Howell

State of Utah
DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL, GAS AND MINING

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January 16, 1996

TO: Ted Stewart, Executive Director
Department of Natural Resources

Art DuFault, Director
Division of Sovereign Lands & Forestry

Robert Valentine, Director
Division of Wildlife Resources

FROM: Jim Carter, Director James P Brady for JWC

RE: Sunnyside Property

This memorandum follows up on our conversation of Tuesday, January 9, 1996, concerning the real property and water rights which are subject to the Division of Oil, Gas and Mining's ("Division's") First Deed of Trust. This property will be the subject of an auction in the Federal Bankruptcy Court for the District of Colorado in the next month to two months.

BACKGROUND

Enclosed with this memorandum is Exhibit A to the Trust Deed providing the legal description of the land and water rights subject to the First Deed of Trust. There is also a map which may not be relied on for determining property boundaries, but which is generally believed to fairly represent the legal description contained in Exhibit A to the Trust Deed. I am attempting to get enough large scale maps for each of you so that you don't have to figure out the legal descriptions in order to figure out what this property is.

The Sunnyside Mine has been in continuous operation for almost 100 years. The mine permanently closed in the Spring of 1994, due to a lack of continuing capital and the loss of a market for its coal. Prior to the acquisition of the mine by Sunnyside Coal Company, the mine was owned by Kaiser Steel who sold the property to Sunnyside Coal in the late 1980s as part of Kaiser Steel's liquidation bankruptcy. There is a universal agreement that the mine will never reopen.

From the desk of
Lowell Braxton

1-22

Mary Ann

F 9j - here's a copy of JWC's memo on Sunnyside Cost. The map gives a good look at the location of the acreage.

I've spoken to JWC about setting up a brainstorm session with other DNR Divisions Thurs of this week. will keep you posted!

Lind

At the time Kaiser Steel filed bankruptcy, the Division held an unsecured promise from Kaiser Steel to conduct reclamation. As a condition of accepting a permit transfer to Sunnyside Coal, the Division took as security for the reclamation obligation the real property described in Exhibit A. During the time Sunnyside Coal held the permit, there were continuous efforts on the part of the Division seeking revisions to the Sunnyside Mine Reclamation Plan to accurately reflect conditions on the ground, and better estimated costs of reclamation. As of today, the best and only estimate of the costs of full reclamation of the area subject to the Sunnyside Coal Company reclamation obligation is $8.6 million. The Division, however, is only secured in the amount of $2.04 million. It is recognized by the Division that an appropriate reclamation plan could be devised if a post-mining land use is proposed and implemented which would substantially reduce the cost of reclamation. Therefore, while the total amount of the Division's claim in the Bankruptcy Court is $8.6 million, it is believed that options may appear which would allow the Division to complete reclamation within or close to the confines of its $2.04 million security.

THE SECURED PROPERTY

The property, subject to the Trust Deed described in Exhibit A, consists predominately of water rights and real property. The bulk of the real property consists of mountain acreage north and northeast of the mine site and the town of Sunnyside and comprises approximately 24,000 acres. There is additional acreage in and around the towns of Sunnyside and East Carbon which are presently used by the cities as parks, ball fields and a golf course. All of the property subject to the Trust Deed is outlined on the large map in blue. The Division's Trust Deed does not cover the area actually disturbed by mining operations (the "disturbed area") which comprises approximately 300-400 acres. The precise boundaries of the disturbed area have never been established, but generally include the mine portal and coal loading areas.

The water rights which are subject to the Deed of Trust consist in part, of a number of small rights appurtenant to the mountain land itself, mainly in the form of stock watering rights. The major water rights are in the Grassy Trail Reservoir and the rights to the water produced from the mine itself. The mine water rights are subject to a sale which is in escrow with Sunnyside Co-Generation Associates, which will net the Division $480,000 cash.

The Grassy Trail water rights are subject to an adverse claim by the municipalities of Sunnyside and East Carbon. While the Division believes it would prevail in litigation concerning its security interest in these water rights, there is the obvious problem of selling the sole water supplies of the municipalities.

