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State of Utah

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January 5, 2005

Chris Hansen, Environmental Coordinator
Canyon Fuel Company, LLC
HCR 35 Box 380
Helper, Utah 84526

Incoming
C/007/0005
Copy Dana

Dear Mr. Hansen:

Subject: Salinity Offset Program for UPDES Permit Nos. UT0023540-Skyline Mines and UT0025593-Dugout Canyon Mine

We are in receipt of the *"Colorado River Salinity Offset Program Participation Plan,"* dated January 5, 2005 (copy attached). We appreciate your efforts to incorporate our comments and submit in a timely manner this program plan, which includes an example "Funds Tracking Chart" for tracking the salinity offset credits. We understand that this example tracking chart may be modified in the future, as requested by either party, to better facilitate our common goals of accurately accounting for the salinity offset credits during the UPDES permit cycles.

As stated in Part I.D.1.c/ of the UPDES permits referenced above, which became effective on December 1, 2004, this Salinity Offset Program plan will be appended to the respective UPDES permits and, along with all of the requirements, conditions and limitations of the existing permits, are in full force and effect.

If you have any questions, please contact Jeff Studenka of this office at (801) 538-6779 or by e-mail at jstudenka@utah.gov.

Sincerely,

Walter L. Baker, P.E.
Acting Executive Secretary
Utah Water Quality Board

WLB: JAS: mc

Enclosure

cc (w/encl): Qian Zhang, EPA Region VIII
Claron Bjork, SE Utah District Health Department
Dave Ariotti, DEQ District Engineer
Pam Grubaugh-Littig, Division of Oil Gas & Mines
Mark Quilter, Utah Department of Agriculture and Food
Larry Anderson, UDNR

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Colorado River Salinity Offset Program Participation Plan

Canyon Fuel Company, LLC
Skyline and Dugout Canyon Mines

Introduction

Canyon Fuel Company, LLC (CFC) Skyline Mine and Dugout Canyon Mine currently hold Utah Pollutant Discharge Elimination System (UPDES) permits issued by the Utah Department of Environmental Quality, Division of Water Quality (DWQ). The permit number for Skyline is UT0023540 and the Permit number for Dugout isUT0025593. Skyline mine has three approved discharge points: Point 001 which is the outfall from the mine site and sediment pond, Point 002 which is the outfall from the Rail Loadout Sediment Pond, and Point 003 which is the outfall from the Waste Rock Sediment Pond. Mine water discharges from Point 001 on a daily basis while Point 002 seldom has discharge and Point 003 has not had a discharge since construction of the pond. All of the mine discharge points report to either Eccles Creek or Mud Creek, both are tributary to the Price River drainage.

Dugout Canyon Mine has four discharge locations: Point 001 is the mine discharge to the Left Fork of Dugout Creek, Point 002 is the outfall of the mine site sediment pond, Point 003 is the outfall at the mine water storage tank which discharges to the Left Fork of Dugout Creek, and Point 004 is the outfall of the waste rock sediment pond. Mine water discharge at Point 001 is nearly continuous while Points 002 and 003 only discharge periodically. The waste rock sediment pond is a large pond and is not expected to discharge except in unusual circumstances. No discharge has occurred from this point since it was permitted.

Both Skyline Mine and Dugout Mine have had difficulties recently meeting the TDS (salt) loading limits set forth in their respective UPDES permits. A meeting was requested with the appropriate DWQ staff to discuss a plan for the CFC mines to participate in a salinity offset program consistent with permit requirements. This meeting was held on September 30, 2004 at the DWQ offices. A general plan was verbally presented to the DWQ staff members in attendance with a written copy of the plan sent to DWQ shortly thereafter. Several of the suggestions made by the DWQ staff were included in this plan. A second meeting was held with the DWQ staff and a representative of the Utah Department of Agriculture and Food (UDAF) on November 17, 2004 to clarify the costs associated with the salinity offset program CFC would be participating in and how the monies would be paid. The plan presented in this document includes all of the original plan points, changes discussed in the November 17th meeting, and adjustments to the total plan cost as determined by the UDAF on December 30, 2004. This document discusses the mines' participation in a salinity offset program and includes this Introduction, Discharge History, Plan Elements, Plan Monitoring Schedule, and the Salinity Offset Program Costs and Payment Schedule.

1.0 and 3.5 tons/day of TDS. CFC determined the mine would need to obtain an Individual permit with water quality parameter limits that were better suited to the mine discharge and receiving waters rather than continue to operate under a General discharge permit. A tentative agreement between CFC and DWQ was reached on a one ton/day limit of TDS provided the mine was able to participate in a salinity offset project. The new Individual permit for Dugout was issued on December 1, 2004. The Individual permit has similar requirements as the Skyline Mine UPDES permit for participating in a salinity offset program if the daily TDS tonnage limit is exceeded.

Plan Elements

The CFC Skyline and Dugout Mines will participate in the proposed salinity offset program to remain in compliance with their respective UPDES permits To institute the program, CFC will contribute monies through the DWQ to a fund to be established by the Colorado River Basin Salinity Control Forum for the purpose of defraying the costs of construction and operation of specific salinity offset projects within the Colorado River Basin. The funds will be dispersed to offset projects approved by both the DWQ and the Colorado River Basin Salinity Control Forum. The mines will have no control over the distribution of the funds or involvement in the offset projects.

The amount of the contribution to the proposed salinity offset program fund is based on the concept of offsetting the net discharge of TDS (salt) from the Skyline and Dugout mines (total number of tons of TDS (salt) minus the permitted TDS tons Skyline and Dugout Mines anticipate discharging on a daily basis) against a "bank" of tons of TDS (salt) determined by the cost of removal of a similar number of tons of TDS (salt) from the Colorado River system. DWQ, UDAF and Utah's Colorado River Basin Salinity Control Forum representatives have determined and agreed the cost per ton allocated to the bank will be based on the cost of removing a ton of salt from the Price River Drainage through the construction and implementation of improved irrigation and irrigation water delivery systems. CFC money will fund salinity-offset projects with a 15-year life expectancy and will be credited with the equivalent number of TDS (salt) tons assigned to the investment in the projects.

CFC will contribute sufficient funds to cover the cost of removing approximately 18 tons of TDS/day from the Colorado River system for a period not to exceed 15 years. This number of tons is based on the assumption that Skyline Mine could produce for the next 15 years an average of 20 tons of TDS/day, 12.9 tons over its permitted ton/day limit of 7.1 tons and Dugout Mine could produce approximately six tons of TDS/day, five tons over its permitted ton/day limit of one ton. CFC will offset the excess discharged TDS against credit/tons in a "bank account" of tons of TDS (salt) depleted over a period not exceeding 15years. The rate of depletion will depend upon the 30-day average daily rate of discharge of tons/day of TDS (salt) from Skyline and Dugout Mines to their receiving streams.

In addition to the anticipated approximate 13 tons/day of TDS (salt) that Skyline may produce above its permitted limit over a multi-year period, the mine will produce an additional 13 tons/day for approximately 3 to 4 months beginning in January 2005. This additional production of TDS (salt) tons/day will result from the mine removing water from the abandoned Winter Quarters Mine and flooded portions of the Skyline Mine. Removing the water from these areas is necessary to ensure safe working conditions for

Salinity Offset Program Costs and Payment Schedule

The cost and payment schedule of the salinity offset program presented by the UDAF during the November 17, 2004 meeting between CFC, DWQ, and UDAF personnel and amended by UDAF on December 30, 2004 is as follows:

1. The cost of the salinity offset program as outlined herein for ton credits in the bank of 71,175 TDS tons is $1,148,055.00 for Skyline Mine and $441,658.00 for Dugout Canyon Mine or 27,375 TDS tons.

2. The draining of Mine #3 and the abandoned Winter Quarters Mine will add an additional 1,100 tons of salt over a 110 day period. The cost of the program for ton credits in the bank of 1,100 TDS tons as calculated by CFC is $17,743.

3. The total costs of the salinity offset program for ton credits in the bank of 99,650 TDS tons is $1,607,456.

4. The salinity offset program TDS tons credits will be available to CFC for a period not to exceed 15 years. Credits funded after the end of the 15-year period will be funded based on revised calculations agreed upon between CFC and UDAF.

5. CFC will deposit the funds with the DWQ for the initial 99,650 TDS tons credits pursuant to a mutually acceptable agreement between CFC and DWQ (Fund Agreement). The Fund Agreement will set forth the type and location of the account, the payment schedule into the account, the process to disperse funds from the account, the purpose of the funds and account, and will contain such standard contract terms as approved by both parties counsel. CFC will fund the account in three equal payments of $535,818.67, with each payment being due in the first quarter of 2005, 2006 and 2007.

6. The effective date of the salinity offset program implemented at Skyline Mine will be September 4, 2004 and implementation at Dugout Mine will be the date of approval of the mine's Individual UPDES permit.

Calculations for Purchasing Salt Credits In Utah

The costs for purchasing salt loading credits in Utah will be done in the following manner. Payments will be placed in escrow accounts and deposited as agreed upon in permit negotiations.

DEQ will determine the total yearly discharge of salt in tons and the salinity area where the credits are needed. UDAF will obtain from NRCS the average cost per acre of treatment for the impacted area from the most recent "Mason Report". This report shows "on farm" costs only (FA, farm assistance). There are also planning and engineering costs (TA, technical assistance) associated with the irrigation conversion. This cost is set at 67% of the FA costs.

UDAF will use the published salt loading values for the appropriate area to determine the number of acres needed to obtain the desired salt reduction. The total cost of conversion (FA + TA) will be multiplied by the total acres needed to obtain conversion cost. Supplemental costs may be added such as a 20% Uncertainty Cost to insure projects can be obtained and salt is removed. If discharge waters significantly degrade irrigation quality and farmers will need to apply increased water to protect crops and soil then there will also be added a Leaching Fraction cost.

To the final cost will be added a 10% administration fee to cover contract administration and oversight. The Uncertainty Cost and Leaching Fraction Cost are subject to negotiation.

The salinity program projects are 15 year projects. The participant in this program may obtain a 15 year credit that is not transferable without reapplication.

Below is calculation for Skyline and Dugout Mines:

Skyline Mine Calculation:

Yearly Discharge = 4,745 tons / year = 13 ton / day x 365 days
Total Acreage = 889 acres = 4,745 tons / year / 5.34 tons / 1 acre
Conversion Cost = $1,043,686 = 889 acres x $1,174.00 / acre
Uncertainty Costs = ~~$124,993.00 = 20% of $624,967.00 ($624,967 + $124,993 = $749,960.00)~~
Contract Admin Cost = $104,368.00 = 10% of $1,043,686.00
Final Cost = $1,148,055.00

Dugout Mine Calculation:,
Yearly Discharge: 1,825 tons / year = 5 ton / day x 365 days
Total Acreage = 342 acres = 1,825 tons / 5.34 tons / 1 acre
Conversion Cost = $401,508 = 342 acres x $1,174
Uncertainty Cost = ~~$48,085 = 20% x $240,426~~
Contract Admin Cost = $40,150= 10% x $401,508
Total Cost = $441,658.00

(No leaching fraction was added to Dugout because it is not believed that this water would reach any irrigation system.)

Both mines without LF correction: $1,589,713.00