United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510-6150
WWW.ENERGY.SENATE.GOV

March 10, 2016

The Honorable Sally Jewell
Secretary of the Interior
U.S. Department of the Interior
1849 C Street, NW
Washington, DC 20240

Dear Secretary Jewell:

I am writing to express my deep concerns about self-bonding for coal mine reclamation obligations under the Surface Mining Control and Reclamation Act (SMCRA).

For decades now, financial assurance for reclamation has been a fundamental principle of natural resource policy. As a general rule, firms that extract natural resources cannot merely promise to clean up whatever mess is made as they go about their business. They need to post cash or collateral, or pay a third party to guarantee the cleanup in the event of a bankruptcy. Financial assurance is not free.

When Congress passed SMCRA in 1977, it modernized federal coal policy by requiring financial assurance for reclamation. But it left a significant loophole.

As you know, under Section 509 of SMCRA, the Secretary of the Interior and States with primacy (i.e., States with regulatory programs approved by the Secretary under Section 503) may accept reclamation performance bonds from companies without separate surety, subject to a financial test detailed in regulation (30 CFR 800.23). These bonds, known as self-bonds, are only as valuable as the corporation itself that guarantees them. Today, they represent a significant financial liability to state and federal taxpayers.

It is essential to emphasize the form of this loophole: neither you nor any State is required to accept self-bonds. You are merely authorized to do so. In fact, five States with primacy, including major coal producers, do not allow self-bonding: Kansas, Kentucky, Maryland, Montana, and Virginia.

Flaws with self-bonding

States that do not allow self-bonding may have a higher cost of doing business, but that cost buys taxpayers certainty and protection from the risk of default. While self-bonds, self-insurance, and related instruments may be appropriate for some private sector activity, I am not convinced that coal mining is such an activity.

Because many firms that specialize in natural resource extraction lack diversified lines of business that can dilute the risk of market downturns, self-bonding for these firms is especially risky. The policy places an inappropriate burden on natural resource regulators, requiring financial analysis that generally lies outside of their core competency. Furthermore, the current financial eligibility test fails to disentangle the financial health of holding companies and subsidiaries or to consider the future likely performance of companies.

For example, the State of Wyoming reaffirmed the eligibility of Arch Coal ("Arch") to self-bond in September 2015. Arch filed for bankruptcy under chapter 11 of the Bankruptcy Code less than four months later. At the time of Wyoming's decision, a clear public record existed of Arch's struggles in the capital markets, including credit agency downgrades, restructuring disagreements with bondholders, and a delisting notice from the New York Stock Exchange.

This example highlights the pernicious nature of self-bonding. Once it becomes clear a self-bonded company is heading toward default, regulators have a perverse incentive not to change the terms of financial assurance. Establishing more stringent bond obligations could send the company deeper into insolvency, jeopardizing its ability to generate revenue necessary for continuous reclamation and for performance bonds, not to mention local jobs.

If regulators don't require appropriate financial assurance from the beginning, they may trap themselves down the line. Their first decision is the most important decision.

I am sympathetic to the difficult position of States like Wyoming. I also understand that actual reclamation work performed on Wyoming coal mines has been relatively successful compared to other states. But there is nothing new about commodity market fluctuations. I am especially frustrated because the risks to state and federal taxpayers were foreseeable and avoidable.

I appreciated your firm response on this topic two weeks ago at the Energy and Natural Resources Committee's oversight hearing on the Fiscal Year 2017 budget request of your Department. I would like to learn more about the Department's plans to minimize the exposure of taxpayers to the private sector's reclamation liability and to reform financial assurance requirements for coal mining. I provide further details of this request below.

Past warnings on self-bonding

In the interest of obtaining an independent examination of self-bonding, I have also asked the Government Accountability Office (GAO) to investigate the practice and identify how it compares to financial assurance requirements associated with the extraction of other natural resources and industrial cleanups. I have enclosed that request, which details the history of GAO's investigations of self-bonding and other types of financial assurance.

This topic cuts across natural resources, industries, and communities. We have seen this show before, and I am concerned that the recent slew of bankruptcies by major coal mining companies will lead to the same finale for taxpayers.

