to rescission. The trustee seeks a declaration that the Company has violated the terms of the Indenture, an injunction against the transfer of additional assets out of the ordinary course of business, damages and the imposition of a constructive trust on the assets transferred by the Company to its affiliates. In January 2004, the plaintiff’s motion to schedule a preliminary injunction hearing with respect to further transfers to affiliates and for expedited discovery was denied. In connection with the denial of the plaintiff’s motion, the Company agreed that, through the earlier of December 31, 2004 and the resolution of the lawsuit, it would provide at least thirty days’ notice before entering into any transfer of assets to affiliates, other than payment of management fees. Discovery began in January 2004 and is ongoing. On February 6, 2004, the Defendants filed a motion to dismiss. In May 2004, A hearing was held with respect to defendants’ motion to dismiss. The defendants expect a decision regarding their motion to dismiss with a few months. On March 26, 2004 a motion to stay discovery pending the outcome of the Defendant’s motion to dismiss was denied. On May 17, 2004, the Company received a Notice of Default from the Trustee covering certain of the allegations in the complaint. The Company and its legal counsel believe the litigation to be without merit and intends to vigorously defend itself in the lawsuit.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Members of  
American Forest Resources, LLC

We have audited the accompanying balance sheets of American Forest Resources, LLC (the "Company") (formerly known as US Timberlands Yakima, LLC) as of December 31, 2003 and 2002, and the related statements of operations, redeemable preferred member interest and common members' equity (deficiency) and cash flows for each of the years in the three-year period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of American Forest Resources, LLC as of December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, in December 2003 litigation was instituted against the Company, its subsidiary, Inland Fiber Group, LLC ("IFG") and others by the trustee under IFG's note indenture which alleges, among other matters, that IFG violated certain provisions of the indenture governing its \$225,000,000 of Senior Notes due in 2007 and in May 2004, the Trustee issued a Notice of Default. As described in Note 10, the Company, IFG and their legal counsel believe the litigation to be without merit and have filed a motion to dismiss the complaint. If the trustee were to succeed on its claims, and any potential appeals therefrom, and IFG were unable to cure or obtain waivers with respect to any then outstanding events of default under the indenture, the holders of the requisite percentage of the Notes, and the trustee therefor, would then have the right to accelerate the maturity of the Notes. Such acceleration, were it to occur, could cause an event of default and acceleration of the maturity of the loan payable under the Company's credit facility, if the Company is unable to cure or obtain a waiver with respect to any outstanding event of default under its credit facility. These circumstances raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 1 to the financial statements, effective January 1, 2001, the Company changed its method of accounting for derivative instruments and hedging activities.

Eisner, LLP

New York, New York

January 30, 2004

With respect to Notes 8 and 10

May 17, 2004



**AMERICAN FOREST RESOURCES, LLC**  
(formerly U.S. Timberlands Yakima, LLC)

**Balance Sheet**  
(in thousands)

	December 31,	
	2003	2002
	Consolidated	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents (including restricted cash of \$20 at December 31, 2003 and \$829 at December 31, 2002)	\$ 1,616	\$ 1,754
Accounts receivable	832	126
Other receivables	427	81
Notes receivable	158	49
Prepaid expenses and other current assets	353	80
	<hr/>	<hr/>
Total current assets	3,386	2,090
Timber and timberlands, net	246,319	124,799
Equipment, net	849	33
Restricted cash	14,146	12,791
Deposits	52	52
Interest rate cap agreement	1,030	1,142
Notes receivable, less current portion	10	32
Deferred financing costs, net	5,339	4,036
	<hr/>	<hr/>
	\$ 271,131	\$ 144,975
	<hr/>	<hr/>
<b>LIABILITIES AND MEMBERS' EQUITY (DEFICIENCY)</b>		
Current liabilities:		
Accounts payable	\$ 1,988	\$ 163
Accrued interest	3,192	272
Other accrued liabilities	878	94
Current portion of long-term debt	3,370	282
Short-term notes	588	
Due to affiliate	20	
Customer deposits	5,000	9,000
	<hr/>	<hr/>
Total current liabilities	15,036	9,811
Long-term debt (net of unamortized discount of \$37,045 in 2003), less current portion	309,338	96,053
Redeemable preferred member interest		39,111
Common members' deficiency	(53,243)	
	<hr/>	<hr/>
	\$ 271,131	\$ 144,975
	<hr/>	<hr/>



**AMERICAN FOREST RESOURCES, LLC**  
(formerly U.S. Timberlands Yakima, LLC)

**Statements of Operations**

(in thousands)

	Year Ended December 31,		
	2003	2002	2001
	<u>Consolidated</u>		
Revenues:			
Log, timber deed and stumpage sales, including \$4,756 (2003) to an affiliate and \$1,261 (2002) and \$4,500 (2001) to preferred member	\$ 38,617	\$ 20,215	\$ 13,531
Timber and property sales, including \$10,200 (2003) to an affiliate	24,729	1,800	
By-products and other	2,203	3	43
	<u>65,549</u>	<u>22,018</u>	<u>13,574</u>
Cost of products sold:			
Cost of timber harvested	20,543	10,654	5,406
Cost of timber and property sales	24,621	1,322	
Depletion, depreciation and road amortization	21,826	10,664	5,047
Fire loss		827	
	<u>66,990</u>	<u>23,467</u>	<u>10,453</u>
Gross profit (loss)	<u>(1,441)</u>	<u>(1,449)</u>	<u>3,121</u>
Operating, general and administrative	11,592	4,437	3,082
Operating income (loss)	<u>(13,033)</u>	<u>(5,886)</u>	<u>39</u>
Interest expense and commitment fees	(27,077)	(5,172)	(4,654)
Amortization of deferred financing fees and debt discount	(7,763)	(374)	(637)
Interest income	234	160	52
Preacquisition loss of acquired interest	3,984		
Other income, net	322	47	23
	<u>(30,300)</u>	<u>(5,339)</u>	<u>(5,216)</u>
(Loss) before cumulative effect of accounting change	<u>(43,333)</u>	<u>(11,225)</u>	<u>(5,177)</u>
Cumulative effect of accounting change			(152)
<b>Net (loss)</b>	<u>\$ (43,333)</u>	<u>\$ (11,225)</u>	<u>\$ (5,329)</u>

See notes to financial statements



**AMERICAN FOREST RESOURCES, LLC**  
(formerly U.S. Timberlands Yakima, LLC)

**Statements of Redeemable Preferred Member Interest and Common Members' Equity (Deficiency)**  
(in thousands)

	Common Members Equity (Deficiency)			
	Redeemable Preferred Member Interest	Common Members' Equity (Deficiency)	Note Receivable Pacific Fiber Company, LP	Total Common Members' Equity (Deficiency)
<b>Balance, December 31, 2000</b>	\$ 20,295	\$ 764		\$ 764
Timberlands and related cutting rights contributed	16,289			
Net loss	(4,565)	(764)		(764)
<b>Balance, December 31, 2001</b>	32,019	0		0
Timberlands and related cutting rights contributed	18,317			
Net loss	(11,225)			
<b>Balance, December 31, 2002</b>	39,111	0		0
Timberlands and related cutting rights contributed	10,467			
Loan to finance Pacific Fiber Company, LP privatization transaction			\$ (32,000)	(32,000)
Contribution by Pacific Fiber Company, LP of member interest in IFG, LLC (owner of approximately 99% interest in Inland Fiber Group, LLC*) after completion of privatization transaction	(49,578)	19,898		19,898
Cash contribution by Pacific Fiber Company, LP to Inland Fiber Group, LLC		1,238		1,238
Loan repayment Pacific Fiber Company, LP			954	954
Net loss		(43,333)		(43,333)
<b>Balance, December 31, 2003</b>	<b>\$ 0</b>	<b>\$ (22,197)</b>	<b>\$ (31,046)</b>	<b>\$ (53,243)</b>

\* Owner of the Company's redeemable preferred member interest

*See notes to financial statements*



**AMERICAN FOREST RESOURCES, LLC**  
(formerly U.S. Timberlands Yakima, LLC)

**Statements of Cash Flows**

(in thousands)

	Year Ended December 31,		
	2003	2002	2001
<b>Consolidated</b>			
<b>Cash flows from operating activities:</b>			
Net loss	\$ (43,333)	\$(11,225)	\$ (5,329)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation, depletion and amortization and cost of timber property sold	46,447	11,955	5,046
Fire loss		827	
(Gain) loss on disposal of assets	(58)	3	
Amortization of deferred financing fees and debt discount	7,764	374	637
Preacquisition loss of contributed interest	(3,984)		
Accretion of discount on other long-term debt	83	96	26
Cumulative effect of accounting change			152
Fair value adjustment of interest rate cap agreement	112	831	304
Change in assets and liabilities net of effect of contribution of IFG in 2003:			
Accounts receivable	322	1,602	(153)
Receivable from preferred member			1,110
Other receivables	(135)	33	
Notes receivable	1,267	(81)	761
Prepaid expenses and other current assets	58	34	(219)
Accounts payable and accrued expenses	66	(1,088)	418
Advance payment from customer	(4,000)	9,000	
Payable to affiliate	(241)		
Net cash provided by operating activities	<u>4,368</u>	<u>12,361</u>	<u>2,753</u>
<b>Cash flows from investing activities:</b>			
Acquisition of timber and timberlands	(2,805)	(15,280)	(22,282)
Deposit on seedlings		(52)	
Purchase of equipment			(3)
Proceeds from sale of assets	26		
Cash acquired in connection with contribution of IFG	1,460		
Loan to U.S.T. Acquisitions Co., LLC	(32,000)		
Repayment of principal from U.S.T. Acquisitions Co., LLC	954		
Net cash used in investing activities	<u>(32,365)</u>	<u>(15,332)</u>	<u>(22,285)</u>
<b>Cash flows from financing activities:</b>			
Capital contributions	1,238		
Proceeds from bank credit facility	32,600	7,900	86,500
Payments made on bank credit facility	(3,900)		(52,807)
Advances from affiliates	324		
Payments of other long-term debt	(365)	(365)	(91)
Deferred financing fees	(765)	(652)	(3,871)

Restricted cash, noncurrent portion	<u>(1,273)</u>	<u>(5,982)</u>	<u>(6,809)</u>
Net cash provided by financing activities	<u>27,859</u>	<u>901</u>	<u>22,922</u>
<b>Net (decrease) increase in cash, cash equivalents and restricted cash</b>	<b>(138)</b>	<b>(2,070)</b>	<b>3,390</b>
Cash, cash equivalents and restricted cash, beginning of year	<u>1,754</u>	<u>3,824</u>	<u>434</u>
<b>Cash, cash equivalents and restricted cash, end of year</b>	<b>\$ 1,616</b>	<b>\$ 1,754</b>	<b>\$ 3,824</b>
<b>Supplemental cash flow information:</b>			
Cash paid during the year for interest	<b>\$ 26,909</b>	<b>\$ 5,334</b>	<b>\$ 4,419</b>
<b>Non-cash investing and financing activities:</b>			
Receipt of timber cutting rights and timberlands from affiliate	<b>\$ 10,467</b>	<b>\$ 18,317</b>	<b>\$ 16,289</b>
Interest rate cap agreement acquired for debt			<b>\$ 2,270</b>
Contribution by common member of interest in IFG Holdings, LLC, net of \$1,460 cash acquired	<b>\$ 18,438</b>	<b>\$</b>	<b>\$</b>

*See notes to financial statements*

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**1. Business and Significant Accounting Policies:**

**Business:**

The accompanying financial statements include the accounts of American Forest Resources, LLC (“AFR”) (formerly, U.S. Timberlands Yakima, LLC), a Delaware limited liability company, and in 2003, after approximately 99% of its members’ interests were contributed to AFR (see Going Private Transaction below), Inland Fiber Group, LLC (“IFG”) (formerly, U.S. Timberlands Klamath Falls, LLC), a Delaware limited liability company, and IFG’ s wholly owned subsidiary, Fiber Finance Corp. (“Finance Corp.”) (formerly U.S. Timberlands Finance Corp.), collectively referred to hereafter as the “Company”. Each of AFR, IFG and Finance Corp. changed names in December 2003. Finance Corp. serves as the co-obligor for IFG’ s Notes (defined below). It has nominal assets and does not conduct operations. All intercompany balances and transactions after the contribution have been eliminated in consolidation.

AFR was formed in 1999 to acquire approximately 56,000 acres of timberland in Central Washington and approximately 54,000 acres of timberland in Central Oregon. The primary business activity of AFR is the growing of trees and the sale of logs and standing timber to third party wood processors and others located primarily in central Washington and central Oregon and the sale of excess land. The primary activities of IFG are the same except that its timber and customers are located principally in Oregon, east of the Cascade Range. Logs harvested from the timberlands are sold to unaffiliated domestic conversion facilities. These logs are processed for sale as lumber, plywood and other wood products, primarily for use in new residential home construction, home remodeling and repair and general industrial applications

Prior to July 2003, Pacific Fiber Company, LP, a publicly traded master limited partnership (the “MLP”) (formerly U.S. Timberlands Company, LP) owned a 99% non-managing member interest in IFG. The MLP was formed on June 27, 1997 to acquire and own substantially all of the equity interests in IFG. Timber Resource Services, LLC (formerly known as US Timberlands Services Company, LLC) (the “Manager”) which is controlled by Cascade Resource Holdings, LLC., an entity owned by senior management, which also controls the common membership interest in AFR, manages the business of IFG and owns a 1% non-voting membership interest in IFG. The Manager also managed the business of AFR prior to September 14, 2001. Thereafter, management of AFR was taken over by American Forest Services, LLC, a wholly-owned subsidiary of the Manager. All management decisions related to the Company are made by the Manager or its subsidiary.

**Going Private Transaction:**

On October 17, 2002, the MLP announced that it had signed a definitive agreement to be acquired by an acquisition company formed by a group led by senior management (the “Privatization Transaction”). The group beneficially owned 36.4% of the combined outstanding limited partnership units of the MLP consisting of 16% of the common units and 98% of the subordinated units. The definitive agreement contemplated a cash tender offer for 100% of the outstanding common limited partnership units not already owned by the acquiring entity or its affiliates for \$3.00 per unit in cash, followed by a merger of the acquisition company with and into the MLP, pursuant to which each common limited partnership unit not already owned by the acquiring entity or its affiliates would be converted into the right to receive \$3.00 per unit in cash. The tender offer commenced on November 19, 2002 and was completed on March 6, 2003. In connection with the tender offer, approximately 71% of the MLP’ s common units were tendered. The remaining common units held by non-affiliates not purchased in the tender offer were converted into the right to receive \$3.00 per common unit in the merger, which was completed on June 26, 2003.



**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**1. Business and Significant Accounting Policies: (continued)**

**Going Private Transaction: (continued)**

Subsequent to the Privatization Transaction, the interest in IFG originally held by the MLP was transferred in a series of transactions to a newly-formed limited liability company, IFG Holdings, LLC. IFG Holdings, LLC is 100% owned by AFR, in which IFG holds a preferred LLC member interest (see Note 2). As part of this reorganization of the ownership structure of IFG, a Board of Directors was established for IFG to supervise its operations and a new management arrangement was established under which the Manager provides comprehensive timber management services to IFG pursuant to a fee-based management agreement.

**Basis of Presentation:**

The accompanying consolidated statements have been prepared assuming that the Company will continue as a going concern. As more fully described in Note 10, in December 2003, the trustee under the indenture governing IFG's \$225,000 of 9 5/8% Senior Notes due 2007 (the "Indenture"), commenced litigation against AFR, IFG and others alleging, among other matters, that IFG violated certain covenants contained in the Indenture and in May 2004 the Trustee issued a Notice of Default. AFR and IFG have denied all of the allegations and made a motion to dismiss the complaint. In the event the trustee prevails in the litigation, the trustee, in combination with the required number of bondholders, will have the right to demand repayment and accelerate the maturity of the notes. Such acceleration, were it to occur, could cause an event of default and acceleration of the maturity of the loan payable under the Company's credit facility, if the Company were unable to cure or obtain a waiver with respect to any outstanding event of default under its credit facility. These circumstances raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**Use of Estimates:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Revenue Recognition:**

Revenues from delivered log sales are recognized upon delivery to the customer. Revenues from timber deeds and timberland sales are generally recognized upon closing. Revenue from timber sold under stumpage contracts (i.e., where the customer arranges the harvest and delivery of the logs but without being granted a deed) is recognized at the time the timber is harvested.

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[1] Business and Significant Accounting Policies: (continued)**

**Concentration of Credit Risk:**

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of trade accounts and notes receivable. The majority of the Company's trade accounts and notes receivable are derived from sales to third party wood processors.

The Company's three largest customers accounted for 30%, 11% and 10% of consolidated net revenues from log, timber deed and stumpage sales for the year ended December 31, 2003. AFR's largest customers accounted for 28%, 13% and 13% of AFR's revenues in 2002, and 20% and 12% of its revenues in 2001. The loss of or a material decrease in business from any of these customers could have a material, negative impact on the Company's results of operations. Management does not, however, expect these relationships to be discontinued. No other single customer accounted for more than 10% of aggregate net revenues from log, stumpage and timber deed sales in those years.

Credit risk on trade receivables is mitigated by control procedures to monitor the credit worthiness of customers. The Company mitigates credit risk related to notes receivable by obtaining asset lien rights or performing credit worthiness procedures or both.

The Company periodically reviews its allowance for doubtful accounts and reserves an estimated amount for such accounts, if required. As of December 31, 2003 and 2002, no allowance for doubtful accounts was required.

**Cash, Cash Equivalents and Restricted Cash:**

Cash equivalents consist primarily of highly liquid investments with maturities at date of purchase of 90 days or less.

On September 14, 2001, AFR refinanced its then existing bank debt under an agreement with a new lender (see Note 7) which calls for a series of cash or letter of credit reserve accounts. The obligations under these reserve accounts were met with restricted cash totaling \$14,011 and \$13,620 at December 31, 2003 and 2002, respectively, of which \$20 and \$829 of restricted cash was available to meet the Company's short term obligations at December 31, 2003 and 2002, respectively.

**Timber and Timberlands:**

Timber and timberlands are stated at cost less depletion and road amortization for timber previously harvested. The cost of the timber harvested (including amortization of logging roads) is determined based on the volume of timber harvested in relation to the estimated net merchantable inventory volume on the timberlands, primarily using separate pools for timberlands in Oregon and in Washington. The Company estimates net merchantable inventory using statistical information and data obtained from physical measurements, site maps, photo-types and other information gathering techniques. These estimates are updated periodically and may result in adjustments of timber volumes and depletion rates, which are recognized prospectively. Changes in these estimates have no effect on the Company's cash flow.

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[1] Business and Significant Accounting Policies: (continued)**

**Timber and Timberlands: (continued)**

IFG operates and maintains a seed orchard and nursery. Costs incurred by the orchard and nursery to produce seed and seedlings utilized in the reforestation of IFG's timberlands are capitalized to seed orchard and nursery stock in the accompanying balance sheet. A certain amount of seed and seedling stock is sold to unaffiliated customers and is reflected as a component of by-products and other revenues in the accompanying statements of operations.

**Property, Plant and Equipment:**

Property, plant and equipment, including significant improvements thereto, are stated at cost less accumulated depreciation and amortization. Cost includes expenditures for major improvements and replacements. Maintenance and repairs are charged to expense as incurred. When assets are sold, retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in income.

The cost of property, plant and equipment is depreciated using the straight-line method over the estimated useful lives of the related assets. Buildings and improvements are generally depreciated over 40 years and equipment is depreciated over 3 to 5 years. Leasehold improvements are amortized under the straight-line method based on the shorter of the lease periods or the estimated useful lives of the improvements.

**Deferred Financing Costs:**

Deferred financing costs consist of fees and other costs incurred in connection with obtaining the related debt financing. The Company amortizes the deferred financing costs over the terms of the related debt. Deferred financing costs are presented net of accumulated amortization of \$1,376 and \$468 at December 31, 2003 and 2002, respectively.

**Income Taxes:**

AFR and IFG are limited liability companies. The companies are not liable for federal or state income taxes as their income or loss is reported on the separate tax returns of the members. Accordingly, no provision for current or deferred income taxes has been reflected in the accompanying financial statements.

**Unit-Based Compensation Plans:**

Prior to the Privatization Transaction, the MLP had a Unit Option Plan which provided for the granting of options to purchase common limited partnership units in the MLP to employees and directors of the Manager who performed services for IFG. As permitted under Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure", which was issued in December 2002 and amended SFAS No. 123, "Accounting for Stock-Based Compensation," IFG had elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements as defined by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. There would have been no effect on net loss for 2003 if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.



