



STATE OF
COLORADO

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Skylark Water Rights Memo Supplement

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Good Afternoon Jared and Jeff,

In response to an additional question on the Skylark Water Rights that Jeff recently raised with Jim, Sheela Stack has supplemented the memo I sent you at the end of January to include some more information on Grand County interests (see Pages 5 and 6 in the attached).

We hope to be back in touch regarding the other question on land soon.

Regards,

Miguel



DRMS Memo re Skylark Water Rights and GMR Protocol (supp 032823).pdf
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NAZARENUS STACK & WOMBACHER LLC

MEMORANDUM

To: Miguel Hamarat
cc: Sandy Fabritz, Aaron Hilshorst, Sheila Deely, and James Sanderson
From: Sheela Stack^{SS}
Date: January 31, 2023; supplemented March 28, 2023¹
Subject: Collateralization of the Henderson Skylark Water Rights

Introduction

In April 2021 Climax Molybdenum Company (“CMC”) proposed to the Division of Reclamation, Mining, and Safety (“DRMS”) the use of Deeds of Trust for CMC’s “Skylark Water Rights” as a form of financial warranty. In the course of those discussions, two questions have arisen regarding the Skylark Water Rights. First, whether the contractual dedication of the Skylark Water Rights by the Green Mountain Reservoir Protocol Agreement for use as source of substitute supply to benefit CMC’s “CA 1710 Water Rights” at the Climax Mine complicates DRMS’ ability to sell the Skylark Water Rights.² A related concern is whether the City of Golden’s position on the GMR Protocol and appeal of the decree entered in Case No. 13CW3077 vis a vis the Skylark Water Rights poses a complication. Second, whether, by virtue of the decree entered in Case No. 96CW3681, the Skylark Water Rights are dedicated to satisfying CMC’s obligations under the 1978 Agreement between CMC’s predecessor-in-interest, AMAX, Inc. and the City of Golden.

This memo serves to respond to those questions.

The short answers to these questions are:

1. The GMR Protocol allows for removal of the Skylark Water Rights from use for CA 1710 substitution purposes and provides a framework to acquire new sources to meet the CA 1710 substitution obligations. If the Skylark Water Rights are not used for substitution, CMC would need to acquire new sources to meet the substitution obligations or accept a reduced yield from CA 1710 during extreme drought conditions. Relatedly, Denver’s right to use the excess Skylark Water Rights stored in Williams Fork Reservoir is not perpetual.

¹ This supplemental memo includes a discussion of the 2012 Settlement Agreement between CMC and Grand County involving CMC’s Skylark Water Rights and the right of first refusal held by the City and County of Denver.

² The term “Green Mountain Reservoir Settlement” or “GMR Settlement” as used in this memo consists of three related documents: (1) the “Green Mountain Reservoir Protocol,” dated February 22, 2013, (“GMR Protocol”) which contains the substantive terms of the settlement in relation to Green Mountain Reservoir, (2) the “Green Mountain Reservoir Protocol Agreement,” dated August 16, 2013, which effectively is the parties’ agreement on the procedures for the adjudication and implementation of the GMR Protocol, and (3) the September 25, 2013 Settlement Agreement between CMC and Denver Water (“Climax-Denver Settlement Agreement”), which contains settlement terms specific to CMC and Denver. Copies of all three documents are provided with this memo as **Exhibits A** through **C**.

2. The decreed right of exchange of the Skylark Water Rights for the City of Golden's use does not provide Golden with a legal right to the Skylark Water Rights nor does it obligate CMC to deliver the Skylark Water Rights to Golden.

I. Green Mountain Reservoir Settlement

A. Background Facts

CMC owns water rights decreed by the Summit County District Court in CA 1710 in the Clinton Creek drainage basin, a tributary of Ten Mile Creek, a tributary of the Blue River, which have historically been used for mining and manufacturing purposes at its Climax Mine and Mill ("CA 1710 Water Rights"). Green Mountain Reservoir, a United States Bureau of Reclamation ("BuRec") project, is a vital supply of water for the mainstem of the Colorado River within the State of Colorado. Since the 1950's, the priorities of CMC's CA 1710 Water Rights had been in dispute in relation to the priorities for the downstream Dillon and Green Mountain Reservoirs. This threatened the critical water supply for the Climax Mine during droughts and created substantial uncertainty regarding CMC's ability to divert and beneficially use water under its CA 1710 Water Rights.

