



Research Update

## Wyoming School Financing Idea

January 2, 2020

Charon Special Situations Group

Hyunjae (Brian) Lee  
INVESTMENT ANALYST  
hyunjae.lee@gatech.edu

Esoteric & Niche Assets

The recent trend of mining bankruptcies has created short-term municipal lending opportunities in Wyoming counties seeking to litigate tax claims.

### Campbell County

Campbell County is a 46,000-person county located in northwestern Wyoming, a state that accounts for 40% of US coal production and houses the nation's most efficient coal mines. Its county seat is Gillette, the self-proclaimed "Energy Capital of the Nation," but with growing environmental concerns, regulatory hurdles, and energy market volatility, the city is one of many dealing with tighter budgets.

### Ad Valorem Mineral Taxes

As opposed to severance taxes which are levied at the state level, ad valorem taxes are collected by counties based on local mining rates (both are simply percentages of produced mineral fair market value). 75% of Campbell County's ad valorem taxes are distributed to public education; any decrease in tax revenue increases stress; and unpaid taxes have skyrocketed in the last few years.

According to Wyoming Department of Revenue, \$97.7MM in ad valorem taxes went unpaid from 2009 to 2018; more notably, \$85.8MM was accumulated between 2015 and 2018. The deficit stems from energy companies using bankruptcy to avoid taxes, and successful avoidance has encouraged this strategy.

County-level ad valorem taxes are due biannually, 18 to 24 months after minerals are produced. Under current Wyoming statute, counties cannot file tax liens until taxpayers are actually delinquent. This means taxes due now date back to 2017 while bankrupt companies can continue to mine tax-free since automatic stay prevents counties from pursuing new charges.

## Catalysts

Because of fossil fuel's secular decline, bankruptcies and unpaid ad valorem taxes are fairly common:

- **Moriah Powder River LLC filed Chapter 11 on 10/31/19** – Campbell's neighboring Johnson County found that Moriah's operator, Carbon Creek Energy, owed \$11.2MM in unpaid ad valorem mineral taxes. \$7.7MM of the taxes owed from 2018 equals 13% of Johnson county's total earned tax base.
- **Vanguard Natural Resources exited Chapter 22 on 07/11/19** – In 2018 during its Chapter 11, Vanguard decided to sue seven counties (including Campbell and Johnson). While specific filings on the suit's resolution could not be found, Campbell County spent \$855K in legal fees.
- **Blackjewel LLC filed Chapter 11 on 07/01/19** – Contura Energy won the bankruptcy auction for two of Blackjewel's mines, but because of unpaid federal royalties, it sold the pair to Eagle Specialty Materials. In this process, Contura settled with Campbell County to pay \$13.5MM of a \$15.1MM tax bill, and ESM agreed to pay half of Blackjewel's \$17.5MM ad valorem mineral taxes over five years. Campbell County spent \$309K in legal fees.
- **Cloud Peak Energy Corp filed Chapter 11 on 05/10/19** – The filing date was also the deadline for paying \$8.3MM owed to Campbell County in 2017 ad valorem taxes, which does not include the potential \$25MM+ in taxes for 2018-19. Campbell County spent \$182K in legal fees.
- **Alpha Natural Resources exited Chapter 11 on 07/26/16** – After spending \$1MM in legal fees, Campbell County reached a deal for Alpha to pay \$1.6MM in 2015 taxes and \$14.7MM out of \$19MM owed for 2016. Unpaid interest and legal fees compounded the \$4MM loss further.



## Investment Thesis

### The Opportunity

From August 2018 to October 2019, Campbell County spent \$1.4MM in legal fees in five bankruptcy cases in four states for taxes owed from 2015 to 2019. While counties would previously have had to absorb all of the legal fees, the passing of Wyoming House Bill 72 allows counties to deduct the cost of the suits from the tax portion that belongs to the state.

The problem is timing. The county pays legal fees up front. When taxes are paid, the legal fees would be paid first. 75% of Campbell County ad valorem taxes go to the school district which means 75% of the legal fee would be taken from the education budget. Even though Campbell County recovers the funds through state tax deductions, there is still a squeeze that prevents the county from wholeheartedly pursuing bigger delinquent tax debts. **Injecting short-term liquidity into the county would ameliorate this squeeze and is a unique opportunity for a small fund in the municipal, distressed, or litigation space.**

### Deal Structure

1. A county decides to pursue tax debts against bankrupt energy companies and ends up directing significant public funds on outside legal counsel.
2. An outside fund lends capital to be put towards underfunded public financing needs (i.e. education) for the tax year or an estimated duration of the bankruptcy proceedings.
  - a) The PIK loan would be repaid by a portion of the tax claim equal to principal and interest.
  - b) The indenture could include a clause that collateralizes the loan with a lien on the county's other tax receivables at an extended tenor – which triggers if the tax claim is not paid out.
  - c) Fund could also offer legal insight, network, or influence as added value.
3. County wins tax claim and pays off loan, or county loses and pays out from receivables.