**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[1] Business and Significant Accounting Policies: (continued)**

**Unit-Based Compensation Plans: (continued)**

In connection with the Privatization Transaction, each outstanding unit option granted under the Unit Option Plan was converted into an option to receive, upon exercise, including payment of the exercise price, the \$3.00 per unit merger consideration. Because the exercise price for each option was greater than the merger consideration, the Company does not expect any options to be exercised in the future, and considers outstanding unit options to have been effectively cancelled.

No options were granted in 2003.

**Derivatives:**

The Company adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" as of January 1, 2001. SFAS No. 133 requires the Company to recognize all derivatives in the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If the derivative is a hedge, depending upon the nature of the hedge, changes in the fair value of the derivative will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company recognized a loss of \$152 as of January 1, 2001 from the cumulative effect of adoption of SFAS No. 133 to reduce the carrying value of an interest rate cap agreement to its fair value of \$7.

**[2] Contribution of Member Interest in Inland Fiber Group, LLC ("IFG"):**

Subsequent to the completion of the Privatization Transaction (see Note 1), 100% of the partnership interests in the MLP were held by entities controlled by senior management, as compared with a 36.4% partnership interest held prior to announcement of the transaction. The MLP, which together with one such entity owns indirectly through holding companies the entire outstanding common membership interest in AFR, contributed its 99% member interest in IFG to AFR. IFG also is the owner of AFR's redeemable preferred member interest. The results of operations of IFG have been included in the consolidated financial statements from January 1, 2003. Losses for the period from January 1, 2003 through March 6, 2003 (the date of completion of the tender offer) attributable to the 63.6% interest acquired by senior management in the Privatization Transaction have been shown separately in the accompanying statement of operations as a reduction in the consolidated loss.

The contribution to AFR of IFG has been recorded at \$19,898 which reflects the cost of \$26,961 including acquisition expenses, paid by an entity controlled by senior management for the 63.6% acquired interest in the MLP, reduced by \$7,063 representing the carryover basis for the 36.4% interest in the deficiency in the net assets of the MLP at December 31, 2002 attributable to an entity controlled by senior management prior to the transaction, which deficiency includes 36.4% of the cumulative losses of AFR charged to the preferred member interest. In accordance with accounting principles applicable to business combinations, the excess (\$43,287) of cost over deficiency in net assets attributable to the 63.6% acquired interest in the MLP has been principally recorded as a \$44,075 reduction of long-term debt based on the quoted market price of the \$225,000 publicly traded notes of IFG. Such discount is being amortized by the effective yield method over the term of the debt. The following summarizes the allocation of the recorded amount of the contribution to the assets and liabilities of IFG.

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[2] Contribution of Member Interest in Inland Fiber Group, LLC (“IFG”): (continued)**

	<u>(\$ 000)</u>
Current assets, including cash of \$1,460	\$ 4,426
Timber and timberlands, net	156,663
Investment in redeemable preferred member interest in AFR	44,723
Property, plant and equipment	898
Restricted cash	87
Deferred financing costs	1,200
Notes receivable, less current portion	10
Total assets	<u>208,007</u>
Current liabilities	7,184
Long-term debt, net of discount of \$44,075	180,925
Total liabilities	<u>188,109</u>
Net assets contributed	<u>\$ 19,898</u>

**[3] Timber and Timberlands:**

Timber and timberlands consisted of the following at December 31:

	<u>2003</u>	<u>2002</u>
	<b>Consolidated</b>	
Timber and logging roads	<b>\$ 291,311</b>	\$113,868
Timberlands	<b>52,897</b>	33,137
Seed orchard and nursery stock	<b>1,451</b>	
Water rights	<b>119</b>	119
	<b>345,778</b>	147,124
Less accumulated depletion and road amortization	<b>99,459</b>	22,325
	<b><u>\$ 246,319</u></b>	<b><u>\$124,799</u></b>

In November 2002, AFR agreed to sell the Ochoco timberlands, which it had acquired from IFG, to an unrelated buyer for \$14,600. In connection with this sale, AFR had received a non-refundable deposit of \$9,000 from the buyer of the property, which was reflected as a liability at December 31, 2002. The sale closed on November 8, 2003, at which time the \$5,600 balance from the buyer was collected.

Customer deposits of \$5,000 at December 31, 2003 represent an advance payment received by IFG from a customer.

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[4] Certain Timberland Transactions:**

**Yakima Timberlands:**

On October 4, 1999, AFR acquired approximately 56,000 acres of timber and timberlands and approximately 700 acres of timber cutting rights from Boise Cascade Corporation for approximately \$55,000 (the "Yakima Timberlands"). Substantially all of the purchase price was allocated to timber, timberlands and logging roads. The acquisition was financed through a credit facility obtained by AFR (see Note 7).

**Acquisitions for Preferred LLC Member Interests:**

On October 4, 1999, AFR issued a redeemable preferred member interest (the "Preferred LLC Interest") (see Note 8) to its affiliate, IFG, for IFG's contribution to AFR of approximately 54,000 acres of timberland located in Central Oregon (the "Antelope Timberlands"). AFR recorded the acquisition of timberlands (and the related Preferred LLC Interest) at IFG's basis for the timberlands of \$18,850. This contribution had an agreed upon value of \$22,000.

On February 26, 2001, AFR issued a redeemable preferred member interest (see Note 8) to IFG for IFG's contribution of approximately 80,640 MBF of timber located in Central Oregon. AFR recorded the acquisition of timber (and the related Preferred LLC Interest) at IFG's basis for the timberlands of \$10,886. This contribution had an agreed upon value of \$12,000 and was added to IFG's Preferred LLC Interest in AFR.

On June 30, 2001 AFR issued a redeemable preferred member interest (see Note 8) to IFG for IFG's contribution of approximately 30,585 MBF of timber located in Central Oregon. AFR recorded the acquisition of timber (and the related Preferred LLC Interest) at IFG's basis for the timberlands of \$5,403. This contribution had an agreed upon value of \$6,500 and was added to IFG's Preferred LLC Interest in AFR.

On December 20, 2002, AFR issued a redeemable preferred member interest (see Note 8) to IFG for IFG's contribution of approximately 55,000 acres of timberland located in Central Oregon (the "Camp 6" Timberlands). AFR recorded the acquisition of timberlands (and the related Preferred LLC Interest) at IFG's basis for the timberlands of \$14,363. This contribution had an agreed upon value of \$14,100.

On December 20, 2002, AFR issued a redeemable preferred member interest (see Note 8) to IFG for IFG's contribution of approximately 22,500 acres of timberlands located in Central Oregon (the "West Chemult" Timberlands). AFR recorded the acquisition of timberlands (and the related Preferred LLC Interest) at IFG's basis for the timberlands of \$3,954. This contribution had an agreed upon value of \$4,400.

During the period from January 1, 2003 through March 6, 2003 (the date of completion of the tender offer), AFR issued redeemable preferred member interests (see Note 8) to IFG for IFG's contributions of timberlands located in Central Oregon. AFR recorded the acquisitions of timberlands (and the related Preferred LLC Interest) at IFG's basis for the timberlands of \$10,546. These contributions had an agreed upon value of \$12,900.

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[4] Certain Timberland Transactions: (continued)**

**Timber Deed Purchases from and Sales to Affiliates:**

On December 29, 2000, AFR purchased approximately 8,000 acres of timberland located in Central Oregon (the "Yainax" Timberlands) from its affiliate, IFG, for \$2,900. Substantially all of the purchase price was allocated to timber, timberlands and logging roads.

During 2001, AFR purchased 125,400 MBF of timber located in Central Oregon from IFG for \$19,000. All of the purchase price was allocated to timber. The timber deeds expire in August and October 2004.

During June 2000, AFR sold timber cutting rights for approximately 4,200 MBF to IFG for \$1,300. Those cutting rights expired in June 2003.

During March 2001, AFR sold timber cutting rights for approximately 17,200 MBF to IFG for \$4,500. These cutting rights expired in March 2004.

On April 30, 2002, AFR sold timber cutting rights for approximately 5,100 MBF to an affiliate, U.S. Timberlands Services Yakima, LLC (now known as American Forest Services, LLC) for \$516. Those cutting rights expire in March 2005.

On June 12, 2002, AFR purchased approximately 87,300 MBF of timber located in Central Oregon from IFG for \$9,900. All of the purchase price was allocated to timber.

On November 13, 2002, AFR purchased the underlying approximately 45,000 acres of timberland located in Central Oregon (the "Ochoco" Timberlands) from IFG for \$4,700. Substantially all of the purchase price was allocated to timberlands and logging roads.

On August 30, 2002, AFR sold timber cutting rights for 12,000 MBF to IFG for \$1,261. Those cutting rights expired in August 2003.

In May 2003, IFG sold approximately 21,000 acres of timberland to American Forest Services, LLC ("AFS") for \$8,300.

In December 2003, IFG sold approximately 1,000 acres of timberland to AFS for \$1,900.

In December 2003, IFG sold timber cutting rights for approximately 34,965 MBF to AFS for \$4,756. These timber cutting rights expire in December 2004.

**[5] Equipment:**

Equipment consisted of the following at December 31:

	2003	2002
	_____	_____
	<b>Consolidated</b>	
Equipment	<b>\$ 1,206</b>	<b>\$ 82</b>

Less accumulated depreciation

	<u>357</u>		<u>49</u>
	<b>\$ 849</b>		<b>\$ 33</b>

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**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[6] Interest Rate Cap Agreement:**

In September 2001, AFR entered into an interest rate cap agreement, which expires in September 2013, and which will provide AFR with interest rate protection should the interest rate payable on its long-term debt incurred in 2001 (see Note 7) exceed 8% per annum. The agreement was purchased for \$2,270, payable in varying monthly amounts through September 2013. The agreement is carried at fair value at the end of each financial reporting period, and changes in its value are recorded currently in income. Should interest rates on AFR's long term debt exceed 8% per annum, the cap agreement will become effective as a cash flow hedge and periodic changes in its value related to remaining future interest payments will be recorded in other comprehensive income. AFR had entered into an earlier interest rate cap agreement during 2000 which expired during 2001. Interest expense and commitment fees include \$196 (2003), \$940 (2002) and \$304 (2001) related to interest rate caps.

**[7] Long-Term Debt:**

Long-term debt at December 31 consists of:

	2003	2002
	_____	_____
	<b>Consolidated</b>	
Notes payable under AFR Refinancing Facility	<b>\$ 123,100</b>	\$ 94,400
IFG Senior Notes, 9-5/8%, due November 15, 2007; principal amount \$225,000, less discount of \$ 37,045	<b>187,955</b>	
Other long-term debt	<b>1,653</b>	1,935
	_____	_____
	<b>312,708</b>	96,335
Less current maturities	<b>(3,370)</b>	(282)
	_____	_____
	<b>\$ 309,338</b>	\$ 96,053
	_____	_____

**AFR Credit Facility:**

At December 31, 2000, AFR had a bank credit facility with the Bank of Montreal (the "Bank"), consisting of a revolving bank line of credit ("Line of Credit") and a term credit facility ("Term Note"), collectively referred to hereafter as the "Credit Facility." The Credit Facility was obtained in 1999 by AFR to facilitate the acquisition of the Yakima Timberlands (see Note 4). The Line of Credit provided for borrowings of up to \$2.0 million and the Term Note was for \$58.0 million. The Credit Facility was collateralized by all of AFR's assets. The Credit Facility agreement provided for floating rate interest at either (a) the LIBOR plus applicable margin; or (b) the Bank's prime rate plus applicable margin. Under the terms of the Credit Facility, the borrowing base was based upon eligible receivables and merchantable timber. The term of the Credit Facility was through September 30, 2002.

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[7] Long-Term Debt: (continued)**

**AFR Credit Facility: (continued)**

On September 14, 2001, AFR repaid the Credit Facility with proceeds of a replacement credit facility with BNY Midwest Trust Company as Trustee and MBIA Insurance Corporation as Insurer (the "Refinancing Facility"). The Refinancing Facility provides for borrowings of up to a maximum of \$127,000 for a term of 12 years. The Refinancing Facility is collateralized by all of AFR's assets, which had a book value of approximately \$137,000 at December 31, 2003. The Refinancing Facility indenture provides for floating rate note interest at the applicable commercial paper funding cost of AFR plus applicable margin (0.60% at December 31, 2003, 2002 and 2001). At December 31, 2003 and 2002, the effective rate was 1.79% and 2.23%, respectively. At December 31, 2003 and 2002, \$123,100 and \$94,400 respectively was outstanding in borrowings under the Refinancing Facility.

Under the terms of the Refinancing Facility, the borrowing base is equal to 75% of the sum of eligible receivables and total timber and timberland value as determined by AFR and reviewed by an approved independent consultant on a quarterly basis. The borrowing base recalculation triggers a pay down of all borrowings under the Refinancing Facility in excess of the borrowing base. The Refinancing Facility requires payment of interest only through September 14, 2004, and then requires principal amortization in equal monthly installments for the next 108 months. Under certain circumstances, the commencement of the amortization period may be extended for one year.

The Refinancing Facility contains certain restrictive covenants, including limits on the ability of AFR to make capital expenditures, make cash distributions (including the Preferred LLC Interest guaranteed return), incur liens, incur additional indebtedness and to make loans and investments. In addition, the Refinancing Facility contains certain financial covenants. AFR was in compliance with these covenants at December 31, 2003.

The Refinancing Facility also requires the establishment and maintenance of a series of restricted cash accounts controlled by the indenture trustee, into which substantially all of AFR's cash collections are required to be deposited. A portion of these funds is then released to AFR to pay debt service and operating expenses as provided for in the indenture, and a portion is allocated to the various long-term restricted cash accounts required by the indenture agreement. The Company estimates that amounts, if any, required to be added to long-term restricted cash during 2004 pursuant to indenture provisions will not be significant.

**IFG Senior Notes:**

In 1997, IFG and Finance Corp., a wholly owned subsidiary of IFG (collectively, the "Issuers"), jointly and severally issued \$225,000 of 9 5/8% Senior Notes due 2007 (the "Notes"). The Issuers serve as co-obligors of the Notes. The Notes represent unsecured general obligations of the Issuers and bear interest at 9 5/8% payable semiannually in arrears on May 15 and November 15, and mature on November 15, 2007 unless previously redeemed. The Notes are redeemable at the option of the Issuers in whole or in part at predetermined redemption prices plus accrued interest to the redemption date.

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[7] Long-Term Debt: (continued)**

**IFG Senior Notes: (continued)**

The Notes contain certain restrictive covenants, including limiting the ability of IFG and its subsidiaries to make cash distributions, incur additional indebtedness, sell assets or harvest timber in excess of certain limitations. Under certain restrictive covenants, during 2003 and 2002, IFG was and presently is prohibited from making distributions to its members. In 2002, because of the accelerated harvesting during the fourth quarter 2002 of salvage timber resulting from the Toolbox Fire, IFG exceeded the allowable four year harvest by 6.9 MMBF and, as required under the Indenture, had placed \$662 in a restricted account during the first quarter of 2003 only to be used in ways prescribed in the Indenture. A balance of \$63 remained in the restricted account as of December 31, 2003. As of December 31, 2003, IFG was in compliance with the covenants contained in the Notes, however, the trustee under the indenture has alleged that IFG has violated certain covenants and has commenced litigation as described in note 10.

IFG made its required interest payment, due on November 17, 2003, on its Notes during the 30 day grace period provided for in the Indenture.

**Other Long-Term Debt:**

Other long-term debt consists of amounts payable to a financial institution for the purchase in September 2001 of an interest rate cap agreement (See Note 6). Payments are due monthly starting in October 2001 at the rate of \$30 per month for 36 months, and thereafter at varying monthly amounts through September 2013. Each payment includes interest imputed at an effective rate of 4.7% per annum. The aggregate amount of payments due under this agreement at December 31, 2003 and 2002 was \$1,915 and \$2,280 respectively, before the discounts for imputed interest of \$262 and \$345, respectively.

**Maturities of Long-Term Debt:**

At December 31, 2003, payments of long-term debt are due as follows:

2004	\$3,370
2005	12,586
2006	12,558
2007	237,529
2008	12,498
Thereafter	71,212
	<hr/>
	\$349,753
	<hr/>

As a result of purchase accounting adjustments resulting from the Privatization Transaction more fully described in Note 2, the \$225,000 principal amount of the IFG Notes outstanding has been reduced for financial reporting purposes by \$44,075, which amount is being accreted over the remaining term of the notes by charges to operations. Through December 31, 2003, accretion totaled \$7,030.



**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[8] Common Members' Interest and Redeemable Preferred LLC Interest:**

**Common Interests:**

Concurrent with the acquisition of the Yakima Timberlands (see Note 4), Cascade Resource Holdings Group, LLC and the MLP contributed \$306 and \$294, respectively, for common member interests of 51% and 49%, respectively, (the "Common Interests") in AFR.

As a result of the refinancing transaction entered into by AFR in September 2001, the Common Interests in AFR are now held through a holding company, AFR Holdings II, LLC.

As provided in IFG's Operating Agreement, income and losses are allocated 99% to IFG Holdings, LLC and 1% to the Manager.

**Preferred LLC Interest:**

Concurrent with the acquisition of the Yakima Timberlands, IFG contributed the Antelope Timberlands having an agreed upon value of \$22.0 million for Preferred LLC Interests in AFR.

At December 31, 2003 and 2002, as a result of contributions of timber cutting rights and additional timberlands by IFG to AFR, the agreed upon value of the Preferred LLC Interest aggregated \$72,900 and \$59,900 respectively (see Note 4). Terms of the Preferred LLC Interest include a cumulative annual guaranteed return of 5% of the agreed upon value through December 31, 2001 and 6% thereafter. Subject to the applicable law and the terms of any loan agreement then in effect, the Preferred LLC Interest is redeemable in whole or in part at AFR's option while its long-term debt is outstanding and for one year and one day thereafter, and at the preferred member's option thereafter, in each case, for a redemption price equal to the agreed upon value of the Preferred LLC Interest, payable either in cash or in timberlands, plus any portion of the guaranteed return not yet paid by the Company prior to the redemption date. As of December 31, 2003, the unpaid cumulative guaranteed return amounted to \$9,715. The guaranteed return for 2003, 2002 and 2001 has not been recorded by AFR due to the absence of allocable net income for such years. No payments of the return have been made.

The 2003 financial statements reflect the consolidation of the accounts of AFR with IFG and the resultant elimination of the Preferred LLC Interest in consolidation.

**Allocation of Income (Loss):**

As provided by AFR's operating agreement, income attributable to the Common Interests is generally allocated according to the percentage ownership of the outstanding Common Interests. However, through December 31, 2002, net losses exceeding the account balances of the Common Interest, were allocated to the Preferred LLC Interest.

**Note Receivable from Pacific Fiber Company, LP:**

During 2003, AFR increased its outstanding loans under its Refinancing Facility by \$32,000, and loaned such amount to the MLP, (successor to US Timberlands Acquisition Company LLC) to finance the Privatization Transaction. The loan receivable from the MLP bears interest at LIBOR plus 1 ½% per annum, and is due September 14, 2004 or such later date that AFR and the MLP may agree. Because the MLP's principal asset is its indirect investment through holding companies in the common member's interest in

AFR, and has no source of funds other than AFR with which to repay this loan, AFR has reflected the loan receivable as a deduction from members' equity, and is not accruing interest receivable on this loan.

**Notes to the Financial Statements**  
**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

Payments of principal and interest, if any, which are received by AFR, will be credited to members' equity as received. Payments of \$954 and \$2,590 were received in December 2003 and May 2004, respectively and were reflected as reductions of the note receivable.

**[9] Fair Value of Financial Instruments:**

A summary of the fair value of the Company's financial instruments and the methods and significant assumptions used to estimate these values is presented below. The estimates require subjective judgments and are approximate. Changes in methodologies and assumptions could significantly affect estimates.

**Short-term financial instruments:**

The fair value of short-term financial instruments, including cash and cash equivalents, trade and other receivables, notes receivable, trade accounts payable and certain accrued liabilities, approximate their carrying amounts in the financial statements due to the short maturities of such items.

**Long-term debt:**

The estimated fair value of AFR's long-term debt approximates the carrying value of \$123,100 and \$94,400 at December 31, 2003 and 2002, respectively, given the nature of the debt and because it is tied to major interest rate indexes.

The estimated fair value of IFG's long-term debt was approximately \$117,000 and \$139,500 at December 31, 2003 and 2002, respectively, based on published market quotations.