The Green Mountain Reservoir Settlement is a complicated water settlement entered in 2013 between BuRec, Denver Water, Colorado Springs, the Northern Colorado Water Conservancy District, the Colorado River Water Conservation District ("River District"), assorted West Slope irrigation districts, and CMC. The settlement resolved several long-running issues about the operation and administration of Green Mountain Reservoir, including the dispute over administration of the CA 1710 Water Rights in relation to Green Mountain Reservoir and Denver's Dillon Reservoir.

As relevant here, the Green Mountain Reservoir Settlement provides that (i) the CA 1710 Water Rights are senior to Dillon Reservoir and (ii) when the otherwise senior Green Mountain Reservoir storage right is unable to fill and thus administratively calls for water, the Climax Mine will nevertheless be able to divert and use water under the CA 1710 Water Rights by "substitution."

Under the settlement, CMC provides substitution water owed to Green Mountain Reservoir for its depletions resulting from the use of Climax's CA 1710 Water Rights. CMC's operation of the substitution has the following components:

- CMC will change the use of the Skylark Water Rights to allow their use for Green Mountain Reservoir substitution purposes and storage in Denver's Williams Fork Reservoir, including municipal use by Denver. *GMR Protocol*, para. 3. III.D.1.a; *Climax-Denver Settlement Agreement*, para. 3.1. This case is currently pending in the Division No. 5 Water Court as Case No. 12CW176 and the change has been operating administratively.³

³ Although the change can operate under administrative approval, the actual operation has not been needed. The substitution water will be provided only in extreme drought years when the filling of the GMR Storage right is not satisfied by the bypass of water from Denver's Dillon Reservoir. This has not happened since execution of the GMR Settlement in 2013. The frequency of such extreme drought years has occurred once every 25-30 years since hydrological records for the Blue River have been kept.

- Water from the Skylark Water Rights is stored in a 600 acre-foot storage account in Denver’s Williams Fork Reservoir, which is downstream from the Henderson Mill. *GMR Protocol*, para. III.D.1.a; *Climax-Denver Settlement Agreement*, paras. 3.1 and 3.2.1. Storage of water from the Skylark Water Rights is necessary in order to provide a substitute supply that corresponds with the timing of the needs of Green Mountain Reservoir water users.
- When CMC intends to divert water under its CA 1710 Water Rights, yet Green Mountain Reservoir does not fill due to extreme drought conditions, water from the Skylark Water Rights is released from Williams Fork Reservoir (or later East Branch Reservoir post reclamation) and delivered as a “substitute supply” to downstream water rights that would otherwise receive water from Green Mountain Reservoir. Concurrently, the Climax Mine is able to consume “by substitution” water from the CA 1710 Water Rights in an amount equivalent to the amount of water available for substitution from the Skylark Water Rights. *GMR Protocol*, paras. III.D.1., III.D.1.a, and III.D.1.b.
- For so long as water from the Skylark Water Rights is stored in Williams Fork Reservoir, Denver may use any water from the Skylark Water Rights that is in excess of the amount of water needed for substitution for the CA 1710 Water Rights in a given year, or in excess of the amount needed to refill the Skylark Water Rights’ six hundred acre-feet storage account in Williams Fork Reservoir (“Excess HCU”). *Climax-Denver Settlement Agreement*, para. 3.2.1. Denver’s right to use the Excess HCU terminates when the right to store water from the Skylark Water Rights in Williams Fork Reservoir terminates, as discussed below. *Climax-Denver Settlement Agreement*, paras. 3.2.1 and 3.2.3.
- To the extent there is insufficient water from the Skylark Water Rights stored in Williams Fork Reservoir (or later East Branch Reservoir post reclamation) to offset the amount of water used by the CA 1710 Water Rights in a substitution year, CMC may at its sole discretion reduce its consumption of water under the CA 1710 Water Rights to offset amount of substitution water required, or CMC may obtain additional replacement sources, provided that those additional replacement sources are acceptable to the United States and the River District. *GMR Protocol*, paras. III.D.1.b and III.D.1.c.
- When the Henderson Mine is no longer “Deemed to be in Operation” as contemplated and defined by the August 11, 1995 Settlement Agreement between Denver, the City of Englewood, and Cyprus Climax Metals Company (known as the “Ranch Creek Agreement”), CMC’s right to store water from the Skylark Water Rights in Williams Fork Reservoir, and Denver’s right to the Excess HCU shall terminate. *Climax-Denver Settlement Agreement*, para. 3.2.3.
- Finally, the GMR Protocol allows for removal of the Skylark Water Rights from use for CA 1710 substitution purposes and provides a framework to acquire new sources to meet the CA 1710 substitution obligations. *GMR Protocol*, para. III.D.1.a. The obligation to provide substitution water to Green Mountain Reservoir in order to use water under the CA1710 rights as against the fill of the Storage Right would burden CMC’s successors and assigns of the CA 1710 Water Rights, not a successor of the Skylark Water Rights. The right to conduct substitution against Green Mountain Reservoir and thereby entitle the CA 1710 Water Rights to divert during extreme drought years would be an entitlement