For example, in Washington State we faced the infuriating scenario of pursuing claims under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA, commonly known as Superfund) against ASARCO when it declared bankruptcy in 2005. The company, under the ownership of Grupo Mexico, attempted to walk away from cleaning up yards in and around Tacoma, Washington, that had been polluted by lead and arsenic from the local copper smelter. Eventually, with the critical involvement of the Department of Justice (DOJ), the federal government reached a $1.8 billion settlement in 2009 with ASARCO to clean up 80 contaminated sites nationwide. The agreement included nearly $200 million for sites in Washington.

Superfund sites are among the most widespread examples of industrial pollution with inadequate financial assurance. But SMCRA, unlike CERCLA, is a forward-looking statute. I see no reason why taxpayers and communities should find themselves in a Superfund-like backward-looking position when it comes to cleaning up a coal mine. No mine can operate legally in the first place without obtaining a permit from the Secretary or a State with primacy.

In 2003, the Congressional Budget Office produced a report, at the request of the House Resources Committee, examining proposals to expand alternative forms of financial assurance for federal land reclamation beyond conventional surety bonds. CBO concluded that "[w]hile those alternatives would be less expensive for operators than surety bonds, they could prove insufficient to cover reclamation costs".[1]

CBO explained in more detail why financial assurance instruments like self-bonds, backed by a corporate guarantee, are so risky in a bankruptcy context:

> If an operator defaults on obligations backed by a corporate guarantee and the regulatory authority is unsuccessful in competing for assets with other creditors, the public is left to either bear the costs of reclamation or accept the damaged condition of the federal lands.
>
> [...]
>
> Unlike surety bonds, corporate guarantees do not allow the regulator to lay claim to a specific financial asset in the event that an operator becomes insolvent and cannot meet its reclamation obligations. In a bankruptcy proceeding, since reclamation obligations are likely to be but some of many of the bankrupt firm's general obligations (all subordinate to the claims associated with debt that has a higher priority for payment to creditors), the government could recover only a fraction of the costs of reclaiming the lands.

CBO's findings have been echoed in other contexts by GAO, EPA, EPA's independent financial advisory committee, and other government watchdogs (detailed in the attached letter to GAO).

[1] Congressional Budget Office, *Bonding for Reclaiming Federal Lands* (October 2003).

Indeed, at the time of CBO's report 13 years ago, its findings had already been incorporated into hardrock regulations by the Department itself. This fact in particular troubles me.

Beginning in 2001, BLM prohibited the use of corporate guarantees for hardrock mining reclamation on federal lands. BLM's decision came in the wake of major bankruptcies, including Galactic Resources in Colorado and Arimetco in Nevada. As several GAO investigations subsequently found, the adequacy and quality of BLM's financial assurance requirements have continued to struggle, both from grandfathered guarantees and from insufficient bonding. Nevertheless, the 2000 decision was a major improvement in natural resource management.

Before the final 2000 rule, segments of the mining industry asked BLM to create a system similar to the self-bonding program for coal. BLM rejected this request:

> We found the arguments opposing corporate guarantees persuasive. We agree that a corporate guarantee is less secure than other forms of financial guarantees, especially in light of fluctuating commodity prices. Recent bankruptcies added to the concern that corporate guarantees don't provide adequate protection.

BLM also described its own limitations with respect to analyzing a company's financial health:

> BLM does not currently have the expertise to perform these reviews on a periodic basis, and even if we did, a risk of default would remain. This contributed to our decision not to allow additional corporate guarantees.[2]

Under the Department's current regulations, corporate guarantees are prohibited for hardrock reclamation but are allowed for coal reclamation. Why does BLM's conclusion 16 years ago not apply equally to coal self-bonds backed by corporate guarantees?

More generally, how many times do we have to relearn this lesson?