The estimated fair value of AFR's long-term debt to a financial institution in connection with the purchase of an interest rate cap agreement was approximately \$1,696 and \$2,014 at December 31, 2003 and 2002, respectively, based on quotations from such institution.

**[10] Commitments and Contingencies:**

**Lease Agreement:**

IFG and AFR lease office facilities under non-cancelable operating leases expiring in October 2004. Other office facilities are leased from a related party under a non-cancelable lease expiring in 2024. Rent expense was \$31, \$35 and \$27 for the years ended December 31, 2003, 2002 and 2001, respectively.

Future minimum payments required under the lease agreements are:

2004	\$	39
2005		24
2006		24
2007		24
2008		24
Thereafter		499

Total minimum lease commitments

\$ 634

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**Log Supply Agreement:**

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**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

Concurrently with the acquisition of the Yakima Timberlands, AFR entered into a log supply agreement with Boise Cascade Corporation (“Boise”) to supply a volume of approximately 11 million board feet (“MMBF”), 25 MMBF, 25 MMBF, 9 MMBF, and 9 MMBF in 1999, 2000, 2001, 2002, and 2003, respectively, of merchantable timber to Boise at market prices. The term of the agreement was through November 2003 and it was not renewed.

**Fire Loss:**

In accordance with industry practice, the Company self-insures for fire loss.

**Affiliate Credit Facility:**

IFG had a credit facility with an affiliate of the Manager (the “Affiliate Credit Facility”) consisting of a revolving line of credit up to \$12.0 million. Borrowings under the Affiliate Credit Facility bore interest at the prime lending rate as published in the Wall Street Journal plus applicable margin, which was based on IFG’ s leverage ratio. The Affiliate Credit Facility expired, by its terms, at the end of April 2002. IFG had sought to replace the Affiliate Credit Facility with a working capital facility from an unaffiliated third party, but has been unable to obtain a working capital credit facility in amounts sufficient to fund its working capital needs from a traditional commercial lender. While IFG continues to seek a credit facility from an unaffiliated source, affiliated lenders have agreed to make short term advances to IFG, payable on demand to the affiliates, at an annual interest rate of 10%. During 2003, the maximum amount outstanding was \$424, all of which had been repaid as of December 31, 2003. There were no interest or commitment fees paid to the affiliate in 2003. The affiliate has made no commitment to continue to lend funds to IFG, and each request is considered on a case by case basis.

**Litigation:**

AFR is involved in legal proceedings and claims arising in the normal course of business. In the opinion of management, the outcome of such legal proceedings and claims will not have a material adverse effect on the Company’ s results of operations and financial position.

On June 21, 2002, IFG was notified that it was named in a lawsuit filed in the State Court in Oregon as a codefendant seeking medical expenses and up to \$12.0 million in damages for injuries sustained by the minor child of an employee of the Manager while riding on equipment owned by the Manager. At the time, liability insurance was in place, however, the insurance underwriter has since gone bankrupt and the coverage is limited and is being administered by the Oregon Guarantee Insurance Association. Effective April 5, 2004, this case was dismissed with prejudice.

On December 19, 2003, an action was brought in the Court of Chancery of the State of Delaware in and for New Castle County by the trustee under the Indenture against IFG, Finance Corp., the Manager, AFR, Cascade Resource Holdings Group, LLC, and all of the directors of the Manager as of January 1, 2003 (collectively, the “Defendants”). The complaint alleges that IFG violated the provisions of the Indenture by transferring certain assets to its affiliates, the directors of IFG violated their fiduciary duty to IFG and that the transfers of the assets were fraudulent conveyances and subject to rescission. The trustee seeks a declaration that IFG has violated the terms of the Indenture, an injunction against the transfer of additional assets out of the ordinary course of business, damages and the imposition of a construction trust on the assets transferred by IFG to its affiliates. In January 2004, the plaintiff’ s motion to schedule a preliminary injunction hearing with respect to further transfers to affiliates and for expedited discovery was denied. In connection with the denial of the plaintiff’ s motion, IFG agreed that, through the earlier of December 31, 2004 and the resolution of the lawsuit, it would

provide at least thirty days' notice before entering into any transfer of assets to affiliates, other than payment of management fees. Discovery began in January 2004

**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

and is ongoing. On February 6, 2004, the Defendants filed a motion to dismiss. In May 2004, a hearing was held with respect to defendants' motion to dismiss. The defendants expect a decision regarding their motion to dismiss within a few months. On March 26, 2004 a motion to stay discovery pending the outcome of the Defendant's motion to dismiss was denied. On May 17, 2004, the Company received a Notice of Default from the Trustee covering certain of the allegations in the complaint. The Company and its legal counsel believe the litigation to be without merit and intends to vigorously defend itself in the lawsuit.

**[11] Related Party Transactions:**

**AFR Transactions:**

Prior to September 14, 2001, the Manager received reimbursement for reasonable and necessary direct and indirect expenses related to managing AFR in addition to a fee (the "Manager's Fee") of 2% of AFR's EBITDDA (as defined in AFR's operating agreement). Under agreements then in effect, there was an annual cap of \$750 on the total payments to the Manager including the Manager's Fee. On September 14, 2001, management of AFR was taken over by American Forest Services, LLC ("AF Services"), a wholly owned subsidiary of the Manager, which is paid a flat fee for management services equal to 2% of the agreed upon total timber and timberland asset valuation annually. Management fee expense charged to operations for the years ended December 31, 2003, 2002 and 2001 amounted to \$3,033, \$2,555 and \$1,137, including in 2001, \$298 applicable to the year 2000 which had previously been waived. Reimbursed expenses totaled \$192 in 2003, \$205 in 2002 and \$866 in 2001.

In July 2000, AFR entered into a Road Upgrade Agreement with Cascade Resource Holdings Group, LLC, which controls the common membership interest in AFR, whereby Cascade Resource Holdings Group, LLC is responsible for paying the costs of all road construction, reconstruction, improvements, upgrades, new or repaired bridges, culverts, fords and other stream-crossing structures on the Yakima Timberlands. Cascade Resource Holdings Group, LLC charges a quarterly fee to the Company for use of the roads that have been built or upgraded per the agreement. There were no road use fees for 2003, 2002 or 2001. In September 2001, AFR purchased road improvements from Cascade Resource Holdings Group, LLC for \$1,750.

See Note 4 for timber deed purchases from and sales to, and other timberlands transactions with IFG.

**IFG Transactions:**

Until September 1, 2003, the Manager did not receive any management fee or other compensation in connection with its management of IFG, but was reimbursed for all direct and indirect expenses incurred on behalf of IFG (including wages and salaries of employees, officers and directors of the Manager) and all other necessary or appropriate expenses allocable to IFG or otherwise reasonably incurred by the Manager in connection with the operation of IFG's business.

On September 1, 2003, IFG entered into a management agreement with the Manager. The new management agreement replaced the prior arrangement under which IFG reimbursed the Manager for expenses incurred on IFG's behalf. The new management agreement provides for an annual fee of 2% of the agreed upon valuation of total timber and timberland assets under management, payable monthly. For the period September 1 through December 31, 2003, fees of \$1,138 were incurred under the management agreement.

As of December 31, 2003, IFG had a payable to the Manager of \$46. During 2003, expenses allocated to and reimbursed by IFG totaled \$2,191.

See note 4 for timber deed and other timberland transactions with AFS.



**Notes to the Financial Statements**

**December 31, 2003 and 2002**

(dollar amounts in thousands, except per unit amounts and unless otherwise noted)

**[11] Related Party Transactions: (continued)**

**Consulting Agreements:**

Through June 2003, the Manager had consulting agreements with affiliates of certain persons who were directors of the Manager during the terms of such consulting agreements, pursuant to which each such person or firm had provided consulting services to the Manager. The agreements provided for an annual retainer of \$25, plus an hourly rate for services rendered at the request of the Manager. Payments by the Manager related to consulting agreements in 2003 amounted to \$56. Such fees were reimbursed to the Manager by IFG. The consulting agreements were discontinued in July 2003.

## EXHIBIT INDEX

- 3.3 - [Third Amended and Restated Operating Agreement of U.S. Timberlands Klamath Falls, LLC](#)
- † 10.2 - Indenture among U.S. Timberlands Klamath Falls, LLC, U.S. Timberlands Finance Corp. and State Street Bank and Trust Company, as trustee
- ++10.12- Amended and Restated Operating Agreement of U.S. Timberlands Yakima, LLC (now known as American Forest Resources, LLC)
- # 10.13 - Management Agreement by and among U.S. Timberlands Klamath Falls, LLC Dated as of July 25, 2003
- \*21.1 - List of Subsidiaries
- 31.1 - [§ 302 Certification of CEO pursuant to Rule 13a-14\(a\) or Rule 15d-14\(a\) under the Exchange Act](#)
- 31.2 - [§ 302 Certification of CFO pursuant to Rule 13a-14\(a\) or Rule 15d-14\(a\) under the Exchange Act](#)
- 32.1 - [Certification of CEO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2 - [Certification of CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002.](#)

\* *Incorporated by reference to the same numbered Exhibit to the Registrant's Registration Statement on Form S-1 filed November 13, 1997.*

† *Incorporated by reference to the same numbered Exhibit to the Registrant's Current Report on Form 8-K filed January 15, 1998.*

++ *Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q filed on August 14, 2003*

# *Incorporated by reference to the same numbered Exhibit to the Registrant's Form 10-Q filed on November 19, 2003*

**THIRD AMENDED AND RESTATED  
OPERATING AGREEMENT  
OF  
U.S. TIMBERLANDS KLAMATH FALLS, L.L.C.**

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**THIRD AMENDED AND RESTATED  
OPERATING AGREEMENT OF  
U.S. TIMBERLANDS KLAMATH FALLS, L.L.C.**

THIS THIRD AMENDED AND RESTATED OPERATING AGREEMENT (this "Agreement") OF U.S. TIMBERLANDS KLAMATH FALLS, L.L.C., a Delaware limited liability company (the "Company"), dated as of July 25, 2003 (the "Effective Date"), is entered into by UST KLAMATH FALLS HOLDINGS, LLC, a Delaware limited liability company ("Klamath Holdings"), and U.S. TIMBERLANDS SERVICES COMPANY, L.L.C., a Delaware limited liability company ("Services"), together with any other Persons who hereafter become Members in the Company or parties hereto as provided herein.

WHEREAS, U.S. Timberlands Holdings, L.L.C., a Delaware limited liability company ("Holdings"), and Rudey Timber Company, L.L.C., a Delaware limited liability company ("Rudey Timber"), were parties to the Amended and Restated Operating Agreement of the Company, dated as of August 30, 1996;

WHEREAS, Services, and U.S. Timberlands Company, L.P., a Delaware limited partnership ("MLP"), are parties to the Second Amended and Restated Operating Agreement of the Company (the "Prior Agreement"), dated as of November 19, 1997;

WHEREAS, in connection with the privatization of MLP (the "Privatization"), MLP has contributed its 98.9899% membership interest in the Company to UST Yakima Holdings II, LLC, a Delaware limited liability company ("Yakima Holdings II") pursuant to that certain Contribution Agreement dated as of July 25, 2003 by and among MLP, Yakima Holdings II, UST Yakima Holdings, LLC, a Delaware limited liability company ("Yakima Holdings"), U.S. Timberlands Yakima, LLC, a Delaware limited liability company ("Yakima"), and Klamath Holdings (the "Contribution Agreement");

WHEREAS, pursuant to the Contribution Agreement, Yakima Holdings II subsequently contributed its 98.9899% membership interest in the Company to Yakima Holdings;

WHEREAS, pursuant to the Contribution Agreement, Yakima Holdings subsequently contributed its 98.9899% membership interest in the Company to Yakima;

WHEREAS, pursuant to the Contribution Agreement, Yakima subsequently contributed its 98.9899% membership interest in the Company to Klamath Holdings;

WHEREAS, in connection with the Privatization and pursuant to the U.S. Timberlands Yakima Indenture, dated as of September 14, 2001, by and among Yakima, as issuer, BNY Midwest Trust Company, an Illinois corporation (the "Trustee"), as trustee, and MBIA Insurance Corporation, a New York stock insurance company ("MBIA"), as insurer (as amended, supplemented or modified from time to time, the "Indenture") and the Series 2003-1 Supplement to the Indenture dated as of February 25,

2003 by and among Yakima, the Trustee, MBIA and MBIA, Inc., Yakima issued that certain Series 2003-1 Note, dated as of February 25, 2003, in the aggregate principal amount of \$32,000,000 (the "Series 2003-1 Note");

WHEREAS, it is a condition subsequent to the issuance of the Series 2003-1 Note that MLP, Yakima Holdings II, Yakima Holdings, Yakima and Klamath Holdings consummate the membership interest transfers described above pursuant to the Contribution Agreement and that Klamath Holdings, Services and the Company enter into this Agreement; and

WHEREAS, Klamath Holdings desires to enter into this Agreement to provide for, among other things, the management of the business and affairs of the Company, the rights of Klamath Holdings with respect to the Company, the rights and obligations of any other Persons subsequently admitted as Members, and certain other matters.

NOW, THEREFORE, in consideration of the covenants, conditions and agreements contained herein, the parties hereto hereby agree as follows:

## **ARTICLE I DEFINITIONS**

### **1.1 Definitions**

The following definitions shall be for all purposes, unless otherwise clearly indicated to the contrary, applied to the terms used in this Agreement.

"Additional Member" means a Person admitted to the Company as a Member pursuant to Section 10.2 and who is shown as such on the books and records of the Company.

"Adjusted Capital Account" means the Capital Account maintained for each Member as of the end of each fiscal year of the Company, (a) increased by any amounts that such Member is obligated to restore under the standards set by Treasury Regulations Section 1.704 -1(b)(2)(ii)(c) (or is deemed obligated to restore under Treasury Regulations Sections 1.704 -2(g) and 1.704 -2(i)(5)) and (b) decreased by: (i) the amount of all losses and deductions that, as of the end of such fiscal year, are reasonably expected to be allocated to such Member in subsequent years under Sections 704(e)(2) and 706(d) of the Code and Treasury Regulations Section 1.751 -1(b)(2)(ii); and (ii) the amount of all distributions that, as of the end of such fiscal year, are reasonably expected to be made to such Member in subsequent years in accordance with the terms of this Agreement or otherwise to the extent they exceed offsetting increases to such Member's Capital Account that are reasonably expected to occur during (or prior to) the year in which such distributions are reasonably expected to be made (other than increases as a result of a minimum gain chargeback pursuant to Section 6.1.3.1 or 6.1.3.2) . The foregoing definition of Adjusted Capital Account is intended to comply with the provisions of Treasury Regulations Section 1.704 -1(b)(2)(ii)(d) and shall be interpreted consistently therewith.

"Adjusted Property" means any property the Carrying Value of which has been adjusted pursuant to Section 5.5(c)(i) or 5.5 (c)(ii). Once an Adjusted Property is deemed distributed by, and recontributed to, the Company for federal income tax purposes upon a termination of the Company pursuant to Treasury Regulations Section 1.708 -1(b)(1)(iv), such property shall thereafter constitute a Contributed Property until the Carrying Value of such property is subsequently adjusted pursuant to Section 5.5(c)(i) or 5.5(c)(ii) .

"Affiliate" means, with respect to any Person, any other Person that directly or indirectly through one or more intermediaries controls, is controlled by or is under common control with the Person in question. As used herein, the term "control" means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Person, whether through ownership of voting securities, by contract or otherwise.

"Agreed Allocation" means any allocation, other than a Required Allocation, of an item of income, gain, loss or deduction pursuant to the provisions of Section 6.1, including, without limitation, a Curative Allocation (if appropriate to the context in which the term "Agreed Allocation" is used).

"Agreed Value" of any Contributed Property means the fair market value of such property or other consideration at the time of contribution as determined by the Board using such reasonable method of valuation as it may adopt; provided, however, that the Agreed Value of any property deemed contributed to the Company for federal income tax purposes upon termination and reconstitution thereof pursuant to Section 708 of the Code (whether before or after finalization of Proposed Treasury Regulations Section 1.708 -1(b)(1)(iv)) shall be determined in accordance with Section 5.5(c)(i) . Subject to Section 5.5(c)(i), the Board shall, in its discretion, use such method as it deems reasonable and appropriate to allocate the aggregate Agreed Value of Contributed Properties contributed to the Company in a single or integrated transaction among each separate property on a basis proportional to the fair market value of each Contributed Property.

"Agreement" means this Third Amended and Restated Operating Agreement of U.S. Timberlands Klamath Falls, LLC, as it may be amended, supplemented or restated from time to time. This Agreement shall constitute a "limited liability company agreement" as such term is defined in the Delaware Limited Liability Company Act.

"Associate" means, when used to indicate a relationship with any Person, (a) any corporation or organization of which such Person is a director, officer or partner or is, directly or indirectly, the owner of 20% or more of any class of voting stock or other voting interest; (b) any trust or other estate in which such Person has at least a 20% beneficial interest or as to which such Person serves as trustee or in a similar fiduciary capacity; and (c) any relative or spouse of such Person, or any relative of such spouse, who has the same principal residence as such Person.

"Available Cash" means, with respect to any Quarter ending prior to the Liquidation Date,

### EXHIBIT 3.3

(a) the sum of (i) all cash and cash equivalents of the Company Group on hand at the end of such Quarter and (ii) all additional cash and cash equivalents of the Company Group on hand on the date of determination of Available Cash with respect to such Quarter resulting from borrowings for working capital purposes made subsequent to the end of such Quarter, less

(b) the amount of any cash reserves that is necessary or appropriate in the reasonable discretion of the Board to (i) provide for the proper conduct of the business of the Company Group (including reserves for future capital expenditures and for anticipated future credit needs of the Company Group) subsequent to such Quarter, (ii) comply with applicable law or any loan agreement, security agreement, mortgage, debt instrument or other agreement or obligation to which any Group Member is a party or by which it is bound or its assets are subject, or (iii) provide funds for distributions under Section 6.3 in respect of any one or more of the next four Quarters; provided, however, that disbursements made by a Group Member or cash reserves established, increased or reduced after the end of such Quarter but on or before the date of determination of Available Cash with respect to such Quarter shall be deemed to have been made, established, increased or reduced, for purposes of determining Available Cash, within such Quarter if the Board so determines.

Notwithstanding the foregoing, "Available Cash" with respect to the Quarter in which the Liquidation Date occurs and any subsequent Quarter shall equal zero.

"Bankruptcy" means, with respect to any Person, if such Person (i) makes an assignment for the benefit of creditors, (ii) files a voluntary petition in bankruptcy, (iii) is adjudged a bankrupt or insolvent, or has entered against it an order for relief, in any bankruptcy or insolvency proceedings, (iv) files a petition or answer seeking for itself any reorganization, arrangement, composition, readjustment, liquidation or similar relief under any statute, law or regulation, (v) files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against it in any proceeding of this nature, (iv) seeks, consents to or acquiesces in the appointment of a trustee, receiver or liquidator of the Person or of all or any substantial part of its properties, or (vii) if 120 days after the commencement of any proceeding against the Person seeking reorganization, arrangement, composition, readjustment, liquidation or similar relief under any statute, law or regulation, if the proceeding has not been dismissed, or if within 90 days after the appointment without such Person's consent or acquiescence of a trustee, receiver or liquidator of such Person or of all or any substantial part of its properties, the appointment is not vacated or stayed, or within 90 days after the expiration of any such stay, the appointment is not vacated. The foregoing definition of "Bankruptcy" is intended to replace and shall supersede and replace the definition of "Bankruptcy" set forth in Sections 18-101(I) and 18-304 of the Delaware Limited Liability Company Act.

"Basic Documents" means this Agreement, the Klamath Servicing Agreement and all documents and certificates contemplated thereby, related thereto or delivered in connection therewith.

### EXHIBIT 3.3

"Board" or "Board of Directors" means the Board of Directors of the Company; provided, however, that except where, pursuant to the provisions of Section 7.10, determinations of the Board require the participation of the Independent Directors, and except as the context otherwise requires, references herein to the Board or Board of Directors (or to the makeup of or action by the Board) shall be deemed to exclude reference to the Independent Directors. For the avoidance of doubt, "Board" or "Board of Directors" shall include both the Regular Directors and the Independent Directors for purposes of the making of determinations of the Board pursuant to Sections 7.10(b) and 7.10(c) .