benefiting CMC's successors and assigns of the CA 1710 Water Rights. CMC's Skylark Water Rights would not be obligated to be the source of substitution water for CMC's successors and assigns of the CA 1710 Water Rights. Under the GMR Protocol, CMC's successors and assigns could provide other lawful sources of substitution water.

B. Case No. 13CW3077, Water Division 5

On October 20, 2020, the GMR Protocol parties filed an Amended Application in Case No. 13CW3077 ("Amended Application"), asking the Court for a determination that the GMR Protocol is consistent with the Blue River Decree. Two entities filed statements of opposition to the Amended Application: the City of Golden and Snake River Water District. The City of Golden argued that the GMR Operating Protocol may increase the likelihood of an administrative call on Golden's 1959 Vidler Tunnel Unit Right ("Vidler Right"). Golden asserted that the Vidler Right should have been included in the protections afforded by the GMR Protocol. The United States filed a motion for summary judgment requesting the Court grant the relief requested in the Amended Application.⁴ Golden responded that the Court's jurisdiction to consider this Amended Application extends to whether the GMR Protocol will result in injury to its water rights, and requested the Court deny the United States' Motion because material questions of fact and injury exist. The United States argued that: (1) injury is not an essential inquiry in water determinations, or in this case specifically; (2) Golden failed to demonstrate the GMR Protocol is inconsistent with the Blue River Decree; and (3) even if Golden's allegations of injury were material to the Amended Application, Golden failed to support its allegations with facts. The Court agreed with the United States, finding that the exercise and administration of the water rights, as provided under the terms of the GMR Protocol, is consistent with the Blue River Decree as a matter of law. The Court also ordered the State Engineer to administer and carry out those water rights in accordance with Sections I, II, and III of the GMR Protocol.

On June 10, 2022, Golden filed a Motion for Reconsideration and Clarification. The Court did not rule on the motion; therefore under C.R.C.P. 59(j) any post-trial motion that has not been ruled on within 63 days after it was filed is deemed denied for all purposes, including C.A.R. 4(a) and the time for appeal commences on that date. Golden's post-trial motion was filed on June 10, 2022, and under C.R.C.P. 59(j) was deemed denied on August 12, 2022. Pursuant to C.A.R. 4(a), Golden filed a Notice of Appeal with the Colorado Supreme Court on September 28, 2022. Golden's Opening Appellate Brief was filed on January 23, 2023. Applicants' Joint Answer Brief will be filed by February 22, 2023. Golden's Reply Brief will be due by March 8, 2023. Requests for Oral Arguments will also be filed on March 8, 2023. The Colorado Supreme Court will likely hear oral arguments in May 2023.

The GMR Protocol has been used for water rights administration for the 2014-2022 irrigation years. The parties expect that the State will comply with the Court's Order while the appeal is pending. The Division of Water Resources is expected to issue another notice in March 2023 that unless inconsistent with any decree issued after the notice, the Division Engineer will continue to use the Protocol for the integration of the administration of Green Mountain Reservoir and the Blue River Decrees with the water rights of the Colorado River.

⁴ The other Co-Applicants filed a motion for summary judgment requesting the Court dismiss Opposer Snake River Water District's claims to adjudicate the District's dispute with the Division 5 Engineer over administration of the Myers Ditch and Liftside Wells Nos. 1 and 2 water rights. The Court granted this motion. Snake River Water District did not appeal, so no further discussion on this issue is required here.

1. Golden's Objection in Case No. 13CW3077

DRMS representatives also asked whether Golden in its objection to the GMR Protocol and appeal of the decree entered in Case No. 13CW3077, is asserting a right to the Skylark Water Rights. The answer is "no." Golden's objections to the GMR Protocol are not related to the CA 1710 Water Rights, use of the Skylark Water Rights for substitution purposes, or operation of the substitution itself. As stated above, Golden owns the 1959 Vidler Right, located upstream of Green Mountain Reservoir and was assigned all rights and interest held in a 1996 Power Interference Agreement with BuRec; and therefore, Golden argues that the 1959 Vidler Right should have been protected by the GMR Protocol. Golden asserts that because its 1959 Vidler Right was not recognized in the GMR Protocol, Golden is being injured. Golden does not assert any right, title or interest to the Skylark Water Rights in its objection or appeal.

