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Chapter 11

Distressed Asset Disposition: Selling Encumbered Mineral Properties

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Synopsis

§ 11.01. Introduction.

Times are tough in the coal business. Prices are down. Regulatory pressures and competition from other fuel sources are on the rise. Some producers have been forced into bankruptcy, and many other companies are hoping to avoid it.[1] One option for a company in financial difficulty to improve

1 *See* Moran Zhang, "Coal's Darkest Hour: Fitch Warns of Increased Bankruptcy Possibilities In U.S. Coal Sector," *Int'l Bus. Times*, Feb. 3, 2013, *available at* http://www.ibtimes.com/coals-darkest-hour-fitch-warns-increased-bankruptcy-possibilities-us-coal-sector-1066344 (last visited May 22, 2013).

its liquidity in the current environment is to sell assets, specifically existing mineral reserves, assuming the availability of an interested purchaser. When the seller is in financial distress, however, these types of transactions can be complicated. Companies not making money tend to pay their bills late, if at all, and their creditors are often reluctant to make accommodations for them.

Any transaction with a distressed seller involves not only the buyer and seller, but a number of other parties who are owed (or who believe they are owed) some payment from the seller. These third parties often hold mortgage liens or other encumbrances with respect to the proposed sale property, and these must be addressed before any transaction can be completed. In a thriving market, where all parties are flush with cash and eager for producers to start mining, the interests of mortgagees, statutory lien claimants and other lien holders can be dealt with relatively easily — sales proceeds or operating revenues can be used to pay the mining company's debts in full, and the encumbrances are released. In the current market, where mineral properties and other assets may be worth less than the debts they secure and the parties are not optimistic about the immediate future, things are not so easy.

§ 11.02. Common Encumbrances on Mineral Properties.

[1] — Mortgages and Deeds of Trust.

Due to the immense amount of capital required to operate a coal company, external sources of financing are a necessity. Perhaps the most common source of capital is money borrowed from a lending institution. Whether the loan proceeds are used to provide working capital or fund new acquisitions, the lender will require adequate collateral to secure the loan. Accordingly, coal companies seeking traditional financing must grant to their lenders liens and security interests in assets of sufficient value to support the amount of their loans. A major source of a coal company's value, and therefore an asset commonly used as collateral, is the company's coal reserves and related real property interests, whether owned in fee simple or leased from other parties.

The borrower's obligation to repay conventional financing is evidenced by a credit or loan agreement and/or a promissory note that requires a structured repayment of the principal and interest over time. When that