"Book-Tax Disparity" means with respect to any item of Contributed Property or Adjusted Property, as of the date of any determination, the difference between the Carrying Value of such Contributed Property or Adjusted Property and the adjusted basis thereof for federal income tax purposes as of such date. A Member's share of the Company's Book-Tax Disparities in all of its Contributed Property and Adjusted Property will be reflected by the difference between such Member's Capital Account balance as maintained pursuant to Section 5.5 and the hypothetical balance of such Member's Capital Account computed as if it had been maintained strictly in accordance with federal income tax accounting principles.

"Business Day" means Monday through Friday of each week, except that a legal holiday recognized as such by the government of the United States of America or the states of New York or Washington shall not be regarded as a Business Day.

"Capital Account" means the capital account maintained for a Member pursuant to Section 5.5. The "Capital Account" of a Member in respect of a Membership Interest shall be the amount that such Capital Account would be if such Membership Interest were the only interest in the Company held by a Member from and after the date on which such Membership Interest was first issued.

"Capital Contribution" means any cash, cash equivalents or the Net Agreed Value of Contributed Property that a Member contributes to the Company pursuant to this Agreement.

"Carrying Value" means (a) with respect to a Contributed Property, the Agreed Value of such property reduced (but not below zero) by all depreciation, amortization and cost recovery deductions charged to the Members' Capital Accounts in respect of such Contributed Property and (b) with respect to any other Company property, the adjusted basis of such property for federal income tax purposes, all as of the time of determination. The Carrying Value of any property shall be adjusted from time to time in accordance with Sections 5.5(c)(i) and 5.5(c)(ii) and to reflect changes, additions or other adjustments to the Carrying Value for dispositions and acquisitions of Company properties, as deemed appropriate by the Board.

"Certificate of Formation" means the Certificate of Formation of the Company filed with the Secretary of State of the State of Delaware as referenced in Section 2.1, as

### EXHIBIT 3.3

such Certificate of Formation may be amended, supplemented or restated from time to time.

"Code" means the Internal Revenue Code of 1986, as amended and in effect from time to time. Any reference herein to a specific section or sections of the Code shall be deemed to include a reference to any corresponding provision of a successor law.

"Commission" means the United States Securities and Exchange Commission.

"Company" has the meaning set forth in the recitals hereto.

"Company Group" means the Company and any Subsidiary of the Company, treated as a single consolidated entity.

"Contribution Agreement" has the meaning set forth in the recitals hereto.

"Contributed Property" means each property or other asset, in such form as may be permitted by the Delaware Limited Liability Company Act, but excluding cash, contributed to the Company (or deemed contributed to the Company on termination and reconstitution thereof pursuant to Section 708 of the Code, whether before or after finalization of Proposed Treasury Regulations Section 1.708 -1(b)(1)(iv)). Once the Carrying Value of a Contributed Property is adjusted pursuant to Section 5.5(c), such property shall no longer constitute a Contributed Property, but shall be deemed an Adjusted Property.

"Covered Persons" has the meaning set forth in Section 3.4(a) .

"Curative Allocation" means any allocation of an item of income, gain, deduction, loss or credit pursuant to the provisions of Section 6.1.3.9.

"Delaware Limited Liability Company Act" means the Delaware Limited Liability Company Act, 6 Del. C. §§18-101 et seq., as amended, supplemented or restated from time to time, and any successor to such statute.

"Directors" means the Persons elected to the Board of Directors from time to time by the Members, in their capacity as managers of the Company. The Directors shall consist of "Regular Directors" and "Independent Directors" as provided in Sections 7.1(a) and 7.11. A Director is hereby designated as a "manager" of the Company within the meaning of Section 18-101(10) of the Delaware Limited Liability Company Act.

"Economic Risk of Loss" has the meaning set forth in Treasury Regulations Section 1.752 -2(a).

"Effective Date" has the meaning set forth in the recitals hereto.

"Group Member" means a member of the Company Group.

"Holdings" has the meaning set forth in the recitals hereto.

"Indenture" has the meaning set forth in the recitals hereto.

"Independent Director" means a natural person who (i) is not a member (whether direct, indirect or beneficial), customer or supplier of the Company or any of its Affiliates; (ii) is not a director, officer, employee, Affiliate or Associate of MLP or any of its Affiliates (other than the Company); (iii) is not a Person related to any Person referred to in clauses (i) or (ii); (iv) is not a trustee, conservator or receiver for any Affiliates of MLP; and (v) has, (A) prior experience as an independent director for a corporation or limited liability company whose charter documents required the unanimous consent of all independent directors thereof before such corporation or limited liability company could consent to the institution of bankruptcy or insolvency proceedings against it or could file a petition seeking relief under any applicable federal or state law relating to bankruptcy and (B) at least three years of employment experience with one or more entities (other than the Company or any of its Affiliates) that provide, in the ordinary course of their respective businesses, advisory, management or placement services to issuers of securitization or structured finance instruments, agreements or securities.

"Insurance Agreement" means that certain Insurance and Reimbursement Agreement between Yakima, MBIA and the Trustee, dated as of September 14, 2001, as it may be amended, supplemented or restated from time to time.

"Issuer Pledge Agreement" means that certain Issuer Pledge Agreement, dated as of the date hereof, executed and delivered by Yakima in favor of the Trustee, as it may be amended, supplemented or restated from time to time.

"Klamath Falls Indenture" has the meaning set forth in Section 2.4(a)(ii) .

"Klamath Holdings" has the meaning set forth in the recitals hereto.

"Klamath Servicing Agreement" means that certain management agreement dated as of the date hereof between the Company and Services, as it may be amended, supplemented or restated from time to time.

"Liquidation Date" means (a) in the case of an event giving rise to the dissolution of the Company of the type described in clause (a)(i) of Section 12.1, the date on which the applicable time period during which the personal representative of the last remaining Voting Interest Member has the right to elect to reconstitute the Company and continue its business has expired without such an election being made and (b) in the case of any other event giving rise to the dissolution of the Company, the date on which such event occurs.

"Liquidator" means one or more Persons selected by the Board to perform the functions described in Section 12.3 as liquidating trustee of the Company within the meaning of the Delaware Limited Liability Company Act.

"Majority" means, with respect to Voting Interest Members, Members holding, in the aggregate, more than 50% of the Voting Percentage Interests.

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"Management Agreement" means the management agreement between the Company and each Director substantially in the form attached hereto as Exhibit A.

"Material Action" means to consolidate or merge the Company with or into any Person, or sell all or substantially all of the assets of the Company, or to institute proceedings to have the Company be adjudicated bankrupt or insolvent, or consent to the institution of bankruptcy or insolvency proceedings against the Company or file a petition seeking, or consent to, reorganization or relief with respect to the Company under any applicable federal or state law relating to bankruptcy, or consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the Company or a substantial part of its property, or make any assignment for the benefit of creditors of the Company, or admit in writing the Company's inability to pay its debts generally as they become due, or take action in furtherance of any such action, or, to the fullest extent permitted by law, dissolve or liquidate the Company.

"MBIA" has the meaning set forth in the recitals hereto.

"Member" means Klamath Holdings and Services and any Person admitted as an Additional Member of the Company or a Substituted Member of the Company pursuant to the provisions of this Agreement, each in its capacity as a member of the Company, so long as they remain members; provided, however, the term "Member" shall not include the Special Members.

"Membership Interest" means the ownership interest of a Member in the Company.

"Merger Agreement" has the meaning assigned to such term in Section 14.1.

"MLP" has the meaning set forth in the recitals hereto.

"Net Agreed Value" means, (a) in the case of any Contributed Property, the Agreed Value of such property reduced by any liabilities either assumed by the Company upon such contribution or to which such property is subject when contributed and (b) in the case of any property distributed to a Member by the Company, the Company's Carrying Value of such property (as adjusted pursuant to Section 5.5(c)(ii)) at the time such property is distributed, reduced by any indebtedness either assumed by such Member upon such distribution or to which such property is subject at the time of distribution, in either case, as determined under Section 752 of the Code.

"Net Income" means, for any taxable year, the excess, if any, of the Company's items of income and gain (other than those items taken into account in the computation of Net Termination Gain or Net Termination Loss) for such taxable year over the Company's items of loss and deduction (other than those items taken into account in the computation of Net Termination Gain or Net Termination Loss) for such taxable year. The items included in the calculation of Net Income shall be determined in accordance with Section 5.5(b) and shall not include any items specially allocated under Section 6.1.3.

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"Net Loss" means, for any taxable year, the excess, if any, of the Company's items of loss and deduction (other than those items taken into account in the computation of Net Termination Gain or Net Termination Loss) for such taxable year over the Company's items of income and gain (other than those items taken into account in the computation of Net Termination Gain or Net Termination Loss) for such taxable year. The items included in the calculation of Net Loss shall be determined in accordance with Section 5.5(b) and shall not include any items specially allocated under Section 6.1.3.

"Net Termination Gain" means, for any taxable year, the sum, if positive, of all items of income, gain, loss or deduction recognized by the Company after the Liquidation Date. The items included in the determination of Net Termination Gain shall be determined in accordance with Section 5.5(b) and shall not include any items of income, gain or loss specially allocated under Section 6.1.3.

"Net Termination Loss" means, for any taxable year, the sum, if negative, of all items of income, gain, loss or deduction recognized by the Company after the Liquidation Date. The items included in the determination of Net Termination Loss shall be determined in accordance with Section 5.5(b) and shall not include any items of income, gain or loss specially allocated under Section 6.1.3.

"Non-Voting Interest" means that Membership Interest owned by a Non-Voting Interest Member, including, without limitation, such Non-Voting Interest Member's rights to Net Income, Net Loss and distributions of Available Cash.

"Non-Voting Interest Member" means, initially, Services and thereafter any Member who owns a Non-Voting Interest in the Company.

"Nonrecourse Built-in Gain" means with respect to any Contributed Properties or Adjusted Properties that are subject to a mortgage or pledge securing a Nonrecourse Liability, the amount of any taxable gain that would be allocated to the Members pursuant to Sections 6.2(b)(i)(A), 6.2(b)(ii)(A) and 6.2(b)(iii) if such properties were disposed of in a taxable transaction in full satisfaction of such liabilities and for no other consideration.

"Nonrecourse Deductions" means any and all items of loss, deduction or expenditures (described in Section 705(a)(2)(B) of the Code) that, in accordance with the principles of Treasury Regulations Section 1.704 -2(b), are attributable to a Nonrecourse Liability.

"Nonrecourse Liability" has the meaning set forth in Treasury Regulations Section 1.752 -1(a)(2).

"Notes" has the meaning set forth in the Indenture.

"Obligations" shall mean the indebtedness, liabilities and obligations of Yakima under or in connection with the Related Yakima Documents as in effect as of any date of determination.

### EXHIBIT 3.3

"Officer" means an officer of the Company described in Section 11.

"Officer's Certificate" means a certificate signed by any Officer of the Company who is authorized to act for the Company in matters relating to the Company.

"Partner Nonrecourse Debt" has the meaning set forth in Treasury Regulations Section 1.704 -2(b)(4).

"Partner Nonrecourse Debt Minimum Gain" has the meaning set forth in Treasury Regulations Section 1.704 -2(i)(2).

"Partner Nonrecourse Deductions" means any and all items of loss, deduction or expenditure (including, without limitation, any expenditure described in Section 705(a)(2)(B) of the Code) that, in accordance with the principles of Treasury Regulations Section 1.704 -2(i), are attributable to a Partner Nonrecourse Debt.

"Partnership Minimum Gain" means that amount determined in accordance with the principles of Treasury Regulations Section 1.704 -2(d).

"Percentage Interest" means, with respect to each Member, such Member's share of the profits and losses of the Company and such Member's percentage right to receive distributions of the Company's assets, in each case, that are allocated or distributed to Members pursuant to the terms of this Agreement. Initially, Klamath Holdings has a 98.9899% Percentage Interest and Services has a 1.0101% Percentage Interest.

"Person" means an individual or a corporation, limited liability company, partnership, joint venture, trust, unincorporated organization, association, government agency or political subdivision thereof or other entity.

"Privatization" has the meaning set forth in the recitals hereto.

"Quarter" means, unless the context requires otherwise, a fiscal quarter of the Company.

"Rating Agency" has the meaning assigned to that term in the Indenture.

"Rating Agency Condition" means, with respect to any action, that each Rating Agency shall have been given ten days prior notice thereof and that each of the Rating Agencies shall have notified Yakima in writing that such action will not result in a reduction or withdrawal of the then current rating by such Rating Agency of any of the Notes.

"Recapture Income" means any gain recognized by the Company (computed without regard to any adjustment required by Section 734 or 743 of the Code) upon the disposition of any property or asset of the Company, which gain is characterized as ordinary income because it represents the recapture of deductions previously taken with respect to such property or asset.

### EXHIBIT 3.3

"Related Yakima Documents" means the Indenture, any and all supplements thereto and any and all notes issued thereunder, the Insurance Agreement, the Yakima Holdings Pledge Agreement and the Issuer Pledge Agreement.

"Required Allocations" means any allocation of an item of income, gain, loss or deduction pursuant to Section 6.1.3.1, 6.1.3.2, 6.1.3.4, 6.1.3.7 or 6.1.3.9.

"Residual Gain" or "Residual Loss" means any item of gain or loss, as the case may be, of the Company recognized for federal income tax purposes resulting from a sale, exchange or other disposition of a Contributed Property or Adjusted Property, to the extent such item of gain or loss is not allocated pursuant to Section 6.2(b)(i)(A) or 6.2(b)(ii)(A), respectively, to eliminate Book-Tax Disparities.

"Rudey Timber" has the meaning set forth in the recitals hereto.

"Services" has the meaning set forth in the recitals hereto.

"Special Member" means a Person serving as an Independent Director who is admitted to the Company as a member of the Company pursuant to Section 10.1. A Special Member shall only have the rights and duties expressly set forth in this Agreement.

"Subsidiary" means, with respect to any Person, (a) a corporation of which more than 50% of the voting power of shares entitled (without regard to the occurrence of any contingency) to vote in the election of directors or other governing body of such corporation is owned, directly or indirectly, at the date of determination, by such Person, by one or more Subsidiaries of such Person or a combination thereof, (b) a partnership (whether general or limited) in which such Person or a Subsidiary of such Person is, at the date of determination, a general or limited partner of such partnership, but only if more than 50% of the partnership interests of such partnership (considering all of the partnership interests of the partnership as a single class) is owned, directly or indirectly, at the date of determination, by such Person, by one or more Subsidiaries of such Person, or a combination thereof, or (c) any other Person (other than a corporation or a partnership) in which such Person, one or more Subsidiaries of such Person, or a combination thereof, directly or indirectly, at the date of determination, has (i) at least a majority ownership interest or (ii) the power to elect or direct the election of a majority of the directors or other governing body of such Person.

"Substituted Member" means a Person who is admitted as a Member of the Company pursuant to Section 4.2, subject to Section 10.2.

"Surviving Business Entity" has the meaning assigned to such term in Section 14.2(b).

"Tax Distributions" means distributions to the Members in amounts as will enable the Members to make payment of federal and state income taxes (including quarterly estimates therefor) which may become due or payable with respect to each fiscal period or part thereof.

## EXHIBIT 3.3

"Transfer" has the meaning assigned to such term in Section 4.1(a) .

"Trustee" has the meaning set forth in the recitals hereto.

"Unrealized Gain" attributable to any item of Company property means, as of any date of determination, the excess, if any, of (a) the fair market value of such property as of such date (as determined under Section 5.5(c)) over (b) the Carrying Value of such property as of such date (prior to any adjustment to be made pursuant to Section 5.5(c) as of such date).

"Unrealized Loss" attributable to any item of Company property means, as of any date of determination, the excess, if any, of (a) the Carrying Value of such property as of such date (prior to any adjustment to be made pursuant to Section 5.5(c) as of such date) over (b) the fair market value of such property as of such date (as determined under Section 5.5(c)) .

"U.S. GAAP" means United States Generally Accepted Accounting Principles consistently applied.

"UST Finance Corp." means U.S. Timberlands Finance Corp., a Delaware corporation.

"Voting Interest" means that Membership Interest owned by a Voting Interest Member, including, without limitation, such Voting Interest Member' s rights to Net Income, Net Loss and distributions of Available Cash.

"Voting Interest Member" means, initially, Klamath Holdings and thereafter any Member who owns a Voting Interest in the Company.

"Voting Percentage Interest" means, with respect to each Voting Interest Member, such Member' s right to vote with respect to any matter to be determined by the Voting Interest Members in accordance with the terms of this Agreement. Initially, Klamath Holdings has a 100% Voting Percentage Interest.

"Yakima Holdings" has the meaning set forth in the recitals hereto.

"Yakima Holdings II" has the meaning set forth in the recitals hereto.

"Yakima Holdings Pledge Agreement" means that certain Yakima Holdings Pledge Agreement, dated as of September 14, 2001, executed and delivered by Yakima Holdings in favor of the Trustee, as it may be amended, supplemented or restated from time to time.

### 1.2 Construction

Unless the context requires otherwise: (a) any pronoun used in this Agreement shall include the corresponding masculine, feminine or neuter forms, and the singular form of nouns, pronouns and verbs shall include the plural and vice versa; (b) references

to Articles and Sections refer to Articles and Sections of this Agreement; and (c) "include" or "includes" means includes, without limitation, and "including" means including, without limitation.

## **ARTICLE II ORGANIZATION**

### **2.1 Formation**

The Company filed a Certificate of Formation with the Secretary of State of the State of Delaware on August 7, 1996. The rights, duties, liabilities and obligations of the Members and the administration, dissolution and termination of the Company shall be governed by this Agreement and the Delaware Limited Liability Company Act. All Membership Interests shall constitute personal property of the owner thereof for all purposes, and a Member has no interest in specific Company property.

### **2.2 Name**

The name of the Company shall be "U.S. Timberlands Klamath Falls, L.L.C." The Company's business may be conducted under any other name or names deemed necessary or appropriate by the Board in its sole discretion. The words "Limited Liability Company," "L.L.C." or "LLC" shall be included in the Company's name where necessary for the purpose of complying with the laws of any jurisdiction that so requires. Subject to the restrictions set forth in the Indenture, the Board in its discretion may change the name of the Company at any time and from time to time and shall notify the Members of such change in the next regular communication to the Members.

### **2.3 Registered Office; Registered Agent; Principal Office; Other Offices**

Unless and until changed by the Board, the registered office of the Company in the State of Delaware shall be located at 1209 Orange Street, New Castle County, Wilmington, Delaware 19801, and the registered agent for service of process on the Company in the State of Delaware at such registered office shall be the Corporation Trust Company. The principal office of the Company shall be located at 6400 Highway 66, Klamath Falls, Oregon 97601, or such other place as the Board may from time to time designate by notice to the Members. The Company may maintain offices at such other place or places within or outside the State of Delaware as the Board deems necessary or appropriate. The address of the Board shall be 625 Madison Ave., Suite 10-B, New York, New York 10022, or such other place as the Board may from time to time designate by notice to the Members.

**2.4 Purpose and Business** (a) The purpose and nature of the business to be conducted by the Company shall be to:

## EXHIBIT 3.3

(i) own, hold title to, manage, service, acquire, dispose of and operate (or arrange for an agent to manage, service and/or operate) the timber properties of the Company;

(ii) enter into, perform and comply with the Basic Documents and that certain Indenture, dated November 19, 1997, by and among the Company, U.S. Timberlands Finance Corp., a Delaware corporation ("UST Finance Corp."), and State Street Bank and Trust Company, as Trustee, as amended to date (the "Klamath Falls Indenture");

(iii) own equity interests in UST Finance Corp. and other entities whose purposes are restricted to those of the type set forth in clause (i) above; and

(iv) engage in any lawful act or activity and exercise any powers permitted to limited liability companies organized under the laws of the State of Delaware that are related or incidental to and necessary, convenient or advisable for the accomplishment of the above-mentioned purposes and that are not prohibited by the Basic Documents and the Related Yakima Documents (including the entering into of debt financing arrangements not prohibited by the Basic Documents and the Related Yakima Documents, interest rate or basis swap, cap, floor or collar agreements, currency exchange agreements or similar hedging transactions and referral, management, servicing and administration agreements).

(b) The Company, by or through any Director or Officer on behalf of the Company, may enter into and perform the Basic Documents, the Klamath Falls Indenture and all documents, agreements, certificates, or financing statements contemplated thereby or related thereto, all without any further act, vote or approval of any other Person notwithstanding any other provision of this Agreement, the Delaware Limited Liability Company Act or applicable law, rule or regulation. The foregoing authorization shall not be deemed a restriction on the powers of any Director or Officer to enter into other agreements on behalf of the Company.

### 2.5 Powers

Subject to the limitations set forth in Section 7.10, the Company, and the Directors and Officers on its behalf, shall be empowered to do any and all acts and things necessary, appropriate, proper, advisable, incidental to or convenient for the furtherance and accomplishment of the purposes and business described in Section 2.4 and for the protection and benefit of the Company.

### 2.6 Term

The term of the Company commenced upon the filing of the Certificate of Formation in accordance with the Delaware Limited Liability Company Act and shall be perpetual unless earlier terminated and dissolved in accordance with the provisions of Article XII. The existence of the Company as a separate legal entity shall continue until

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the cancellation of the Certificate of Formation as provided in the Delaware Limited Liability Company Act.

### **2.7 Title to Company Assets**

Title to Company assets, whether real, personal or mixed and whether tangible or intangible, shall be deemed to be owned by the Company as an entity, and no Member, individually or collectively, shall have any ownership interest in such Company assets or any portion thereof. All Company assets shall be recorded as the property of the Company in its books and records, irrespective of the name in which record title to such Company assets is held.

## **ARTICLE III RIGHTS OF MEMBERS**

### **3.1 Limitation of Liability**

Except as otherwise expressly provided by the Delaware Limited Liability Company Act, the debts, obligations and liabilities of the Company, whether arising in contract, tort or otherwise, shall be the debts, obligations and liabilities solely of the Company, and none of the Members, the Special Members, any Director or any Officer shall be obligated personally for any such debt, obligation or liability of the Company solely by reason of being a Member, Special Member, Director or Officer of the Company.

### **3.2 Outside Activities of the Members**

Any Member, Special Member or any Affiliate of the foregoing shall be entitled to and may have business interests and engage in business activities in addition to those relating to the Company, including business interests and activities in direct competition with the Company Group. None of the Company, any Member, Special Member or any Affiliate of the foregoing shall have any rights by virtue of this Agreement in any business ventures of any Member.

### **3.3 Rights of Members**

(a) In addition to other rights provided by this Agreement or by applicable

law, and except as limited by Section 3.3(b), each Member shall have the right, for a purpose reasonably related to such Member's interest as a member in the Company, upon reasonable written demand and at such Member's own expense:

(i) to obtain true and full information regarding the status of the business and financial condition of the Company;

(ii) promptly after their becoming available, to obtain a copy of the Company's federal, state and local income tax returns for each year;

## EXHIBIT 3.3

(iii) to have furnished to it a current list of the name and last known business, residence or mailing address of each Member;

(iv) to have furnished to it a copy of this Agreement and the Certificate of Formation and all amendments thereto;

(v) to obtain true and full information regarding the amount of cash and a description and statement of the Net Agreed Value of any other Capital Contribution by each Member and which each Member has agreed to contribute in the future, and the date on which each became a Member; and

(vi) to obtain such other information regarding the affairs of the Company as is just and reasonable.

(b) The Board may keep confidential from the Members, for such period of time as the Board deems reasonable, (i) any information that the Board reasonably believes to be in the nature of trade secrets or (ii) other information the disclosure of which the Board in good faith believes (A) is not in the best interests of the Company Group, (B) could damage the Company Group, or (C) any Group Member is required by law or by agreement with any third party to keep confidential (other than agreements with Affiliates of the Company the primary purpose of which is to circumvent the obligations set forth in this Section 3.3) .

### 3.4 Indemnification

(a) No Member, Special Member, Officer, Director, employee or agent of the

Company nor any employee, representative, agent or Affiliate of any Member or Special Member (collectively, the "Covered Persons") shall be liable to the Company or any other Person who has an interest in or claim against the Company for any loss, damage or claim incurred by reason of any act or omission performed or omitted by such Covered Person in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of the authority conferred on such Covered Person by this Agreement, except that a Covered Person shall be liable for any such loss, damage or claim incurred by reason of such Covered Person's gross negligence or willful misconduct.

(b) To the fullest extent permitted by applicable law, a Covered Person shall be entitled to indemnification from the Company for any loss, damage or claim incurred by such Covered Person by reason of any act or omission performed or omitted by such Covered Person in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of the authority conferred on such Covered Person by this Agreement, except that no Covered Person shall be entitled to be indemnified in respect of any loss, damage or claim incurred by such Covered Person by reason of such Covered Person's gross negligence or willful misconduct with respect to such acts or omissions; provided, however, that any indemnity under this Section 3.4 by the Company shall be provided out of and to the extent of Company assets only, and the Members and the Special Members shall not have personal liability on account thereof, and provided further, that so long as any Obligation is outstanding, no indemnity payment from funds

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of the Company (as distinct from funds from other sources, such as insurance) of any indemnity under this Section 3.4 shall be payable from amounts allocable to any other Person pursuant to the Basic Documents.

(c) To the fullest extent permitted by applicable law, expenses (including legal fees) incurred by a Covered Person defending any claim, demand, action, suit or proceeding shall, from time to time, be advanced by the Company prior to the final disposition of such claim, demand, action, suit or proceeding upon receipt by the Company of an undertaking by or on behalf of the Covered Person to repay such amount if it shall be determined by a court of competent jurisdiction that the Covered Person is not entitled to be indemnified as authorized in this Section 3.4.

(d) A Covered Person shall be fully protected in relying in good faith upon the records of the Company and upon such information, opinions, reports or statements presented to the Company by any Person as to matters the Covered Person reasonably believes are within such other Person's professional or expert competence and who has been selected with reasonable care by or on behalf of the Company, including information, opinions, reports or statements as to the value and amount of the assets, liabilities, or any other facts pertinent to the existence and amount of assets from which distributions to the Member might properly be paid.

(e) To the extent that, at law or in equity, a Covered Person has duties (including fiduciary duties) and liabilities relating thereto to the Company or to any other Covered Person, a Covered Person acting under this Agreement shall not be liable to the Company or to any other Covered Person for its good faith reliance on the provisions of this Agreement or any approval or authorization granted by the Company or any other Covered Person. The provisions of this Agreement, to the extent that they restrict the duties and liabilities of a Covered Person otherwise existing at law or in equity, are agreed by the Members and the Special Members to replace such other duties and liabilities of such Covered Person.

(f) The foregoing provisions of this Section 3.4 shall survive any termination of this Agreement.

### 3.5 Voting

Each Voting Interest Member shall be entitled to the number of votes equal to its Voting Percentage Interest on any matter requiring the approval of the Members, whether pursuant to this Agreement or the Delaware Limited Liability Company Act. Except as provided in Article XIII, the Non-Voting Interest Members shall not be entitled to vote or consent on any matter requiring the approval of the Members, whether pursuant to this Agreement or the Delaware Limited Liability Company Act.

## **ARTICLE IV TRANSFERS OF INTERESTS**

### **4.1 Transfer Generally**

(a) The term "transfer," when used in this Agreement with respect to a

Membership Interest, shall be deemed to refer to a transaction by which the holder of a Membership Interest assigns such Membership Interest to another Person who is or becomes a Member, and includes a sale, assignment, gift, pledge, encumbrance, hypothecation, mortgage, exchange or any other disposition by law or otherwise.

(b) No Membership Interest shall be transferred, in whole or in part, except in accordance with the terms and conditions set forth in this Article IV. Any transfer or purported transfer of a Membership Interest not made in accordance with this Article IV shall be null and void.

### **4.2 Transfer of Membership Interest**

Subject to Section 10.2, any Member may assign in whole or in part its Membership Interest in the Company. If a Member transfers all or part of its

Membership Interest in the Company pursuant to this Section 4.2, the transferee shall be admitted to the Company as a Substituted Member of the Company with respect to such transferred Membership Interest upon its execution of an instrument signifying its agreement to be bound by the terms and conditions of this Agreement, which instrument may be a counterpart signature page to this Agreement. Such admission shall be deemed effective immediately prior to the transfer and, immediately following such admission, the transferor Member shall cease to be a Member of the Company. Notwithstanding anything in this Agreement to the contrary, any successor to the Member by merger or consolidation in compliance with the Basic Documents shall, without further act, be a Member hereunder, and such merger or consolidation shall not constitute an assignment for purposes of this Agreement and the Company shall continue without dissolution.

### **4.3 Restrictions on Transfers**

(a) Notwithstanding Section 4.2 and subject to Section 4.3(c), no transfer of

any Membership Interest shall be made if such transfer would (i) violate the then applicable federal or state securities laws or rules and regulations of the Commission, any state securities commission or any other governmental authority with jurisdiction over such transfer, (ii) terminate the existence or qualification of the Company or any Member under the laws of the jurisdiction of its formation, (iii) violate any terms of any Basic Documents, or (iv) cause the Company or any Member to be treated as an association taxable as a corporation or otherwise to be taxed as an entity for federal income tax purposes (to the extent not already so treated or taxed).

(b) The Board may impose restrictions on the transfer of Membership Interests if a subsequent opinion of counsel determines that such restrictions are necessary to avoid a significant risk of the Company or any Member becoming taxable as a corporation or otherwise to be taxed as an entity for federal income tax purposes. The restrictions may be

imposed by making such amendments to this Agreement as the Board may determine to be necessary or appropriate to impose such restrictions.

**ARTICLE V****ADMISSION OF MEMBERS; CAPITAL****5.1 Classes of Interests**

The Company shall be authorized to issue two classes of Membership Interests, which classes shall be designated as Voting Interests and Non-Voting Interests.

**5.2 Capital Contributions**

(a) As described in the Prior Agreement, pursuant to the Contribution and

Conveyance Agreement (as defined in the Prior Agreement) (i) Services contributed to the Company, as a Capital Contribution, all of its timber operations in exchange for a Membership Interest and, immediately following such contribution, Services transferred all but a 1.0101% Membership Interest to MLP in exchange for certain interests therein as more particularly described in the Registration Statement (as defined in the Prior Agreement); (ii) Rudey Timber contributed to Holdings all of its Membership Interest in the Company in exchange for an additional member interest in Holdings; (iii) the Company assumed certain indebtedness of Holdings and, immediately following such assumption, Holdings contributed all of its Membership Interest to MLP in exchange for certain interests therein as more particularly described in the Registration Statement. Thereafter, MLP contributed to the Company all of the net proceeds from the sale of Common Units (as defined in the Prior Agreement) offered pursuant to the Registration Statement. Following the foregoing transactions, Services held a 1.0101% Membership Interest and MLP held a 98.9899% Membership Interest in the Company.

(b) In connection with the Privatization and pursuant to the Contribution Agreement, MLP contributed all of its Membership Interests in the Company to Yakima Holdings II, Yakima Holdings II contributed such Membership Interests to Yakima Holdings, Yakima Holdings contributed such Membership Interests to Yakima, and Yakima contributed such Membership Interests to Klamath Holdings. Accordingly, Klamath Holdings owns a 98.9899% Membership Interest in the Company (which is a Voting Interest) and Services owns a 1.0101% Membership Interest in the Company (which is a Non-Voting Interest).

**5.3 Additional Capital Contributions**

With the consent of the Board, any Member may, but shall not be obligated to, make additional Capital Contributions to the Company. The provisions of this Agreement, including this Section 5.3, are intended to benefit the Members and the Special Members and, to the fullest extent permitted by law, shall not be construed as conferring any benefit upon any creditor of the Company (and no such creditor of the Company shall be a third-party beneficiary to this Agreement) and the Members and the Special Members shall not have any duty or obligation to any creditor of the Company to make any contributions to the Company or to issue any call for capital pursuant to this Agreement.

## 5.4 Interest and Withdrawal

No interest shall be paid by the Company on Capital Contributions. No Member shall be entitled to the withdrawal or return of its Capital Contribution, except to the extent, if any, that distributions made pursuant to this Agreement or upon termination of the Company may be considered as such by law and then only to the extent provided for in this Agreement. Except to the extent expressly provided in this Agreement, no Member shall have priority over any other Member either as to the return of Capital Contributions or as to profits, losses or distributions.

## 5.5 Capital Accounts

(a) The Company shall maintain for each Member (or a beneficial owner of

Membership Interests held by a nominee in any case in which the nominee has furnished the identity of such owner to the Company in accordance with Section 6031(c) of the Code or any other method acceptable to the Board in its sole discretion) owning a Membership Interest a separate Capital Account with respect to such Membership Interest in accordance with the rules of Treasury Regulations Section 1.704 -1(b)(2)(iv). Such Capital Account shall be increased by (i) the amount of all Capital Contributions made to the Company with respect to such Membership Interest pursuant to this Agreement and (ii) all items of Company income and gain (including, without limitation, income and gain exempt from tax) computed in accordance with Section 5.5(b) and allocated with respect to such Membership Interest pursuant to Section 6.1, and decreased by (x) the amount of cash or Net Agreed Value of all actual and deemed distributions of cash or property made with respect to such Membership Interest pursuant to this Agreement and (y) all items of Membership deduction and loss computed in accordance with Section 5.5(b) and allocated with respect to such Membership Interest pursuant to Section 6.1.

(b) For purposes of computing the amount of any item of income, gain, loss or deduction that is to be allocated pursuant to Article VI and is to be reflected in the Members' Capital Accounts, the determination, recognition and classification of any such item shall be the same as its determination, recognition and classification for federal income tax purposes (including, without limitation, any method of depreciation, cost recovery or amortization used for that purpose), provided, that:

(i) Solely for purposes of this Section 5.5, the Company shall be treated as owning directly its proportionate share (as determined by the Board) of all property owned by any Subsidiary that is classified as a partnership for federal income tax purposes.

(ii) All fees and other expenses incurred by the Company to promote the sale of (or to sell) a Membership Interest that can neither be deducted nor amortized under Section 709 of the Code, if any, shall, for purposes of Capital Account maintenance, be treated as an item of deduction at the time such fees and other expenses are incurred and shall be allocated among the Members pursuant to Section 6.1.

(iii) Except as otherwise provided in Treasury Regulations Section 1.704 -1(b)(2)(iv)(m), computation of all items of income, gain, loss and deduction shall

### EXHIBIT 3.3

be made without regard to any election under Section 754 of the Code that may be made by the Company and, as to those items described in Section 705(a)(1)(B) or 705(a)(2)(B) of the Code, without regard to the fact that such items are not includible in gross income or are neither currently deductible nor capitalized for federal income tax purposes. To the extent an adjustment to the adjusted tax basis of any Company asset pursuant to Section 734(b) or 743(b) of the Code is required, pursuant to Treasury Regulations Section 1.704 -1(b)(2)(iv)(m), to be taken into account in determining Capital Accounts, the amount of such adjustment in the Capital Accounts shall be treated as an item of gain or loss.

(iv) Any income, gain or loss attributable to the taxable disposition of any Company property shall be determined as if the adjusted basis of such property as of such date of disposition was equal in amount to the Company's Carrying Value with respect to such property as of such date.

(v) In accordance with the requirements of Section 704(b) of the Code, any deductions for depreciation, cost recovery or amortization attributable to any Contributed Property shall be determined as if the adjusted basis of such property on the date it was acquired by the Company was equal to the Agreed Value of such property. Upon an adjustment pursuant to Section 5.5(c) to the Carrying Value of any Company property subject to depreciation, cost recovery or amortization, any further deductions for such depreciation, cost recovery or amortization attributable to such property shall be determined (A) as if the adjusted basis of such property were equal to the Carrying Value of such property immediately following such adjustment and (B) using a rate of depreciation, cost recovery or amortization derived from the same method and useful life (or, if applicable, the remaining useful life) as is applied for federal income tax purposes; provided, however, that, if the asset has a zero adjusted basis for federal income tax purposes, depreciation, cost recovery or amortization deductions shall be determined using any reasonable method that the Board may adopt.

(vi) If the Company's adjusted basis in a depreciable or cost recovery property is reduced for federal income tax purposes pursuant to Section 48(q)(1) or 48(q)(3) of the Code, the amount of such reduction shall, solely for purposes hereof, be deemed to be an additional depreciation or cost recovery deduction in the year such property is placed in service and shall be allocated among the Members pursuant to Section 6.1. Any restoration of such basis pursuant to Section 48(q)(2) of the Code shall, to the extent possible, be allocated in the same manner to the Members to whom such deemed deduction was allocated.

(vii) A transferee of a Membership Interest shall succeed to a pro rata portion of the Capital Account of the transferor relating to the Membership Interest so transferred.

(c)

(i) In accordance with Treasury Regulations Section 1.704 - 1(b)(2)(iv)(f), on an issuance of additional Membership Interests for cash or Contributed

Property, the Capital Account of all Members and the Carrying Value of each Company property immediately prior to such issuance shall be adjusted upward or downward to reflect any Unrealized Gain or Unrealized Loss attributable to such Company property, as if such Unrealized Gain or Unrealized Loss had been recognized on an actual sale of each such property immediately prior to such issuance and had been allocated to the Members at such time pursuant to Section 6.1 in the same manner as any item of gain or loss actually recognized during such period would have been allocated. In determining such Unrealized Gain or Unrealized Loss, the aggregate cash amount and fair market value of all Company assets (including, without limitation, cash or cash equivalents) immediately prior to the issuance of additional Membership Interests shall be determined by the Board using such reasonable method of valuation as it may adopt; provided, however, that the Board, in arriving at such valuation, must take fully into account the fair market value of the Membership Interests of all Members at such time. The Board shall allocate such aggregate value among the assets of the Company (in such manner as it determines in its discretion to be reasonable) to arrive at a fair market value for individual properties.

(ii) In accordance with Treasury Regulations Section 1.704 -1(b)(2)(iv)(f), immediately prior to any actual or deemed distribution to a Member of any Company property (other than a distribution of cash that is not in redemption or retirement of a Membership Interest), the Capital Accounts of all Members and the Carrying Value of all Company property shall be adjusted upward or downward to reflect any Unrealized Gain or Unrealized Loss attributable to such Company property, as if such Unrealized Gain or Unrealized Loss had been recognized in a sale of such property immediately prior to such distribution for an amount equal to its fair market value, and had been allocated to the Members at such time pursuant to Section 6.1 in the same manner as any item of gain or loss actually recognized during such period would have been allocated. In determining such Unrealized Gain or Unrealized Loss, the aggregate cash amount and fair market value of all Company assets (including, without limitation, cash or cash equivalents) immediately prior to a distribution shall (A) in the case of an actual distribution that is not made pursuant to Section 12.4 or in the case of a deemed contribution and/or distribution occurring as a result of a termination of the Company pursuant to Section 708 of the Code, be determined and allocated in the same manner as that provided in Section 5.5(c)(i) or (B) in the case of a liquidating distribution pursuant to Section 12.4, be determined and allocated by the Liquidator using such reasonable method of valuation as it may adopt.

## **5.6 Loans From Members**

Loans by a Member to the Company shall not constitute Capital Contributions. If any Member shall advance funds to the Company in excess of the amounts required hereunder to be contributed by it to the capital of the Company, the making of such excess advances shall not result in any increase in the amount of the Capital Account of such Member. The amount of any such excess advances shall be a debt obligation of the Company to such Member and shall be payable or collectible only out of the Company assets in accordance with the terms and conditions upon which such advances are made.

### **5.7 Limited Preemptive Rights**

No Person shall have preemptive, preferential or other similar rights with respect to (a) additional Capital Contributions; (b) the issuance or sale of any class or series of Membership Interests, whether unissued, held in the treasury or hereafter created; (c) the issuance of any obligations, evidences of indebtedness or other securities of the Company convertible into or exchangeable for, or carrying or accompanied by any rights to receive, purchase or subscribe to, any such Membership Interests; (d) the issuance of any right of subscription to or right to receive, or any warrant or option for the purchase of, any such Membership Interests; or (e) the issuance or sale of any other securities that may be issued or sold by the Company.

### **5.8 Fully Paid and Nonassessable Nature of Membership Interests**

All Membership Interests issued pursuant to, and in accordance with the requirements of, this Article V shall be fully paid and nonassessable Membership Interests, except as such nonassessability may be affected by Section 18-607 or Section 18-804 of the Delaware Limited Liability Company Act.

## **ARTICLE VI**

### **ALLOCATIONS AND DISTRIBUTIONS**

#### **6.1 Allocations for Capital Account Purposes**

For purposes of maintaining the Capital Accounts and in determining the rights of the Members among themselves, the Company's items of income, gain, loss and deduction (computed in accordance with Section 5.5(b)) shall be allocated among the Members in each taxable year (or portion thereof) as provided herein below.