C. Change of Skylark Water Rights for New Beneficial Uses/High Marketability of the Skylark Water Rights

The purpose of the application in Case No. 12CW176 is to add beneficial uses associated with the GMR Protocol and Climax-Denver Settlement Agreement. In Case No. 96CW3681, the Skylark Water Rights were changed from agricultural use to add industrial use and other uses, and for use in exchanges and in an augmentation plan. The Skylark Water Rights are now being changed to include storage in Williams Fork Reservoir, use for GMR substitution purposes, and municipal use by Denver.

In the unlikely event of a need for DRMS to exercise its rights under the Financial Warranty and to take ownership of the Skylark Water Rights, Denver will be the State's most likely buyer of these water rights from DRMS for several reasons: (1) Denver currently uses the Skylark Water Rights stored in Williams Fork Reservoir for its municipal use. (2) The Ranch Creek Agreement provides Denver with the first right of refusal if CMC sells the Skylark Water Rights under the same terms and conditions set forth in any bona fide offer made or received by CMC concerning sale of these water rights. (3) The Climax-Denver Settlement Agreement gives Denver the right, for the life of the Henderson Mine, to receive water from the Skylark Water Rights that is not needed for CA 1710 substitution purposes.⁵ (4) Denver regularly provides substitution water to Green Mountain Reservoir from Williams Fork Reservoir. (5) Denver often releases water for augmentation purposes on the west slope. (6) Denver has existing facilities that may convey the water yield associated with these rights to the east slope for its municipal use.

In the event DRMS takes ownership of the Skylark Water Rights, and Denver does not purchase the Skylark Water Rights, Grand County is the next likely buyer. The Skylark Water Rights are located lower in the William Fork River basin and are ideal for continued uses in Grand County. It is well known across the West Slope that Grand County has been interested in securing more water rights in the Williams Fork River basin to ensure that water will be physically and legal available to the County in the future. In an effort to support Grand County in these efforts, Climax and Grand County agreed to a process wherein the County may have an equal opportunity

⁵ CMC agreed to this arrangement as consideration for Denver's agreement to allow the storage of water from the Skylark Water Rights in Williams Fork Reservoir pursuant to the GMR Settlement. Storage of water from the Skylark Water Rights is necessary in order to provide a substitute supply that corresponds with the timing of the needs of Green Mountain Reservoir water users.

to purchase the Skylark Water Rights as they may become available. In 2012, Climax entered into a Settlement Agreement with Grand County as part of Climax's Skylark diligence case, Case No. 09CW59. The 2012 Agreement recognizes that Denver has the right of first refusal to purchase all or a portion of the Skylark Water Rights. However, in the event of a sale of all or a portion of the Skylark Ranch Rights in an open bidding process, the 2012 Agreement provides Grand County with an equal opportunity to purchase the Skylark Water Rights as to all other potential bidders.

Moreover, the substitution that is allowed by the GMR Settlement and being sought in Case No. 12CW176 essentially enables the use of the Skylark Water Rights to be transferred from the location of the Henderson Mill on the Williams Fork River to the location of the Climax Mine on Tenmile Creek, which is a tributary of the Blue River. Due to a variety of factors, there is substantial demand for water in the vicinity of the Climax Mine: (i) Denver's Dillon Reservoir and Roberts Tunnel (which deliver water to the Front Range) are closely downstream; (ii) Summit County, which is also downstream, has significant growth and demand for water; (iii) Eagle County, which also has growth and water demand, could be delivered water from the Climax Mine with infrastructure improvements; and (iv) the Arkansas River basin, a major source of supply for Aurora and Colorado Springs, could be delivered water from the Climax Mine with infrastructure improvements.

D. The Skylark Water Rights would not be required for Substitution if CA 1710 Water Rights are not used

The primary purpose of the GMR Settlement for CMC is to allow CMC to consumptively use the water diverted under CMC's CA 1710 Water Rights. In the unlikely event of a need for DRMS to exercise its rights under the Financial Warranty and to take ownership of the Skylark Water Rights, that would mean that CMC is not operating either the Henderson or Climax Mines, and thus the CA 1710 Water Rights will not be used. In this case the GMR Settlement will not limit the ability of the State to liquidate the Skylark Rights.

There would not be a priority dispute, and thus no need to use the Skylark Water Rights for CA 1710 substitution purposes, if the use of the CA 1710 Water Rights permanently ceased or if the priority of the CA 1710 Water Rights was permanently subordinated to the water rights for Green Mountain Reservoir, Denver, and Colorado Springs. Consequently, if the benefits of the GMR Settlement for the CA 1710 Water Rights were permanently relinquished, the GMR Settlement would not limit the ability of the State of Colorado to liquidate the Skylark Rights, if they served as collateral for the Henderson Financial Warranty.

In addition, Denver's entitlement under the Climax-Denver Settlement Agreement to yield from the Skylark Water Rights in excess of the amount of water needed for substitution or in excess of the amount needed to refill the Skylark six hundred acre-feet storage account in Denver's Williams Fork Reservoir would also terminate. The Climax-Denver Settlement Agreement only gives Denver the right, for the life of the Henderson Mine, to receive water from the Skylark Water Rights that is not needed for CA 1710 Water Rights substitution purposes. Therefore, if the use of the CA 1710 Water Rights permanently ceased or there was no longer a priority dispute, there would be no need to use the Skylark Water Rights for CA 1710 substitution purposes and Denver's right to the excess yield would terminate.

II. Case No. 96CW3681 and the 1978 AMAX-Golden Agreement

In Consolidated Case Nos. 96CW3681 and 96CW3682, Water Division 5 (consolidated into Case No. 96CW3681) (“96CW3681 Decree”), the historic consumptive use of the Skylark Water Rights was quantified, and the water rights were changed to industrial and other uses, including use as sources of substitute supply for a number of exchanges decreed in Case No. 96CW3681. The 96CW3681 Decree also changed the Skylark Water Rights to allow exchanges for trans-basin delivery of the water to Clear Creek for municipal use by the City of Golden.

The 96CW3681 Decree acknowledges that there is a substantial likelihood that the pumping of nontributary water from the Henderson Mine, and the discharge of the water to Clear Creek, will cease at the life of the Henderson Mine. For these reasons, CMC filed for exchanges in order to responsibly and reasonably plan for an alternative to deliver a replacement source to meet its obligations to Golden. ¶¶ 3.2.3 through 3.2.5 and 3.3.7.a. The 96CW3681 Decree also limits the use of transmountain diversions to fulfilling CMC’s obligation to deliver the 1 cfs to the City of Golden in accordance with the 1978 Agreement between CMC’s predecessor AMAX and the City of Golden. ¶ 3.3.7.b. The decreed right of exchange of the Skylark Water Rights for the City of Golden’s use does not provide Golden with a legal right to the Skylark Water Rights nor does it obligate CMC to operate the exchange in order to deliver the Skylark Water Rights to Golden.

DRMS has expressed a concern that Golden may claim it’s entitled to the Skylark Water Rights by virtue of the 96CW3681 Decree and the 1978 Agreement. This is an unnecessary concern. First, the 1978 Agreement allows Climax to meet the 1 cfs delivery obligation with “equivalent replacement from any other sources” if that 1 cfs is not available from the Henderson Mine. *1978 Agreement*, p. 3. Therefore, the 1978 Agreement should not put a cloud on the potential sale of the Skylark Water Rights. Second, the actual operation of the exchange is infeasible because the CMC infrastructure required for the exchange do not exist. While the Henderson Haulage Tunnel does exist, the Henderson Tunnel Pipeline, diversion Intake 1 through 3, and pump systems do not. Golden also has no infrastructure available on the West Slope to operate the exchange. Therefore, it is legally and technically impractical for Golden to claim that it has the right to the Skylark Water Rights by virtue of the 1978 Agreement or the exchange approved by the 96CW3681 Decree. If a potential buyer seeks to change the Skylark Water Rights for another use, the exchange in the 96CW3681 Decree and use of the Skylark Water Rights for Golden would not prohibit the subsequent change.

III. Conclusion

While the Skylark Water Rights are currently dedicated by the GMR Settlement for use as a source of substitute supply to benefit the Climax Mine’s CA 1710 Water Rights, such dedication is not absolute or indefinite and is not a fatal flaw in DRMS using of the Skylark Water Rights as collateral for the Henderson financial assurance obligation. CMC can decide to not dedicate Skylark for substitution and in so doing reduce the potential yield of CA 1710. If the State became the owner of the Skylark Water Rights, those rights would be available for multiple beneficial uses, including municipal use and are fully transferable to a future buyer. In addition, the option to use the Skylark Water Rights to meet CMC’s obligations under the 1978 Agreement does not create an obligation for such a dedication and does not prohibit the potential sale of these water rights.