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MEMORANDUM

TO: Division of Oil, Gas, & Mining
Att: M. A. Wright
 Associate Director, Mining

FROM: John B. Maycock
 Assistant Attorney General

DATE: April 3, 2002

SUBJECT: Lodestar Energy, Inc.
 Bankruptcy Settlement

I am attaching as Exhibit "A" a copy of the Agreed Order signed by the parties and the bankruptcy judge and date-stamped as entered by the United States Bankruptcy Court for the Eastern District of Kentucky February 25, 2002, case Nos. 01-50969 and 01-50972, setting forth the terms and conditions of the settlement between DOGM, Lodestar (as debtor-in-possession), and Wexford Capital LLC (as the post-petition superpriority lien holder) regarding replacement of the Frontier bonds. Because the Agreed Order is full of bankruptcy jargon, this memo is to explain the structure, purpose and intent of the settlement. I am attaching as Exhibit "B" a separate schedule of the multiple deadlines that the Agreed Order requires Lodestar and Wexford to meet, in hope of making the deadlines easier to track.

The structure of the agreement is twofold: first, Wexford has now granted to DOGM, as security for any shortfall in the Frontier bonds, 10% of Wexford's superpriority lien, not to exceed \$1 million. This will increase to 20%, not to exceed \$2 million, unless the December 12, 2002 deadline is met (see "superpriority lien" below and Exhibit B).

Second, Wexford and Lodestar have agreed to replace the Frontier bonds 100% by a qualified and licensed surety bond company by defined steps within the specific deadlines on Exhibit B. Bond replacement can be done either by Wexford acquiring the Utah operations from Lodestar or within the terms of an approved plan of reorganization. In return, DOGM has agreed not to take further bond enforcement action against Lodestar so long as Wexford and Lodestar meet the specific deadlines on Exhibit B. If any deadline is missed, DOGM can take immediate enforcement action against Lodestar without further order of the bankruptcy court, free of the automatic stay, and the parties and any person claiming by or through them are barred from seeking any injunction or stay.

The overall purposes of the agreement are:

- To ensure that any Plan of Reorganization will include 100% replacement of the Frontier bonds by a qualified and licensed surety bond company;
- To provide immediate additional security, in the form of a percentage of Wexford's superpriority lien, to cover any shortfall in the amount recoverable from the Frontier bonds during the time necessary for Lodestar's reorganization and rebonding process, or in the event the reorganization fails (see "superpriority lien" below);
- To give Lodestar and Wexford the necessary time to negotiate, draft and obtain bankruptcy court confirmation of a Plan of Reorganization acceptable to the creditors, but on a very specific timetable, with verifiable deadlines for each important step in the court-supervised process of reorganization;
- To provide a strong incentive for Wexford to accomplish a successful reorganization with 100% bond replacement, by reducing the amount Wexford can recover under its superpriority lien should the plan fail; and
- To provide immediate relief from the automatic stay and from any bankruptcy injunction by Wexford, Lodestar and all parties claiming by or through them, thus avoiding further time, costs and attorney's fees, if Lodestar or Wexford fail to meet any deadline in the rebonding-reorganization process (see Exhibit "B").

The superpriority lien

As of February 25, 2002, the principal amount of Wexford's superpriority lien (representing the amount Wexford has loaned to Lodestar post-petition) was \$10 million. It has since increased to over \$13 million. "Superpriority" means that, in the event of a liquidation of Lodestar, these claims are junior in priority only to prepetition claims secured by Lodestar's assets. Superpriority claims must be paid in full before any other claims are paid.

Ten percent of any payment to Wexford on account of its superpriority lien will be held in escrow until 180 days after DOGM has made written demand on the Frontier bonds. The escrowed amount will then be paid to DOGM to the extent that Frontier has failed to pay the full amount of the bond demand. If Wexford has proposed a reorganization plan and has provided a Bond Replacement Commitment, but is unable to obtain court approval of the plan by the December 12, 2002 Plan Confirmation deadline, the percent and amount of the superpriority lien assigned to DOGM will increase to 20%, not to exceed \$2 million, and the Plan Confirmation deadline will be extended by an additional 60 days, to February 25, 2003. DOGM's participation in the superpriority lien will continue until all reclamation and other permit obligations have been met.



JBM

cc: L. Braxton
T. Mitchell
K. Seel