##### **6.1.1 Net Income**

After giving effect to the special allocations set forth in Section 6.1.3, Net Income for each taxable year and all items of income, gain, loss and deduction taken into account in computing Net Income for such taxable period shall be allocated among the Members as follows:

(a) First, in accordance with their Percentage Interests until the cumulative amount of Net Income allocated to the Members pursuant to this Section 6.1.1(a) equals the cumulative amount of Net Losses allocated to the Members pursuant to Section 6.1.2(c);

(b) Second, in accordance with their Percentage Interests until the cumulative amount of Net Income allocated to the Members pursuant to this Section 6.1.1(b) equals the cumulative amount of Net Losses allocated to the Members pursuant to Section 6.1.2(b); and

(c) Thereafter, to the Members in accordance with their respective Percentage Interests.

### **6.1.2 Net Loss**

After giving effect to the special allocations set forth in Section 6.1.3, Net Loss for each taxable period and all items of income, gain, loss and deduction taken into account in computing Net Loss for such taxable period shall be allocated among the Members as follows:

(a) First, in accordance with their Percentage Interests until the cumulative amount of Net Losses allocated to the Members pursuant to this Section 6.1.2(a) equals the cumulative amount of Net Income allocated to the Members pursuant to Section 6.1.1(c);

(b) Second, in proportion to and to the extent necessary to cause each Member's Capital Account to equal zero; and

(c) Thereafter, among the Members in accordance with their respective Percentage Interests.

### **6.1.3 Special Allocations**

Notwithstanding any other provision of this Section 6.1, the following special allocations shall be made for such taxable period:

#### **6.1.3.1 Partnership Minimum Gain Chargeback**

Notwithstanding any other provision of this Section 6.1, if there is a net decrease in Partnership Minimum Gain during any Company taxable period, each Member shall be allocated items of Company income and gain for such period (and, if necessary, subsequent periods) in the manner and amounts provided in Treasury Regulations Sections 1.704 -2(f)(6), 1.704 -2(g)(2) and 1.704 -2(j)(2)(i), or any successor provision. For purposes of this Section 6.1.3, each Member's Adjusted Capital Account balance shall be determined, and the allocation of income or gain required hereunder shall be effected, prior to the application of any other allocations pursuant to this Section 6.1.3 with respect to such taxable period (other than an allocation pursuant to Sections 6.1.3.5 and 6.1.3.6) . This Section 6.1.3.1 is intended to comply with the Partnership Minimum Gain chargeback requirement in Treasury Regulations Section 1.704 -2(f) and shall be interpreted consistently therewith.

#### **6.1.3.2 Chargeback of Partner Nonrecourse Debt Minimum Gain**

Notwithstanding the other provisions of this Section 6.1 (other than Section 6.1.3.1), except as provided in Treasury Regulations Section 1.704 -2(i)(4), if there is a net decrease in Partner Nonrecourse Debt Minimum Gain during any Company taxable period, any Member with a share of Partner Nonrecourse Debt Minimum Gain at the beginning of such taxable period shall be allocated items of Company income and gain for such period (and, if necessary, subsequent periods) in the manner and amounts provided in Treasury Regulations Sections 1.704 -2(i)(4) and 1.704 -2(j)(2)(ii), or any successor provisions. For purposes of this Section 6.1.3, each Member's Adjusted Capital Account balance shall be determined, and the allocation of income or gain required hereunder shall be effected, prior to the application of any other allocations

pursuant to this Section 6.1.3, other than Section 6.1.3.1 and other than an allocation pursuant to Sections 6.1.3.5 and 6.1.3.6, with respect to such taxable period. This Section 6.1.3.2 is intended to comply with the chargeback of items of income and gain requirement in Treasury Regulations Section 1.704 -2(i)(4) and shall be interpreted consistently therewith.

### **6.1.3.3 Qualified Income Offset**

In the event any Member unexpectedly receives any adjustments, allocations or distributions described in Treasury Regulations Section 1.704 -1(b)(2)(ii)(d)(4), 1.704 -1(b)(2)(ii)(d)(5) or 1.704 -1(b)(2)(ii)(d)(6), items of Company income and gain shall be specially allocated to such Member in an amount and manner sufficient to eliminate, to the extent required by the Treasury Regulations promulgated under Section 704(b) of the Code, the deficit balance, if any, in its Adjusted Capital Account created by such adjustments, allocations or distributions as quickly as possible unless such deficit balance is otherwise eliminated pursuant to Section 6.1.3.1 or 6.1.3.2.

### **6.1.3.4 Gross Income Allocations**

In the event any Member has a deficit balance in its Capital Account at the end of any Company taxable period in excess of the sum of (A) the amount such Member is required to restore pursuant to the provisions of this Agreement and (B) the amount such Member is deemed obligated to restore pursuant to Treasury Regulations Sections 1.704 -2(g) and 1.704 -2(i)(5), such Member shall be specially allocated items of Company gross income and gain in the amount of such excess as quickly as possible; provided, however, that an allocation pursuant to this Section 6.1.3.4 shall be made only if and to the extent that such Member would have a deficit balance in its Capital Account as adjusted after all other allocations provided for in this Section 6.1 have been tentatively made as if this Section 6.1.3.4 were not in this Agreement.

### **6.1.3.5 Nonrecourse Deductions**

Nonrecourse Deductions for any taxable period shall be allocated to the Members in accordance with their respective Percentage Interests. If the Board determines in its good faith discretion that the Company's Nonrecourse Deductions must be allocated in a different ratio to satisfy the safe harbor requirements of the Treasury Regulations promulgated under Section 704(b) of the Code, the Board is authorized, upon notice to the Members, to revise the prescribed ratio to the numerically closest ratio that does satisfy such requirements.

### **6.1.3.6 Partner Nonrecourse Deductions**

Partner Nonrecourse Deductions for any taxable period shall be allocated 100% to the Member that bears the Economic Risk of Loss with respect to the Partner Nonrecourse Debt to which such Partner Nonrecourse Deductions are attributable in accordance with Treasury Regulations Section 1.704 -2(i). If more than one Member bears the Economic Risk of Loss with respect to a Partner Nonrecourse Debt, such Partner Nonrecourse Deductions attributable thereto shall be allocated between or among

such Members in accordance with the ratios in which they share such Economic Risk of Loss.

#### **6.1.3.7 Nonrecourse Liabilities**

For purposes of Treasury Regulations Section 1.752 -3(a)(3), the Members agree that Nonrecourse Liabilities of the Company in excess of the sum of (A) the amount of Partnership Minimum Gain and (B) the total amount of Nonrecourse Built-in Gain shall be allocated among the Members in accordance with their respective Percentage Interests.

#### **6.1.3.8 Code Section 754 Adjustments**

To the extent an adjustment to the adjusted tax basis of any Company asset pursuant to Section 734(b) or 743(c) of the Code is required, pursuant to Treasury Regulations Section 1.704 -1(b)(2)(iv)(m), to be taken into account in determining Capital Accounts, the amount of such adjustment to the Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases such basis), and such item of gain or loss shall be specially allocated to the Members in a manner consistent with the manner in which their Capital Accounts are required to be adjusted pursuant to such Section of the Treasury Regulations.

#### **6.1.3.9 Curative Allocation**

(a) Notwithstanding any other provision of this Section 6.1, other than the Required Allocations, the Required Allocations shall be taken into account in making the Agreed Allocations so that, to the extent possible, the net amount of items of income, gain, loss and deduction allocated to each Member pursuant to the Required Allocations and the Agreed Allocations, together, shall be equal to the net amount of such items that would have been allocated to each such Member under the Agreed Allocations had the Required Allocations and the related Curative Allocation not otherwise been provided in this Section 6.1. Notwithstanding the preceding sentence, Required Allocations relating to (1) Nonrecourse Deductions shall not be taken into account except to the extent that there has been a decrease in Partnership Minimum Gain and (2) Partner Nonrecourse Deductions shall not be taken into account except to the extent that there has been a decrease in Partner Nonrecourse Debt Minimum Gain. Allocations pursuant to this Section 6.1.3.9(a) shall only be made with respect to Required Allocations to the extent the Board reasonably determines that such allocations will otherwise be inconsistent with the economic agreement among the Members. Further, allocations pursuant to this Section 6.1.3.9(a) shall be deferred with respect to allocations pursuant to clauses (1) and (2) above to the extent the Board reasonably determines that such allocations are likely to be offset by subsequent Required Allocations.

(b) The Board shall have reasonable discretion, with respect to each taxable period, to (1) apply the provisions of Section 6.1.3.9(a) in whatever order is most likely to minimize the economic distortions that might otherwise result from the Required Allocations and (2) divide all allocations pursuant to Section 6.1.3.9(a) among the Members in a manner that is likely to minimize such economic distortions.

## 6.2 Allocations for Tax Purposes

(a) Except as otherwise provided herein, for federal income tax purposes,

each item of income, gain, loss and deduction shall be allocated among the Members in the same manner as its correlative item of "book" income, gain, loss or deduction is allocated pursuant to Section 6.1.

(b) In an attempt to eliminate Book-Tax Disparities attributable to a Contributed Property or Adjusted Property, items of income, gain, loss, depreciation, amortization and cost recovery deductions shall be allocated for federal income tax purposes among the Members as follows:

(i) (A) In the case of a Contributed Property, such items attributable thereto shall be allocated among the Members in the manner provided under Section 704(c) of the Code that takes into account the variation between the Agreed Value of such property and its adjusted basis at the time of contribution; and (B) any item of Residual Gain or Residual Loss attributable to a Contributed Property shall be allocated among the Members in the same manner as its correlative item of "book" gain or loss is allocated pursuant to Section 6.1.

(ii) (A) In the case of an Adjusted Property, such items shall (1) first, be allocated among the Members in a manner consistent with the principles of Section 704(c) of the Code to take into account the Unrealized Gain or Unrealized Loss attributable to such property and the allocations thereof pursuant to Section 5.5(c)(i) or 5.5(c)(ii), and (2) second, in the event such property was originally a Contributed Property, be allocated among the Members in a manner consistent with Section 6.2(b)(i)(A); and (B) any item of Residual Gain or Residual Loss attributable to an Adjusted Property shall be allocated among the Members in the same manner as its correlative item of "book" gain or loss is allocated pursuant to Section 6.1.

(iii) The Board shall apply the principles of Treasury Regulations Section 1.704 -3(d) to eliminate Book-Tax Disparities.

(c) For the proper administration of the Company and for the preservation of uniformity of the Membership Interests (or any class or classes thereof), the Board shall have sole discretion to (i) adopt such conventions as it deems appropriate in determining the amount of depreciation, amortization and cost recovery deductions; (ii) make special allocations for federal income tax purposes of income (including, without limitation, gross income) or deductions; and (iii) amend the provisions of this Agreement as appropriate (x) to reflect the proposal or promulgation of Treasury Regulations under Section 704(b) or Section 704(c) of the Code or (y) otherwise to preserve or achieve uniformity of the Membership Interests (or any class or classes thereof). The Board may adopt such conventions, make such allocations and make such amendments to this Agreement as provided in this Section 6.2(c) only if such conventions, allocations or amendments would not have a material adverse effect on the Members and if such allocations are consistent with the principles of Section 704 of the Code.

(d) The Board in its discretion may determine to depreciate or amortize the portion of an adjustment under Section 743(b) of the Code attributable to unrealized appreciation in any Adjusted Property (to the extent of the unamortized Book-Tax Disparity) using a predetermined rate derived from the depreciation or amortization method and useful life applied to the Company's common basis of such property, despite any inconsistency of such approach with Proposed Treasury Regulations Section 1.168 -2(n), Treasury Regulations Section 1.167(c) -l(a)(6) or the legislative history of Section 197 of the Code. If the Board determines that such reporting position cannot reasonably be taken, the Board may adopt depreciation and amortization conventions under which all purchasers acquiring Membership Interests in the same month would receive depreciation and amortization deductions, based on the same applicable rate as if they had purchased a direct interest in the Company's property. If the Board chooses not to utilize such aggregate method, the Board may use any other reasonable depreciation and amortization conventions to preserve the uniformity of the intrinsic tax characteristics of any Membership Interests that would not have a material adverse effect on the Members.

(e) Any gain allocated to the Members upon the sale or other taxable disposition of any Company asset shall, to the extent possible, after taking into account other required allocations of gain pursuant to this Section 6.2, be characterized as Recapture Income in the same proportions and to the same extent as such Members (or their predecessors in interest) have been allocated any deductions directly or indirectly giving rise to the treatment of such gains as Recapture Income.

(f) All items of income, gain, loss, deduction and credit recognized by the Company for federal income tax purposes and allocated to the Members in accordance with the provisions hereof shall be determined without regard to any election under Section 754 of the Code that may be made by the Company; provided, however, that such allocations, once made, shall be adjusted as necessary or appropriate to take into account those adjustments permitted or required by Sections 734 and 743 of the Code.

(g) The Board may adopt such methods of allocation of income, gain, loss or deduction between a transferor and a transferee of a Membership Interest as it determines necessary, to the extent permitted or required by Section 706 of the Code and the Regulations and rulings promulgated thereunder.

(h) Allocations that would otherwise be made to a Member under the provisions of this Article VI shall instead be made to the beneficial owner of Membership Interests held by a nominee in any case in which the nominee has furnished the identity of such owner to the Company in accordance with Section 6031(c) of the Code or any other method acceptable to the Board in its sole discretion.

### **6.3 Distributions**

(a) Notwithstanding any limitations provided elsewhere in this Agreement,

the Board shall cause the Company to (i) for each taxable year, distribute pro rata among the Members the Tax Distributions and (ii) distribute to Klamath Holdings an amount sufficient to pay ordinary and reasonable holding company operating expenses (including

any expenses necessary to maintain the “bankruptcy remote” status of Klamath Holdings); provided, however, that no such distributions shall be made to the extent that the Board determines, in its sole discretion, that funds are not legally available for such distribution by virtue of applicable law or contractual obligation. Distributions pursuant to this Section 6.3(a) shall be applied against amounts otherwise distributable to Members pursuant to Section 6.3(b) or 6.3(c)

(b) The Board may make such other distributions as it deems appropriate in its sole discretion. Any distributions made pursuant to this Section 6.3(b) shall first be made to the Members pro rata in proportion to their Percentage Interests. No such distributions shall be made if prohibited by Section 18-607 or Section 18-804 of the Delaware Limited Liability Company Act or any other applicable law or by any loan agreement, security agreement, mortgage, debt instrument or other agreement or obligation to which the Company is a party or by which it is bound or its assets are subject.

(c) The Board shall have the discretion to treat taxes paid by the Company on behalf of, or amounts withheld with respect to, all or less than all of the Members as a distribution of Available Cash to such Members.

## ARTICLE VII

### MANAGEMENT AND OPERATION OF BUSINESS

#### 7.1 Board of Directors

(a) Pursuant to Section 18-404 of the Delaware Limited Liability Company

Act, the Company shall have two classes of Directors which are hereby established: the first class shall consist of the Regular Directors and the second class shall consist of the Independent Directors appointed in accordance with Section 7.11. The Regular Directors shall manage the business and affairs of the Company subject to the provisions of Section 7.10 and the Independent Directors shall have only the powers and duties set forth in Section 7.10 and Section 10.1.

(b) Subject to Sections 7.10 and 7.11, the business and affairs of the Company shall be managed by or under the direction of a Board of one or more Directors designated by the Majority of the Voting Interest Members. Subject to Section 7.11, the Majority of the Voting Interest Members may determine at any time in their sole and absolute discretion the number of Directors to constitute the Board. The authorized number of Directors may be increased or decreased by the Majority of the Voting Interest Members at any time in their sole and absolute discretion, upon notice to all Directors, and subject in all cases to Section 7.11. The initial number of Directors shall be seven, two of whom shall be Independent Directors pursuant to Section 7.11. Each Director elected, designated or appointed by the Majority of the Voting Interest Members shall hold office until a successor is elected and qualified or until such Director's earlier death, resignation, or removal. Each Director shall execute and deliver a copy of the

Management Agreement upon the commencement of his or her service as a Director. Each Officer of the Company is hereby authorized to execute any Management

Agreement on behalf of the Company. A Director need not be a Member. The initial Directors designated by the Voting Interest Members are listed on Schedule A hereto.

## **7.2 Powers**

Subject to Section 7.10, the Board of Directors shall have the power to do any and all acts necessary, convenient or incidental to or for the furtherance of the purposes described herein, including all powers, statutory or otherwise. Subject to Section 2.4, the Board of Directors has the authority to bind the Company. No Member, in its capacity as a Member, will have any right, power or authority to act for or on behalf of the Company or to bind the Company.

## **7.3 Meeting of the Board of Directors**

The Board of Directors of the Company may hold meetings, both regular and special, within or outside the State of Delaware. Regular meetings of the Board may be held without notice at such time and at such place as shall from time to time be determined by the Board. Special meetings of the Board may be called by the President on not less than one day's notice to each Director by telephone, facsimile, mail, telegram, e-mail or any other means of communication, and special meetings shall be called by the President or Secretary in like manner and with like notice upon the written request of any one or more of the Directors.

## **7.4 Quorum: Acts of the Board**

At all meetings of the Board or any committee thereof, a majority of the Directors constituting the Board or such committee, as applicable, shall constitute a quorum for the transaction of business and, except as otherwise provided in any other provision of this Agreement, the act of a majority of the Directors present at any meeting at which there is a quorum shall be the act of the Board. If a quorum shall not be present at any meeting of the Board or any committee thereof, the Directors present at such meeting may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present. Any action required or permitted to be taken at any meeting of the Board or of any committee thereof may be taken without a meeting if the minimum number of members of the Board or committee, as the case may be, that would be necessary to authorize or take such action at a meeting attended by all members of the Board or such committee, as the case may be, consent thereto in writing and the writing or writings are filed with the minutes of proceedings of the Board or committee, as the case may be.

## **7.5 Electronic Communications**

Members of the Board, or any committee designated by the Board, may participate in meetings of the Board, or any committee, by means of telephone conference or similar communications equipment that allows all Persons participating in the meeting to hear each other, and such participation in a meeting shall constitute presence in Person at the meeting. If all the participants are participating by telephone

conference or similar communications equipment, the meeting shall be deemed to be held at the principal place of business of the Company.

## **7.6 Committees of Directors**

(a) The Board may, by resolution passed by a majority of the whole Board,

designate one or more committees, each committee to consist of one or more of the Directors of the Company. The Board may designate one or more Directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee.

(b) In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not such members constitute a quorum, may unanimously appoint another member of the Board to act at the meeting in the place of any such absent or disqualified member.

(c) Any such committee, to the extent provided in the resolution of the Board, and subject to, in all cases, Sections 7.10 and 7.11, shall have and may exercise all the powers and authority of the Board in the management of the business and affairs of the Company. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board. Each committee shall keep regular minutes of its meetings and report the same to the Board when required.

## **7.7 Compensation of Directors; Expenses**

The Board shall have the authority to fix the compensation of Directors. The Directors may be paid their expenses, if any, of attendance at meetings of the Board, which may be a fixed sum for attendance at each meeting of the Board or a stated salary as Director. No such payment shall preclude any Director from serving the Company in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

## **7.8 Removal of Directors**

Unless otherwise restricted by law and subject to Section 7.11, any Director or the entire Board of Directors may be removed or expelled, with or without cause, at any time by the Majority of the Voting Interest Members, and any vacancy caused by any such removal or expulsion may be filled by action of the Majority of the Voting Interest Members.

## **7.9 Directors as Agents**

To the extent of their powers set forth in this Agreement and subject to Section 7.10, the Directors are agents of the Company for the purpose of the Company's business, and the actions of the Directors taken in accordance with such powers set forth in this Agreement shall bind the Company. Notwithstanding the last sentence of Section 18-402

of the Delaware Limited Liability Company Act, except as provided in this Agreement or in a resolution of the Directors, a Director may not bind the Company.

### **7.10 Limitations on the Company's Activities**

(a) This Section 7.10 is being adopted in order to comply with certain

provisions required in order to qualify the Company as a "special purpose" entity.

(b) The Members shall not, so long as any Obligation is outstanding, amend, alter, change or repeal the definition of "Independent Director," Article XI or XIII, or Sections 1.1, 2.4, 2.5, 3.4, 4.2, 6.3, 7.1 -7.11, 10.1, 10.2, 12.1, 12.7 or 15.5 of this Agreement without the unanimous written consent of the Board (including all Independent Directors). Subject to this Section 7.10, the Members reserve the right to amend, alter, change or repeal any provisions contained in this Agreement in accordance with Article XIII.