Bankruptcy proceedings

I am pleased to see the Department, acting through the Office of Surface Mining Reclamation and Enforcement (OSMRE), pursuing more aggressive oversight of recent self-bonding decisions by States with primacy. As we discussed at the budget hearing, the State of Wyoming's actions in particular in the bankruptcy proceedings of Arch and Alpha Natural Resources ("Alpha") are deeply troubling. As the Department itself, as well as DOJ in recent court filings, has pointed out: side agreements that establish a small portion of bonding obligations as "superpriority" claims (in Wyoming: 15 percent of Alpha's self-bonds and 19 percent of Arch's self-bonds) are on their face unlawful.[3] The State of West Virginia also reached a similar agreement with Alpha in December.

While SMCRA authorizes self-bonding, it does not authorize partial bonding. As DOJ wrote in its reservation of rights filing of February 18, 2016, in the Bankruptcy Court for the Eastern

---

[2] 65 Fed. Reg. 69,998 (Nov. 21, 2000).

[3] See, for example, the Reservation of Rights of the United States of America and Response to Debtor's Motion Pursuant to Bankruptcy Rule 9019, In re: Arch Coal, Inc., No. 16-40120 (Bankr. E.D. Mo., Feb. 18, 2016).

District of Missouri, "SMCRA's requirement for full reclamation bonding [...] is an additional and distinct requirement from the requirement for contemporaneous reclamation during ongoing mining operations." The State of Wyoming's claim that its agreement with the companies "sets Debtors on a path to comply with their bonding obligations"[4] is unacceptable. Reclamation obligations are not a journey. The companies are in compliance or they are not.

At the same time that Alpha is shirking its bond obligations, potentially shifting hundreds of millions of dollars in liability to taxpayers, it succeeded in obtaining approval from the Bankruptcy Court for the Eastern District of Virginia to pay 15 executives $12 million in bonuses this year. Meanwhile, the company is separately seeking to reduce medical, life insurance, and retirement benefits for its workers. This behavior is indicative of the challenge your agency faces in holding companies accountable once they enter bankruptcy.

There are many ways for a private company to raise money to pay for the equipment and workforce needed to operate a mine. There is exactly one way to receive permission to operate a mine. A key federal condition of the mine permit should not be treated just like any other debt in bankruptcy proceedings. This particularly debt (financial assurance) is specifically designed to keep the public safe and protect the environment, as opposed to keeping whole investors who knowingly risked funds on a self-bonded coal company. I hope that the Administration is successful in representing this view.

It is imperative that the Department vigorously protect the public interest by requiring compliance with SMCRA by every solvent and bankrupt coal company. It is also imperative that you seek full protection for bankrupt companies' bonding obligations in bankruptcy proceedings. The Administration has begun this process by filing its concerns and reservations of rights in the proceedings. I am anxious to learn of your next steps.

Request
I request your response to the following questions:

- Beyond issuing ten-day notices to states, reserving rights in bankruptcy proceedings, and filing concerns about side agreements States are reaching with bankrupt companies, what more will the Department do to enforce the requirements of SMCRA and shield taxpayers from liability for reclamation?

- What is the Department's plan to establish and implement its concurrent enforcement authority under SMCRA?

- Does the Department plan to notify currently solvent companies of expectations the Department holds for compliance with SMCRA should the companies enter bankruptcy?

[4] The State of Wyo. and the Wyo. Dep't of Env't Quality's Reply to the W. Org. of Res. Councils' Combined Ltd. Objection, In re: Arch Coal, Inc., No. 16-40120 (Bankr. E.D. Mo., Feb. 22, 2016).

- Beyond the topic of self-bonding, are there related financial assurance challenges the Department foresees in the surety bond market, bond pools, or other forms of financial assurance?

- Are there any changes need to current law to minimize those other challenges?

- Are there successful examples of bonding compliance under bankruptcy proceedings that the Department is suggesting States follow?

- Why should BLM's conclusion 16 years ago about hardrock financial assurance not apply equally to coal self-bonds backed by corporate guarantees?

- Does the Administration support a prohibition on any new self-bonds for coal mining reclamation going forward?

Thank you for your consideration and for your continued to work to address problems in the federal coal programs.

Sincerely,

Maria Cantwell
Ranking Member
Committee on Energy and Natural Resources

Enclosure