Alternatively, an investor could finance the litigation itself, paying the expected value of the tax debt lawsuit upfront for the full amount if the county wins. However, directly financing public needs would reduce exposure to the lawsuit outcome, requires less capital, and can be paid back from the county's other receivables.

### Variant Opinions

- **Precedent:** Campbell County has settled several outstanding tax debts (see Catalysts), showing that in more than one case, ad valorem taxes can be recovered.
- **Lots of Bankruptcies:** The steady stream of distressed companies lends itself to the possibility that this deal could reoccur. The PIK loan could instead be restructured as an automated line of credit.
- **Unique Mandate:** Few funds have the resources to commit time to such small deals (which also probably fall outside conventional mandates). A fund could corner the market for this type of deal.
- **Supportive Legislature:** WY state bills (setting ad valorem tax debts as high priority, giving WY's AG the authority represent counties, making ad valorem taxes due monthly) imply overwhelming support for (if not interest in) county bankruptcy lawsuits.

### Other Benefits

- **Reputation:** Establishing trust in the community as a credible lender could lead to other opportunities in the region – especially since bankruptcies have been exceedingly prevalent.
- **Operational Efficiency:** Setting a precedent for this type of lending would allow the fund to use the same deal structure as a scalable and mechanized template.
- **ESG:** This could be marketed as an ESG investment to clients insofar as the loan is repaid by seizing assets from fossil fuel bankruptcy estates. For Campbell County in particular, 75% of ad valorem taxes are distributed to fund public school education.



## Additional Notes

### About Charon Special Situations Group

Charon Special Situations Group (CSSG or Charon SSG) is an independent investment research firm focused on covering quantitative and event-driven strategies for institutional investors.

### About the Analyst

Hyunjae (Brian) Lee is an incoming Investment Banking Summer Analyst in Guggenheim Partners' Restructuring Group with previous experiences at Morgan Stanley, RBC Capital Markets, and SunTrust Robinson Humphrey. Brian studies computer science and finance at the Georgia Institute of Technology.

## Sources

### Sources Used, Ordered by Date Published

12/17/19	WyoFile	<a href="#">Lawmakers eye AG help on bankruptcies</a>
12/17/19	WyoFile	<a href="#">Bankruptcy fixes take shape, meet skeptics</a>
12/04/19	Buffalo Bulletin	<a href="#">Methane bust</a>
11/08/19	WY Public Media	<a href="#">Campbell County officials use new law to recover legal fees</a>
10/18/19	Gillette News Record	<a href="#">Contura pays county \$13.5MM...</a>
10/05/19	WyoFile	<a href="#">A breakdown of the Blackjewel, ESM deal</a>
09/30/19	WSGS	<a href="#">Coal Production &amp; Mining</a>
07/30/19	WyoFile	<a href="#">State left Campbell County to fend for itself in bankruptcies</a>
06/10/19	Buffalo Bulletin	<a href="#">Officials pushed to act on unpaid coal taxes</a>
___/___/19	Campbell County	<a href="#">Fiscal Year 2017-2018 Annual Report</a>
09/24/18	Gillette News Record	<a href="#">Vanguard sues seven counties alleging tax overpayment</a>
08/___/18	PRB Resource Council	<a href="#">Ad valorem taxes in Wyoming: proposed improvements</a>
06/29/18	WY Public Media	<a href="#">How the Alpha bankruptcy could lead to change in the law</a>
06/26/18	WY Public Media	<a href="#">Campbell County receives millions less than owed in Alpha...</a>
06/20/18	Casper Star Tribune	<a href="#">After \$1MM legal battle, Campbell County wins settlement...</a>
06/02/17	WaPo	<a href="#">How the Energy Capital of the Nation regained its optimism...</a>
___/___/12	WY Dept. of Revenue	<a href="#">Mineral Tax Division</a>

### Important Disclosures

The information and opinions in this report were prepared by Charon Special Situations Group and its members (collectively known as "CSSG" or "Charon SSG"). Though the information herein is believed to be reliable and has been obtained from public sources believed to be reliable, CSSG makes no representation as to its accuracy or completeness. Hyperlinks to third-party websites in this report are provided for reader convenience only. CSSG neither endorses the content nor is responsible for the accuracy or security controls of these websites.

### Analyst Certification

The views expressed in this report accurately reflect the personal views of the analyst(s) about the subject issuer and the securities of the issuer. In addition, the analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report.