(c) Notwithstanding any other provision of this Agreement and any provision of law that otherwise so empowers the Company, the Members, the Board, any Officer or any other Person, none of the Members, the Board, any Officer or any other Person shall be authorized or empowered, nor shall they permit the Company, without the prior written consent of the Majority of the Voting Interest Members and the prior unanimous written consent of the Board (including all Independent Directors), to take any Material Action, provided, however, that the Board may not vote on, or authorize the taking of, any Material Action, unless there are at least two Independent Directors then serving in such capacity.

(d) The Board and each Member shall cause the Company to do or cause to be done all things necessary to preserve and keep in full force and effect its existence, rights (charter and statutory) and franchises; provided, however, that the Company shall not be required to preserve any such right or franchise if (i) the Board shall determine that the preservation thereof is no longer desirable for the conduct of its business and that the loss thereof is not disadvantageous in any material respect to the Company and (ii) the Rating Agency Condition is satisfied. The Board also shall cause the Company to:

accounts;

- (i) maintain its own separate books and records and bank
- (ii) at all times hold itself out to the public and all other Persons as

a legal entity separate from each Member and any other Person and not as a department or division of any Member or any other Person;

(iii) have a Board of Directors separate from that of each Member and any other Person;

(iv) file its own tax returns, if any, as may be required under applicable law, to the extent (1) not part of a consolidated group filing a consolidated return or returns or (2) not treated as a division for tax purposes of another taxpayer, and pay any taxes so required to be paid under applicable law;

### EXHIBIT 3.3

- (v) not commingle its assets with assets of any other Person;
- (vi) conduct its business in its own name and strictly comply with

all organizational formalities to maintain its separate existence;

- (vii) maintain separate financial statements;
- (viii) pay its own liabilities only out of its own funds (subject to any

arrangements under the Klamath Servicing Agreement, and any successor agreement thereto, pursuant to which a third party advances expenses to be reimbursed by the Company at a later date);

Members;

- (ix) maintain an arm's length relationship with its Affiliates and the
- (x) pay the salaries of its own employees, if any;
- (xi) not hold out its credit or assets as being available to satisfy the obligations of others;
- (xii) allocate fairly and reasonably any overhead for shared office space and other shared expenses;
- (xiii) use separate stationery, invoices and checks;
- (xiv) not pledge its assets for the benefit of any other Person;
- (xv) correct any misunderstanding known to it regarding its separate identity;
  
- (xvi) maintain adequate capital in light of its contemplated business purpose, transactions and liabilities;
  
- (xvii) cause its Board of Directors to meet at least annually or act pursuant to written consent and keep minutes of such meetings and actions and observe all other Delaware limited liability company formalities;
  
- (xviii) not acquire any securities of any Member (other than preferred membership interests in Yakima or as otherwise contemplated by the Basic Documents and not prohibited by the Related Yakima Documents); and
  
- (xix) cause the Directors, Officers, agents and other representatives of the Company to act at all times with respect to the Company consistently and in furtherance of the foregoing and in the best interests of the Company.

Failure of the Company, or any Member or the Board on behalf of the Company, to comply with any of the foregoing covenants or any other covenants contained in this

Agreement shall not affect the status of the Company as a separate legal entity or the limited liability of the Members or the Directors.

(e) So long as any Obligation is outstanding, the Board shall not cause or permit the Company to:

Affiliate;

- (i) guarantee any obligation of any Person, including any
- (ii) engage, directly or indirectly, in any business other than the

actions required or permitted to be performed under Section 2.4, the Basic Documents or this Section 7.10;

(iii) incur, create or assume any indebtedness prohibited by the Basic Documents and the Related Yakima Documents;

(iv) make or permit to remain outstanding any loan or advance to, or own or acquire any stock or securities of, any Person (other than preferred membership interests in Yakima, stock in UST Finance Corp. and equity interests in any Subsidiary permitted under Section 7.10(e)(vi)) to the extent that such loan, advance or ownership or acquisition of stock or securities is prohibited by the Basic Documents or the Related Yakima;

(v) to the fullest extent permitted by law, engage in any dissolution, liquidation, consolidation, merger, asset sale or transfer of ownership interests prohibited by the Basic Documents or the Related Yakima Documents; or

(vi) form, acquire or hold any Subsidiary other than UST Finance Corp., any entity owning UST Finance Corp. or any other entity which is restricted to purposes of the type set forth in Section 2.4(a)(i) .

### **7.11 Independent Directors**

As long as any Obligation is outstanding, each Member shall cause the Company at all times to have at least two Independent Directors who will be appointed by the Majority of the Voting Interest Members. Each Independent Director accepts its right and authority as an Independent Director under this Agreement and agrees to perform and discharge its duties and obligations as an Independent Director under this Agreement, and further agrees that such rights, authorities, duties and obligations shall continue until its successor as an Independent Director is appointed in accordance with the provisions of this Section 7.11. The initial Independent Directors of the Company are listed on Schedule A attached hereto. Each initial Independent Director shall indicate acceptance of his appointment by execution of a counterpart of this Agreement. To the fullest extent permitted by law, including Section 18-1101 (c) of the Delaware Limited Liability Company Act, the Independent Directors shall consider only the interests of the Company, including its respective creditors, in acting or otherwise voting on the matters referred to in Sections 7.10(b) and 7.10(c) . No resignation or removal of an Independent Director, and no appointment of a successor Independent Director, shall be effective until

such successor (i) shall have accepted his or her appointment as an Independent Director by a written instrument, which may be a counterpart signature page to the Management Agreement, and (ii) shall have executed a counterpart to this Agreement as required by Section 10.1. In the event of a vacancy in the position of Independent Director, the Majority of the Voting Interest Members shall, as soon as practicable, appoint a successor Independent Director. All right, power and authority of the Independent Directors shall be limited to the extent necessary to exercise those rights and perform those duties specifically set forth in this Agreement. Except as provided in the fifth sentence of this Section 7.11, in exercising their rights and performing their duties under this Agreement, any Independent Director shall have a fiduciary duty of loyalty and care similar to that of a director of a business corporation organized under the General Corporation Law of the State of Delaware. It is hereby further agreed by all the parties hereto, including the Members, that, to the extent that, at law or at equity, the Independent Directors have duties (including fiduciary duties) and liabilities relating thereto to the Company or to the Members, the Independent Directors' duties and liabilities at law or at equity have been expressly modified by contract as herein provided. No Independent Director shall at any time serve as trustee in bankruptcy for any Affiliate of the Company.

## 7.12 Officers

(a) Officers. The initial Officers of the Company shall be designated by the

Majority of the Voting Interest Members. The additional or successor Officers of the Company shall be chosen by the Board and shall consist of at least a President, a Secretary and a Treasurer. The Board of Directors may also choose one or more Vice Presidents, Assistant Secretaries and Assistant Treasurers, and such other Officers and agents as it shall deem necessary or advisable, who shall hold their offices for such terms, and shall exercise such powers and perform such duties, as shall be determined from time to time by the Board. Any number of offices may be held by the same person. The salaries of all Officers and agents of the Company shall be fixed by or in the manner prescribed by the Board. The Officers of the Company shall hold office until their successors are chosen and qualified. Any Officer may be removed at any time, with or without cause, by the affirmative vote of a majority of the Board. Any vacancy occurring in any office of the Company shall be filled by the Board. The initial Officers of the Company designated by the Majority of the Voting Interest Members are listed on Schedule B hereto.

(b) President. The President shall be the chief executive officer of the Company, shall preside at all meetings of the Board, shall be responsible for the general and active management of the business of the Company and shall see that all orders and resolutions of the Board are carried into effect. The President or any other Officer authorized by the President or the Board shall execute all bonds, mortgages and other contracts.

(c) Vice President. In the absence of the President or in the event of the President's inability to act, the Vice President, if any (or in the event there be more than one Vice President, the Vice Presidents in the order designated by the Directors, or in the absence of any designation, then in the order of their election), shall perform the duties of

the President, and when so acting, shall have all the powers of and be subject to all the restrictions upon the President. The Vice Presidents, if any, shall perform such other duties and have such other powers as the Board may from time to time prescribe.

(d) Secretary and Assistant Secretary. The Secretary shall be responsible for filing legal documents and maintaining records for the Company. The Secretary shall attend all meetings of the Board and record all the proceedings of the meetings of the Board in a book to be kept for that purpose and shall perform like duties for the standing committees when required. The Secretary shall give, or shall cause to be given, notice of all meetings of each Member, if any, and special meetings of the Board, and shall perform such other duties as may be prescribed by the Board or the President, under whose supervision the Secretary shall serve. The Assistant Secretary, or if there be more than one, the Assistant Secretaries in the order determined by the Board (or if there be no such determination, then in order of their election), shall, in the absence of the Secretary or in the event of the Secretary's inability to act, perform the duties and exercise the powers of the Secretary and shall perform such other duties and have such other powers as the Board may from time to time prescribe.

(e) Treasurer and Assistant Treasurer. The Treasurer shall have the custody of the Company funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the Company and shall deposit all moneys and other valuable effects in the name and to the credit of the Company in such depositories as may be designated by the Board. The Treasurer shall disburse the funds of the Company as may be ordered by the Board, taking proper vouchers for such disbursements, and shall render to the President and to the Board, at its regular meetings or when the Board so requires, an account of all of the Treasurer's transactions and of the financial condition of the Company. The Assistant Treasurer, or if there shall be more than one, the Assistant Treasurers in the order determined by the Board (or if there be no such determination, then in the order of their election), shall, in the absence of the Treasurer or in the event of the Treasurer's inability to act, perform the duties and exercise the powers of the Treasurer and shall perform such other duties and have such other powers as the Board may from time to time prescribe.

(f) Officers as Agent. The Officers, to the extent of their powers set forth in this Agreement or otherwise vested in them by action of the Board not inconsistent with this Agreement, are agents of the Company for the purpose of the Company's business and, subject to Section 7.10 the actions of the Officers taken in accordance with such powers shall bind the Company.

(g) Duties of Board and Officers. Except to the extent otherwise provided herein, each Director and Officer shall have a fiduciary duty of loyalty and care similar to that of directors and officers of business corporations organized under the General Corporation Law of the State of Delaware.

## ARTICLE VIII

### BOOKS, RECORDS AND ACCOUNTING

#### 8.1 Books, Records and Accounting

The Board shall keep or cause to be kept at the principal office of the Company appropriate books and records with respect to the Company's business, including all books and records necessary to provide to the Members any information required to be provided pursuant to Section 3.3(a) . Any books and records maintained by or on behalf of the Company in the regular course of its business, including books of account and records of Company proceedings, may be kept on, or be in the form of, computer disks, hard drives, punch cards, magnetic tape, photographs, micrographics or any other information storage device; provided, however, that the books and records so maintained are convertible into clearly legible written form within a reasonable period of time. The books of the Company shall be maintained, for financial reporting purposes, on an accrual basis in accordance with U.S. GAAP.

#### 8.2 Fiscal Year

The fiscal year of the Company shall be a fiscal year ending December 31.

#### 8.3 Reports

(a) Within 60 days after the end of each fiscal quarter, the Board shall cause

to be prepared an unaudited report setting forth as of the end of such fiscal quarter:

(i) unless such quarter is the last fiscal quarter, a balance sheet of the Company; and

(ii) unless such quarter is the last fiscal quarter, an income

statement of the Company for such fiscal quarter.

(b) The Board shall use diligent efforts to cause to be prepared and mailed to each Member, within 90 days after the end of each fiscal year, an audited or unaudited report setting forth as of the end of such fiscal year:

(i) a balance sheet of the Company; and

(ii) an income statement of the Company for such fiscal year.

(c) The Board shall, after the end of each fiscal year, use reasonable efforts to cause the Company's independent accountants, if any, to prepare and transmit to each Member as promptly as possible any such tax information as may be reasonably necessary to enable each Member to prepare its federal, state and local income tax returns relating to such fiscal year.



## ARTICLE IX TAX MATTERS

### 9.1 Tax Returns and Information

The Company shall timely file all returns of the Company that are required for federal, state and local income tax purposes on the basis of the accrual method and a taxable year ending on December 31. The tax information reasonably required by the Members for federal and state income tax reporting purposes with respect to a taxable year shall be furnished to them within 90 days of the close of the calendar year in which the Company's taxable year ends. The classification, realization and recognition of income, gain, losses and deductions and other items shall be on the accrual method of accounting for federal income tax purposes.

### 9.2 Tax Elections

(a) With the best interests of the Members in mind, the Board shall make a

determination as to whether the Company shall make the election under Section 754 of the Code in accordance with applicable Regulations thereunder.

(b) The Company shall elect to deduct expenses incurred in organizing the Company ratably over a 60 month period as provided in Section 709 of the Code.

(c) Except as otherwise provided herein, the Board shall determine whether the Company should make any other elections permitted by the Code.

### 9.3 Tax Controversies

Subject to the provisions hereof, Klamath Holdings is designated as the "tax matters partner" (as defined in the Code) and is authorized and required to represent the Company (at the Company's expense) in connection with all examinations of the Company's affairs by tax authorities, including resulting administrative and judicial proceedings, and to expend Company funds for professional services and costs associated therewith. Each Member agrees to cooperate with Klamath Holdings and to do or refrain from doing any or all things reasonably required by Klamath Holdings to conduct such proceedings.

### 9.4 Withholding

Notwithstanding any other provision of this Agreement, the Board is authorized to take any action that it determines in its discretion to be necessary or appropriate to cause the Company to comply with any withholding requirements established under the Code or any other federal, state or local law, including, without limitation, pursuant to Sections 1441, 1442, 1445 and 1446 of the Code. To the extent that the Company is required or elects to withhold and pay over to any taxing authority any amount resulting from the allocation or distribution of income to any Member (including, without limitation, by reason of Section 1446 of the Code), the amount withheld may at the discretion of the Board be treated by the Company as a distribution of cash pursuant to Section 6.3 in the amount of such withholding from such Member.



**ARTICLE X****ADMISSION OF SPECIAL AND ADDITIONAL MEMBERS****10.1 Admission of Special Members**

Upon the occurrence of any event that causes the last remaining Voting Interest Member to cease to be a Member of the Company, each Person acting as an Independent Director pursuant to Section 7.11 shall, without any action of any Person and simultaneously with such Voting Interest Member ceasing to be a Member of the Company, automatically be admitted to the Company as a Special Member and shall continue the Company without dissolution. No Special Member may withdraw from the Company or transfer its rights as Special Member unless (i) a successor Special Member has been admitted to the Company as Special Member by executing a counterpart to this Agreement, and (ii) such successor has also accepted its appointment as Independent Director pursuant to Section 7.11; provided, however, the Special Members shall automatically cease to be Members of the Company upon the admission to the Company of an Additional Member as a Voting Interest Member in accordance with Section 10.2. Upon admission to the Company, each Special Member shall be a member of the Company that has no interest in the profits, losses and capital of the Company and has no right to receive any distributions of Company assets. Pursuant to Section 18-301 of the Delaware Limited Liability Company Act, a Special Member shall not be required to make any Capital Contributions to the Company and shall not receive a Membership Interest. A Special Member, in its capacity as Special Member, may not bind the Company. Except as required by any mandatory provision of the Delaware Limited Liability Company Act, each Special Member, in its capacity as Special Member, shall have no right to vote on, approve or otherwise consent to any action by, or matter relating to, the Company, including, without limitation, the merger, consolidation or conversion of the Company. In order to implement the admission to the Company of each Special Member, each person acting as an Independent Director pursuant to Section 7.11 shall execute a counterpart to this Agreement. Prior to its admission to the Company as Special Member, each Person acting as an Independent Director shall not be a member of the Company and shall have no rights or obligations under this Agreement except its duties and obligations as an Independent Director, including, without limitation, its duty and obligation to become a Special Member and be admitted to the Company upon the occurrence of the conditions specified in this Section 10.1.

**10.2 Admission of Additional Members and Substituted Members**

(a) A Person (other than Klamath Holdings, Services or a Substituted

Member) who makes a Capital Contribution to the Company in accordance with this Agreement shall be admitted to the Company as an Additional Member only upon furnishing to the Board (i) evidence of acceptance in form satisfactory to the Board of all the terms and conditions of this Agreement, and (ii) such other documents or instruments

as may be required in the discretion of the Board to effect such Person's admission as an Additional Member.

(b) Notwithstanding anything to the contrary in this Section 10.2, (i) no Person shall be admitted as an Additional Member or a Substituted Member without the consent of a Majority of the Voting Interest Members which consent may be given or withheld in their discretion and (ii) so long as any Obligation remains outstanding, no Additional Member or a Substituted Member may be admitted to the Company unless (i) the Rating Agency Condition is satisfied and (ii) such admission is not prohibited under the Basic Documents. The admission of any Person as an Additional Member or a Substituted Member shall become effective on the date on which the name of such Person is recorded as such in the books and records of the Company, following the consent of the Majority of the Voting Interest Members to such admission.

### **10.3 Amendment of Agreement and Certificate of Formation**

To effect the admission to the Company of any Member, the Board shall take all steps necessary and appropriate under the Delaware Limited Liability Company Act to amend the records of the Company to reflect such admission and, if necessary, to prepare as soon as practicable an amendment to this Agreement, and, if required by law, the Board shall prepare and file an amendment to the Certificate of Formation.

## **ARTICLE XI WITHDRAWAL OF MEMBERS**

So long as any Obligation is outstanding, no Member may withdraw from the Company, unless such withdrawal is not prohibited under the Basic Documents and the Rating Agency Condition is satisfied. If any Member is permitted to withdraw from the Company pursuant to this Article XI, an Additional Member of the Company shall be admitted to the Company, subject to Section 10.2, upon its execution of an instrument signifying its agreement to be bound by the terms and conditions of this Agreement, which instrument may be a counterpart signature page to this Agreement. Such admission shall be deemed effective immediately prior to the withdrawal and, immediately following such admission, the withdrawing Member shall cease to be a member of the Company.

## **ARTICLE XII DISSOLUTION AND LIQUIDATION**

### **12.1 Dissolution**

(a) Subject to Section 7.10 and Section 10.1, the Company shall be dissolved,

and its affairs shall be wound up upon the first to occur of the following: (i) the termination of the legal existence of the last remaining Voting Interest Member of the Company or the occurrence of any other event which terminates the continued membership of the last remaining Voting Interest Member of the Company in the

Company unless the business of the Company is continued in a manner permitted by this Agreement or the Delaware Limited Liability Company Act or (ii) the entry of a decree of judicial dissolution under Section 18-802 of the Delaware Limited Liability Company Act. Upon the occurrence of any event that causes the last remaining Voting Interest Member of the Company to cease to be a Member of the Company, to the fullest extent permitted by law, the personal representative of such Voting Interest Member is hereby authorized to, and shall, within 90 days after the occurrence of the event that terminated the continued membership of such Voting Interest Member in the Company, agree in writing (i) to continue the Company and (ii) to the admission of the personal representative or its nominee or designee, as the case may be, as a Substituted Member of the Company, effective as of the occurrence of the event that terminated the continued membership of the last remaining Voting Interest Member of the Company in the Company.

(b) Notwithstanding any other provision of this Agreement, the Bankruptcy of a Member or a Special Member shall not cause the Member or Special Member, respectively, to cease to be a Member or Special Member of the Company and upon the occurrence of such an event, the business of the Company shall continue without dissolution.

(c) Notwithstanding any other provision of this Agreement, each of the Members and the Special Members waives any right it might have to agree in writing to dissolve the Company upon the Bankruptcy of a Member or a Special Member, or the occurrence of an event that causes a Member or a Special Member to cease to be a Member or Special Member of the Company.

(d) In the event of dissolution, the Company shall conduct only such activities as are necessary to wind up its affairs (including the sale of the assets of the Company in an orderly manner), and the assets of the Company shall be applied in the manner, and in the order of priority, set forth in Section 18-804 of the Delaware Limited Liability Company Act.

(e) The Company shall terminate when (i) all of the assets of the Company, after payment of or due provision for all debts, liabilities and obligations of the Company shall have been distributed to the Members in the manner provided for in this Agreement and (ii) the Certificate of Formation shall have been canceled in the manner required by the Delaware Limited Liability Company Act.

## **12.2 Liquidator**

Upon dissolution of the Company, the Board shall select one or more Persons to act as Liquidator. The Liquidator shall be entitled to receive such compensation for its services as may be approved by the Majority of the Voting Interest Members. The Liquidator shall agree not to resign at any time without 15 days' prior notice and may be removed at any time, with or without cause, by notice of removal approved by the Majority of the Voting Interest Members. Upon dissolution, removal or resignation of the Liquidator, a successor and substitute Liquidator (who shall have and succeed to all

rights, powers and duties of the original Liquidator) shall within 30 days thereafter be approved by the Majority of the Voting Interest Members. The right to approve a successor or substitute Liquidator in the manner provided herein shall be deemed to refer also to any such successor or substitute Liquidator approved in the manner herein provided. Except as expressly provided in this Article XII, the Liquidator approved in the manner provided herein shall have and may exercise, without further authorization or consent of any of the parties hereto, all the powers conferred on the Board under the terms of this Agreement (but subject to all the applicable limitations, contractual and otherwise, on the exercise of such powers) to the extent necessary or desirable in the good faith judgment of the Liquidator to carry out the duties and functions of the Liquidator hereunder for and during such period of time as shall be reasonably required in the good faith judgment of the Liquidator to complete the winding up and liquidation of the Company as provided for herein.

## **12.3 Liquidation**

The Liquidator shall proceed to dispose of the assets of the Company, discharge its liabilities, and otherwise wind up its affairs in such manner and over such period as the Liquidator determines to be in the best interest of the Members, subject to Section 18-804 of the Delaware Limited Liability Company Act and the following:

### **12.3.1 Disposition of Assets**

The assets may be disposed of by public or private sale or by distribution in kind to one or more Members on such terms as the Liquidator and such Member or Members may agree. If any property is distributed in kind, the Member receiving the property shall be deemed for purposes of Section 12.3.3 to have received cash equal to its fair market value; and contemporaneously therewith, appropriate cash distributions must be made to the other Members. The Liquidator may, in its absolute discretion, defer liquidation or distribution of the Company's assets for a reasonable time if it determines that an immediate sale or distribution of all or some of the Company's assets would be impractical or would cause undue loss to the Members. The Liquidator may, in its absolute discretion, distribute the Company's assets, in whole or in part, in kind if it determines that a sale would be impractical or would cause undue loss to the Members.

### **12.3.2 Discharge of Liabilities**

Liabilities of the Company include amounts owed to Members otherwise than in respect of their distribution rights under Article VI. With respect to any liability that is contingent, conditional or unmatured or is otherwise not yet due and payable, the Liquidator shall either settle such claim for such amount as it thinks appropriate or establish a reserve of cash or other assets to provide for its payment. When paid, any unused portion of the reserve shall be distributed as additional liquidation proceeds.

### **12.3.3 Liquidation Distributions**

All property and all cash in excess of that required to discharge liabilities as provided in Section 12.3.2 shall be distributed among the Members, in accordance with,

and to the extent of, the positive balances in such Members' Capital Accounts, as determined after taking into account all Capital Account adjustments (other than those made by reason of distributions pursuant to this Section 12.3.3) for the taxable year of the Company during which the liquidation of the Company occurs (with such date of occurrence being determined pursuant to Treasury Regulations Section 1.704 -1(b)(2)(ii)(g)), and such distribution shall be made by the end of such taxable year (or, if later, within 90 days after said date of such occurrence).

#### **12.4 Cancellation of Certificate of Formation**

Upon the completion of the distribution of Company cash and property as provided in Section 12.3 in connection with the liquidation of the Company, the Company shall be terminated and the Certificate of Formation, as well as all qualifications of the Company as a foreign limited liability company in jurisdictions other than the State of Delaware, shall be canceled and such other actions as may be necessary to terminate the Company shall be taken.

#### **12.5 Return of Contributions**

The Directors shall not be personally liable for, and shall have no obligation to contribute or loan any monies or property to the Company to enable it to effectuate, the return of the Capital Contributions of the Members, or any portion thereof, it being expressly understood that any such return shall be made solely from Company assets.

#### **12.6 Waiver of Partition**

Except as otherwise expressly provided in this Agreement, to the fullest extent permitted by law, each of the Members and the Special Members hereby irrevocably waives any right or power that such Person might have to cause the Company or any of its assets to be partitioned, to cause the appointment of a receiver for all or any portion of the assets of the Company, to compel any sale of all or any portion of the assets of the Company pursuant to any applicable law or to file a complaint or to institute any proceeding at law or in equity to cause the dissolution, liquidation, winding up or termination of the Company. No Member shall have any interest in any specific assets of the Company, in whole or in part, in property of the Company, and no Member shall have the status of a creditor with respect to any distribution pursuant to Section 6.3 hereof.

#### **12.7 Capital Account Restoration**

No Member shall have any obligation to restore any negative balance in its Capital Account upon liquidation of the Company.

### **ARTICLE XIII AMENDMENT OF AGREEMENT**

Subject to Section 7.10, this Agreement may be modified, altered, supplemented or amended pursuant to a written agreement executed and delivered by the Majority of the Voting Interest Members; provided, however, that no modification, alteration,

supplement or amendment which would have a material adverse effect on a Non-Voting Interest Member or would modify, alter, supplement or amend any of the terms of this Agreement applicable to the Non-Voting Interests shall be effective without the prior written consent of the holders of a majority of the Non-Voting Interests (as measured by reference to the Non-Voting Interest Members respective Percentage Interests).

Notwithstanding anything to the contrary in this Agreement, so long as any Obligation is outstanding, this Agreement may not be modified, altered, supplemented or amended unless the Rating Agency Condition is satisfied and such action is not prohibited by the Basic Documents except:

- (a) to cure any ambiguity;
- (b) to convert or supplement any provision in a manner consistent with the

intent of this Agreement and the other Basic Documents; or

(c) to effect a change that, in the sole discretion of the Board, is necessary or advisable to qualify or continue the qualification of the Company as a limited liability company in which the Members have limited liability under the laws of any state or to ensure that the Company will not be treated as an association taxable as a corporation or otherwise taxed as an entity for federal income tax purposes.

## ARTICLE XIV

### MERGER

#### 14.1 Authority

The Company may merge or consolidate with one or more corporations, limited liability companies, business trusts or associations, real estate investment trusts, common law trusts or unincorporated businesses, including a general partnership or limited partnership, formed under the laws of the State of Delaware or any other state of the United States of America, pursuant to a written agreement of merger or consolidation ("Merger Agreement") in accordance with this Article XIV.

#### 14.2 Procedure for Merger or Consolidation

Merger or consolidation of the Company pursuant to this Article XIV requires the prior approval of the Board. If the Board shall determine, in the exercise of its discretion, to consent to the merger or consolidation, the Board shall approve the Merger Agreement, which shall set forth:

(a) The names and jurisdictions of formation or organization of each of the business entities proposing to merge or consolidate;

(b) The name and jurisdiction of formation or organization of the business entity that is to survive the proposed merger or consolidation (the "Surviving Business Entity");

### EXHIBIT 3.3

- (c) The terms and conditions of the proposed merger or consolidation;
- (d) The manner and basis of exchanging or converting the equity securities of

each constituent business entity for, or into, cash, property or general or limited partner interests, rights, securities or obligations of the Surviving Business Entity; and (i) if any general or limited partner interests, securities or rights of any constituent business entity are not to be exchanged or converted solely for, or into, cash, property or general or limited partner interests, rights, securities or obligations of the Surviving Business Entity, the cash, property or general or limited partner interests, rights, securities or obligations of any limited partnership, corporation, trust or other entity (other than the Surviving Business Entity) that the holders of such general or limited partner interests, securities or rights are to receive in exchange for, or upon conversion of, their general or limited partner interests, securities or rights, and (ii) in the case of securities represented by certificates, upon the surrender of such certificates, which cash, property or general or limited partner interests, rights, securities or obligations of the Surviving Business Entity or any general or limited partnership, corporation, trust or other entity (other than the Surviving Business Entity), or evidences thereof, are to be delivered;

(e) A statement of any changes in the constituent documents or the adoption of new constituent documents (the articles or certificate of incorporation, articles of trust, declaration of trust, certificate or agreement of limited partnership or other similar charter or governing document) of the Surviving Business Entity to be effected by such merger or consolidation;

(f) The effective time of the merger, which may be the date of the filing of the certificate of merger pursuant to Section 14.4 or a later date specified in or determinable in accordance with the Merger Agreement (provided, that if the effective time of the merger is to be later than the date of the filing of the certificate of merger, the effective time shall be fixed no later than the time of the filing of the certificate of merger and stated therein); and

(g) Such other provisions with respect to the proposed merger or consolidation as are deemed necessary or appropriate by the Board or as required by applicable law.

### **14.3 Approval by Members of Merger or Consolidation**

(a) Except as provided in Section 14.3(d), the Board, upon its approval of the

Merger Agreement, shall direct that the Merger Agreement be submitted to a vote of the Voting Interest Members, whether at a special meeting or by written consent. A copy or a summary of the Merger Agreement shall be included in or enclosed with the notice of a special meeting or the written consent.

(b) Except as provided in Section 14.3(d), the Merger Agreement shall be approved upon receiving the affirmative vote or consent of all of the Members.

(c) Except as provided in Section 14.3(d), after such approval by vote or consent of all of the Voting Interest Members, and at any time prior to the filing of the

certificate of merger pursuant to Section 14.4, the merger or consolidation may be abandoned pursuant to provisions therefor, if any, set forth in the Merger Agreement.

(d) Notwithstanding anything else contained in this Article XIV or in this Agreement, the Board is permitted, in its discretion, without Member approval, to merge the Company or any Group Member into, or convey all the Company's assets to, another limited liability entity that shall be newly formed and shall have no assets, liabilities or operations at the time of such Merger other than those it receives from the Company or other Group Member if (i) the Board has received an opinion of counsel that the merger or conveyance, as the case may be, would not result in the loss of the limited liability of any Member or cause the Company to be treated as an association taxable as a corporation or otherwise to be taxed as an entity for federal income tax purposes (to the extent not previously treated as such), (ii) the sole purpose of such merger or conveyance is to effect a mere change in the legal form of the Company into another limited liability entity, and (iii) the governing instruments of the new entity provide the Members with the same rights and obligations as are herein contained.

#### **14.4 Certificate of Merger**

Upon the required approval of the Merger Agreement by the Board and the Voting Interest Members, a certificate of merger shall be executed and filed with the Secretary of State of the State of Delaware in conformity with the requirements of the Delaware Limited Liability Company Act.

#### **14.5 Effect of Merger**

- (a) At the effective time of the certificate of merger:
  - (i) all the rights, privileges and powers of each of the business

entities that has merged or consolidated, and all property, real, personal and mixed, and all debts due to any of those business entities and all other things and causes of action belonging to each of those business entities, shall be vested in the Surviving Business Entity and after the merger or consolidation shall be the property of the Surviving Business Entity to the extent they were of each constituent business entity;

(ii) the title to any real property vested by deed or otherwise in any of those constituent business entities shall not revert and is not in any way impaired because of the merger or consolidation;

(iii) all rights of creditors and all liens on or security interests in property of any of those constituent business entities shall be preserved unimpaired; and

(iv) all debts, liabilities and duties of those constituent business entities shall attach to the Surviving Business Entity and may be enforced against it to the same extent as if the debts, liabilities and duties had been incurred or contracted by it.

(b) A merger or consolidation effected pursuant to this Article XIV shall not be deemed to result in a transfer or assignment of assets or liabilities from one entity to another.

## ARTICLE XV GENERAL PROVISIONS

### 15.1 Addresses and Notices

Any notice, demand, request, report or proxy materials required or permitted to be given or made to a Member under this Agreement shall be in writing and shall be deemed given or made when delivered in person or when sent by first class United States mail or by other means of written communication to the Member at the address described below. Any notice to the Company shall be deemed given if received by the Board at the principal office of the Company designated pursuant to Section 2.3. The Board may rely and shall be protected in relying on any notice or other document from a Member or other Person if believed by it to be genuine.

### 15.2 Further Action

The parties shall execute and deliver all documents, provide all information and take or refrain from taking action as may be necessary or appropriate to achieve the purposes of this Agreement.

### 15.3 Binding Effect

The parties hereto hereby acknowledge and agree that the Company will become a party to this Agreement by execution of a copy hereof by a Director or Officer on behalf of the Company, and in connection therewith, the Company shall have the right to enforce the terms of this Agreement against each of the parties hereto. Notwithstanding any other provision of this Agreement, each Member agrees that this Agreement including, without limitation, Articles XI and XIII and Sections 2.4, 2.5, 3.4, 4.2, 7.1 -7.11, 10.2, 12.1, 15.3 and 15.5, constitutes a legal, valid and binding agreement of such Members, and is enforceable against such Members by the Independent Directors, in accordance with its terms. In addition, the Independent Directors shall be intended beneficiaries of this Agreement.

### 15.4 Integration

This Agreement constitutes the entire agreement among the parties hereto pertaining to the subject matter hereof and supersedes all prior agreements and understandings pertaining thereto.

### 15.5 Creditors

None of the provisions of this Agreement shall be for the benefit of or enforceable by any creditor of the Company or by any creditor of a Member or a Special Member. Nothing in this Agreement shall be deemed to create any right in any Person (other than

Covered Persons) not a party hereto, and this Agreement shall not be construed in any respect to be a contract in whole or in part for the benefit of any third Person (except as provided in Section 15.3) .

### **15.6 Waiver**

No failure by any party to insist on the strict performance of any covenant, duty, agreement or condition of this Agreement or to exercise any right or remedy consequent upon a breach thereof shall constitute a waiver of any such breach of any other covenant, duty, agreement or condition.

### **15.7 Counterparts**

This Agreement may be executed in counterparts, all of which together shall constitute an agreement binding on all the parties hereto, notwithstanding that all such parties are not signatories to the original or the same counterpart. Each party shall become bound by this Agreement immediately upon affixing its signature hereto.

### **15.8 Applicable Law**

This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware, without regard to the principles of conflicts of law.

### **15.9 Severability of Provisions**

Each provision of this Agreement shall be considered severable and if for any reason any provision or provisions herein are determined to be invalid, unenforceable or illegal under any existing or future law, such invalidity, unenforceability or illegality shall not impair the operation of or affect those portions of this Agreement which are valid, enforceable and legal.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first written above.

UST KLAMATH FALLS HOLDINGS,  
LLC, a Delaware limited liability company

By: \_\_\_\_\_  
Name: John M. Rudey  
Title: President

U.S. TIMBERLANDS SERVICES  
COMPANY, L.L.C, a Delaware limited  
liability company

By: \_\_\_\_\_  
Name: John M. Rudey  
Title: President

In accordance with Section 15.3 of this Agreement, U.S. Timberlands Klamath Falls, L.L.C. hereby executes this Agreement for the purpose of becoming a party hereto and agreeing to perform its obligations and duties hereunder and becoming entitled to enjoy its rights and benefits hereunder and, without limiting the generality of the foregoing, U.S. Timberlands Klamath Falls, L.L.C. shall have the right to enforce the terms of this Agreement against the parties hereto.

U.S. TIMBERLANDS KLAMATH FALLS,  
L.L.C.

By: \_\_\_\_\_  
Name: John M. Rudey  
Title: President

Agreed and Consented to by the Independent Directors, and in the event admitted as a Special Member pursuant to Section 10.1 of this Agreement, by the Special Members.

By: \_\_\_\_\_  
Suzanne M. Hay, Independent Director

By: \_\_\_\_\_  
Carrie L. Tillman, Independent Director

Schedule A  
Directors of U.S. Timberlands Klamath Falls, L.L.C.

Regular Directors

John M. Rudey  
Laurie G. Rudey  
George R. Hornig  
Mel A. Sachs  
John David Layton

Independent Directors

Suzanne M. Hay  
Carrie L. Tillman

Schedule B  
Officers of U.S. Timberlands Klamath Falls, L.L.C.

John M. Rudey - President

Thomas C. Ludlow - Vice President, Secretary and Treasurer

Exhibit A  
Management Agreement

U.S. Timberlands Klamath Falls, L.L.C.  
625 Madison Avenue, Suite 10-B  
New York, New York 10022  
July 25, 2003

The Board of Directors

Re: Management Agreement - U.S. Timberlands Klamath Falls, L.L.C., a Delaware limited liability company (the "Company")

Ladies and Gentlemen:

Reference is made to the Third Amended and Restated Operating Agreement of U.S. Timberlands Klamath Falls, L.L.C., a Delaware limited liability company (the "Company"), dated as of July 25, 2003, as it may be amended or restated from time to time (the "Operating Agreement"). Capitalized terms used and not otherwise defined herein have the meanings set forth in the Operating Agreement.

For good and valuable consideration, each of the undersigned Persons, who have been designated as Regular Directors or Independent Directors of the Company (as set forth on Schedule A hereto) in accordance with the Operating Agreement, hereby agrees as follows:

1. Each of the undersigned accepts such Person's rights and authority as a Regular Director or Independent Director, as the case may be, under the Operating Agreement and agrees to perform and discharge such Person's duties and obligations as a Regular Director or Independent Director, as the case may be, under the Operating Agreement, and further agrees that such rights, authorities, duties and obligations under the Operating Agreement shall continue until such Person's successor as a Regular Director or Independent Director, as the case may be, is designated or until such Person's resignation or removal as a Regular Director or Independent Director, as the case may be, in accordance with the Operating Agreement. Each Regular Director agrees and acknowledges that it has been designated as a "manager" of the Company within the meaning of the Delaware Limited Liability Company Act.

2. So long as any Obligation is outstanding, each of the undersigned agrees, solely in its capacity as a creditor of the Company on account of any indemnification or other payment owing to the undersigned by the Company, not to acquiesce, petition or otherwise invoke or cause the Company to invoke the process of any court or governmental authority for the purpose of commencing or sustaining a case against the Company under any federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of the Company or any substantial part of the property of the Company, or ordering the winding up or liquidation of the affairs of the Company.

3. THIS MANAGEMENT AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF DELAWARE, AND ALL RIGHTS AND REMEDIES SHALL BE GOVERNED BY SUCH LAWS WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAWS.

4. This Management Agreement may be executed in any number of counterparts, each of which shall be deemed an original of this Management Agreement and all of which together shall constitute one and the same instrument

EXHIBIT 3.3

IN WITNESS WHEREOF, the undersigned have executed this Management Agreement as of the day and year first above written.

U.S. Timberlands Klamath Falls, L.L.C.

By: \_\_\_\_\_

Name: John M. Rudey

Title: President

\_\_\_\_\_  
John M. Rudey

\_\_\_\_\_  
Laurie G. Rudey

\_\_\_\_\_  
George R. Hornig

\_\_\_\_\_  
Mel A. Saks

\_\_\_\_\_  
John David Layton

\_\_\_\_\_  
Suzanne M. Hay

\_\_\_\_\_  
Carrie L. Tillman

Schedule A

**Regular Directors**

John M. Rudey  
Laurie G. Rudey  
George R. Hornig  
Mel A. Sachs  
John David Layton

**Independent Directors**

Suzanne M. Hay  
Carrie L. Tillman

**CERTIFICATION**

I, John M. Rudey, certify that:

I have reviewed this annual report on Form 10-K of Inland Fiber Group, LLC.

1. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
2. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
3. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
4. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal control; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
5. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ John M. Rudey

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John M. Rudey  
Chairman, Chief Executive Officer and President

Date: May 17, 2004

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**CERTIFICATION**

I, Thomas C. Ludlow, certify that:

I have reviewed this annual report on Form 10-K of Inland Fiber Group, LLC.

1. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
2. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
3. The registrant' s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant' s disclosure controls and procedures as of a date within 90 days prior to the filing of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
4. The registrant' s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant' s auditors and the audit committee of registrant' s board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant' s ability to record, process, summarize and report financial data and have identified for the registrant' s auditors any material weaknesses in internal control; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal controls; and
5. The registrant' s other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Thomas C. Ludlow

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Thomas C. Ludlow  
Chief Financial Officer

Date: May 17, 2004

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

**In connection with the Annual report of Inland Fiber Group, LLC (the “Company”) on Form 10-K for the period ending December 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, John M. Rudey, Chief Executive Officer of the general partner of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:**

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John M. Rudey

John M. Rudey  
Chief Executive Officer  
May 17, 2004

A signed original of the written statement required by section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Inland Fiber Group, LLC and will be retained by Inland Fiber Group LLC and furnished to the Securities and Exchange Commission or its staff upon request.

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

**In connection with the Annual report of Inland Fiber Group, LLC (the “Company”) on Form 10-K for the period ending December 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Thomas C. Ludlow, Chief Financial Officer of the general partner of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:**

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Thomas C. Ludlow

Thomas C. Ludlow  
Chief Financial Officer  
May 17, 2004

A signed original of the written statement required by section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Inland Fiber Group, LLC and will be retained by Inland Fiber Group LLC and furnished to the Securities and Exchange Commission or its staff upon request.

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