MARKET VALUE

Appraisals of the real property and water rights performed in 1993 established the values as follows: Grassy Trail water rights - $1,345,000, Mine water rights (subject to sale in escrow) $602,000 , Sewage Effluent water rights - $14,000, Mountain land (24,000 acres - $750,000, Other land values - between $0 and $200,000. The appraisals of the land are based upon comparable sales and do not reflect any timber values. Since these appraisals were performed, there have been numerous parties expressing interest in the timber values on the secured land. It has become apparent that there is a considerable market for timber which is not subject to federal environmental regulations. We believe the 1993 appraisals fail to accurately reflect the value of these lands. While no reliable sources have provided the Division with an estimate of the value of the timber, numerous proposals seem to be based around an assumed value of approximately $3 million for the timber.

The majority of the adjoining mountain land to the northeast consists of lands belonging to the Bureau of Land Management and State and Institutional Trust Lands. Although, there has been some grazing on the northern end of the lands, there has been little or no human impact on these lands and they are in a pristine condition. In addition to timber, the property provides watershed, wildlife habitat and a historical trout fishery.

STATUS OF THE BANKRUPTCY

The Division believes a Notice will soon be forthcoming reflecting a written agreement between the trustee and PentaCreek Properties, L.L.C. to purchase the subject acreage which excludes the mine water rights and the disturbed area, for $2.4 million. The trustees' intent is to notice the sale for approval, subject to the opportunity of any party with a $250,000 deposit to submit a higher bid. The Division may credit bid up to its entire secured claim of $2.04 million. The Division is the largest secured creditor, and is also the largest unsecured creditor, so even after sale of the property and satisfaction of its secured claim, the Division stands to receive additional money from the proceeds of the sale.

One option would be for the Division to seek relief from the automatic stay so as to foreclose on its security. However, to obtain relief from the automatic stay the Division would have to demonstrate to the Bankruptcy Court that its collateral was being impaired. Inasmuch as there is about to be an offer in front of the Bankruptcy Court for an amount greater than its secured claim, the Division is unlikely to prevail on such an argument. Even if the Division were to succeed in lifting the stay and obtaining the property through foreclosure, it would be required to liquidate the collateral in a commercially reasonable fashion to deal with the claims of the

principals of Sunnyside Coal. Sunnyside Coal principals remain liable for any deficiency which will result from the inadequacy of the collateral for reclamation.

Another option would be for the Division to bid its claim, and sufficient additional money, to acquire the property at the auction. Our best guess is that a bid in the neighborhood of $2.8 million will be necessary to secure the property. The State would then be free to sell the timber and/or the property on terms to its satisfaction, retaining wildlife easements, watershed protections and so forth while recouping its expenditure. If the property is retained by the State, the Division will require $2.04 million to begin reclamation of the mine site.

CONCLUSION

If the timber, wildlife, land and watershed values are sufficient to warrant an expenditure of $800,000 to $1,000,000 beyond the credit bed to secure ownership of the property, the Division should be prepared to bid its claim and additional money at the auction. In addition, the genuine and real concerns surrounding the municipalities reliance upon certain land and water rights subject to the Security Deed could be equitably addressed. The acquisition of the Grassy Trail Reservoir by the municipalities or the State could be addressed in light of ongoing dam safety concerns.

I would suggest that DWR and Lands personnel visit the site to evaluate the potential of the property. The Division can make staff available to answer additional questions in this regard, as well as its counsel for further clarification of the Division's position in the bankruptcy.

vb
Enclosures
Exhibit A to the Trust Deed
Map
cc: L. Braxton
T. Mitchell
SUNNYSID.MEM.

Document Information Form

Mine Number: C/007/007

File Name: Sunnyside Mine Internal

To: Mary Ann Wright

From:

Person Lowell Braxton

Company DOGM

Date Received: 1-22-96

Explanation: Map - S.C.C. Owned Surface

cc: