

Mine Reclamation Bonding- From Dilemma to Crisis to Reinvention: What's a State Regulator to Do?

Presented by
Gregory E. Conrad
Executive Director

**Interstate Mining
Compact Commission**



What is the IMCC?

- Multi-State Governmental Organization
- Represents Natural Resource/Environmental Protection interests of the 21 Full member and 5 associate member state on both Coal Noncoal/Hardrock Mining Issues in Washington, DC

Member States:

Alabama
Alaska
Arkansas
Illinois
Indiana
Kentucky
Louisiana
Maryland
Missouri
New York
North Carolina
North Dakota
Ohio
Oklahoma

Pennsylvania
South Carolina
Tennessee
Texas
Utah
Virginia
West Virginia

Associate Members:

Colorado
Mississippi
New Mexico
Nevada
Wyoming

Legal Background – Coal

Cooperative Federalism

- Surface Mining Control and Reclamation Act (“SMCRA”), 30 U.S.C. §1201 *et seq.*
- State Primacy
- Permit Required
 - Mining and Reclamation Plan
 - Reclamation Bonding Requirements
- Evolving nature of bonding challenges

Bonding Overview

- Bonding is the backbone of the SMCRA Program: providing assurance that reclamation will be completed if an operator is unable to do so.
- General goal: have enough money on hand at any time to cover the cost of reclamation in order to complete the reclamation plan.

Bonding Overview

Determining Bond Amount

- After the permit is reviewed, the applicant's operation and reclamation plan is used to calculate total cost for a third party to reclaim the site.
- “Worst Case bonding”- determine the point of the maximum reclamation cost liability
 - For surface mining, examples might be the longest/deepest pit, the largest area of prime farmland, etc.
- Use of Bonding Handbook

Bonding Overview

Types of acceptable Bonding Instruments

- Surety bonds
- Collateral
 - Cash, letters of credit, property, etc.
- Self-bonding
- Trust Funds
- Alternative bonding systems (bond pools)

Types of Financial Assurance In IMCC Member States (Coal)

COAL	Trad. Sureties	T.S. 50%+	Corp. Guar.	Collateral	Trust Fund	Bond Pool	Other
AL	X	X		X			
AK	X		X	X			
AR	X		X	X			
CO	X	X	X	X			
IL	X	X	X	X			
IN	X		X	X		X	X
KY	X	X	X	X	X	X	
LA	X	X		X			
MD	X			X		X	
NM			X	X			X
OH	X	X			X	X	X
OK	X	X		X			
PA	X	X		X	X		X
TX	X		X	X			
UT	X	X		X	X		X
VA	X	X	X	X		X	X
WV	X	X	X	X			X
WY	X		X				
% total	95%	57%	63%	89%	21%	26%	42%

“T.S. 50%+” - Traditional Sureties represent over 50% of bonding obligations

“Other” - includes Self Bond, Parent Guarantee, and Third-Party Guarantee

Long Term Treatment Dilemma

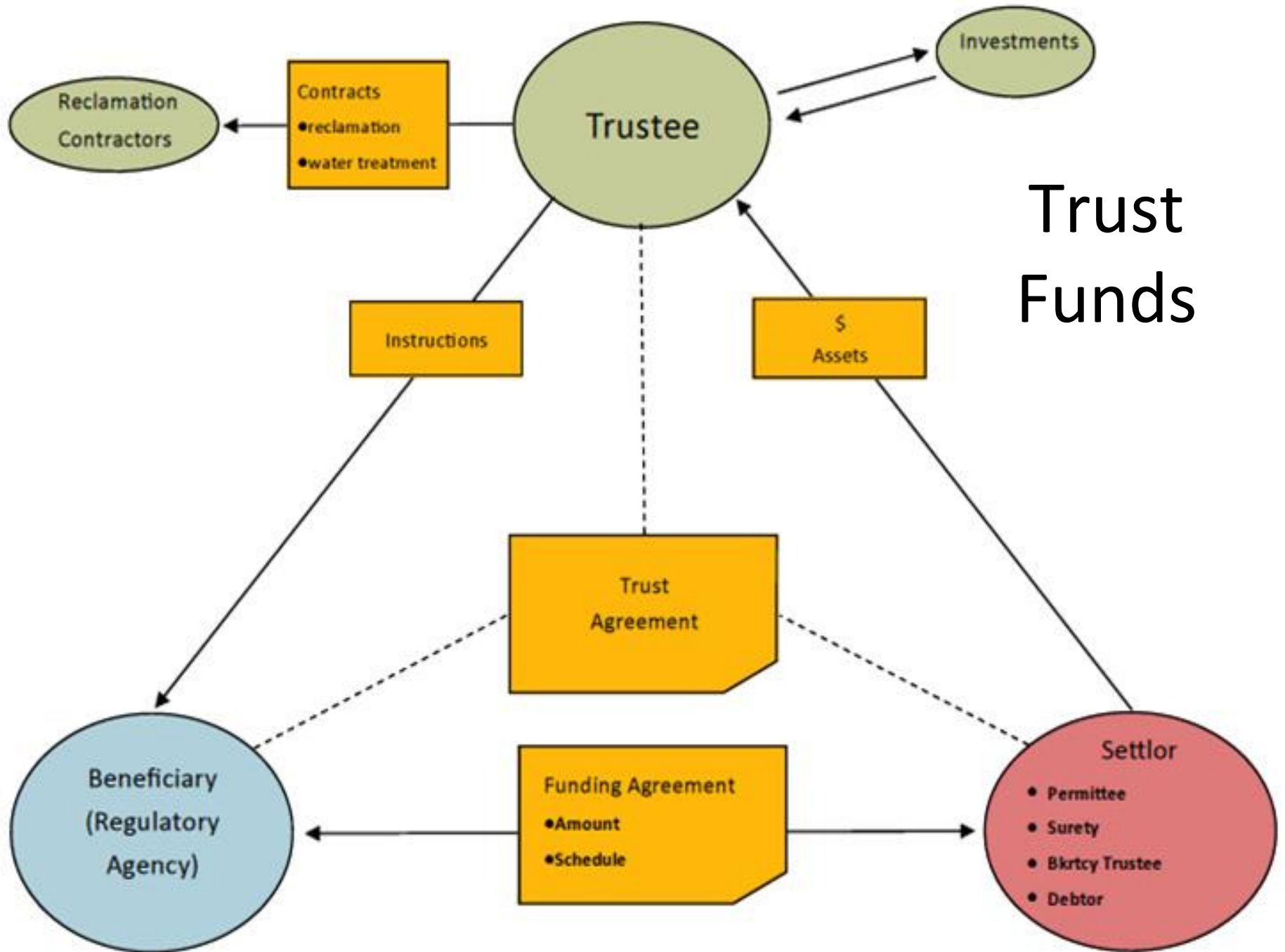
- Surety bonds are generally not available solely for perpetual obligations such as AMD; it's not the nature of a surety bond.
- A proper bond amount cannot be calculated:
 - AMD can be forever, so cost is undefined
 - Bonds are fixed value, so “no amount of bond can be calculated to pay for AMD treatment in perpetuity.”

Long Term Treatment Dilemma

- Operators with AMD are currently treating their discharges, even though bonding is inadequate.
- Inability to comply with bond increase leads to progressive enforcement, cessation of operations, and termination of water treatment.
- **Trust fund solution**: appreciation of the fund over time means water pollution can be treated in perpetuity.
 - Trust is not a bond. It is an alternative financially-backed agreement enforceable under other provisions of law.

Trust Funds

- Three Parties
 - Settlor = Permittee if active or others in default situation (Surety, Debtor, Purchaser)
 - Beneficiary = Regulatory Authority
 - Trustee = Third Party satisfactory to Settlor and Beneficiary
- Settlor, Beneficiary and Trustee negotiate terms of trust agreement, trust amount (corpus), payment schedule



Trust Fund Components

- Treatment system design
 - Formulate performance criteria
 - End of pipe or in-stream?
 - Yearly O&M; Capital cost details
- Legal language
 - Alternative bonding agreement (ABA), Trust documents
 - Time frames – yearly review, deposits/disbursements
 - Right of Entry
- Financial instrument and language
 - Financial vehicles/instruments
 - Financial assumptions: ROI, investment mix, inflation
 - Trustee, management fees

Trust Fund Setup

- Two setup components:
 - Initial set up
 - Yearly review
- Team approach
 - Engineer
 - Hydrologist
 - Lawyer
 - Economist
 - Biologist (stream surveys)

Treatment System Design

- Team: Manager, engineer, hydrologist, biologist
- Pertinent questions to be answered:
 - What are the goals of the treatment system?
 - Is system designed to meet those goals?
 - How complicated is the design?
 - Who will manage/maintain treatment system?
 - Operator, Regulatory Authority, Trustee?
 - High flow events – what are the contingencies?
 - What is cost breakdown – Capital, O&M?
 - Are economies of scale included in estimates?
 - What is third party cost of operating treatment system?

Financial Instruments

- Team: Economist, manager, lawyer
- Pertinent Questions to be Answered:
 - What is the investment vehicle and mix?
 - What is the assumed inflation rate?
 - What is expected ROI? Market volatility?
 - Who is trustee and how much are the trustee and management fees?
 - How will market volatility be handled?
 - How will trust fund balances be tracked?
 - How will fund excesses be handled?

Legal Language

- Team: Lawyer, manager, engineer, hydrologist
- Pertinent Questions to be Answered:
 - What happens if operator no longer viable entity?
 - What is the Regulatory Authority/obligation?
 - Who has the legal right of entry?
 - What becomes of existing permit?
 - What are the timeframes for annual reviews?
 - What are the exact dollars and treatment system designs?
 - What are the performance criteria for long and short term?
 - How will fund shortfalls/excess be reconciled?
 - How will unexpected events be handled?

Yearly Review Treatment Trusts

- Review Areas:
 - Treatment system performance
 - Review yearly expenditures
 - How well did estimates match actuals?
 - Trust fund performance
 - Legal agreement language
- Develop yearly review report

Self Bonding/ Corporate Guarantee

- 11 states allow use of Self-bond/Corporate guarantee
 - 50%+ in Alaska, Indiana, New Mexico, Texas, and Wyoming
 - Allowed by SMCRA ; Not allowed by FLPMA
- Certified Financial Statement, requires tests to demonstrate Financial Solvency
 - Credit Ratings- Standard and Poor or Moody's
 - Generally must be investment grade, but some require higher
 - Asset minimums and ratios
 - Minimum net worth ; minimum percentage of US assets ; minimum ratio of net worth to proposed financial assurance, positive net income ; assets or net worth to liabilities ratio
- Often requires a Guarantor; “Parent” or “Third Party”
 - Can be the company itself ; Often requires another corporate entity
 - Corporate relationship allowed between guarantor and permittee depends on regulations; some require guarantor to be distinct

Self Bonding Concerns

- Concerns with Large Self bonded companies
 - Some struggle to maintain financial solvency tests
 - Often due to recent restructuring/ downturn in Coal markets
 - Due in turn to fuel switching and or expanded regulatory requirements related to burning of coal
- Large companies often have commercial interests in several states
 - Agency decisions to accept self-bonds are based on intra-state information.
 - The state regulators have a limited picture of a company's bonded capacity
- If financial health of a large company is overestimated, unexpected defaults will fall to the state
 - Could be caused by defaulted projects in other states

Possible Solutions to Self Bonding Concerns

- Financial Health Assessments for Self-bonded companies
 - Engage in more stringent and frequent evaluations of Financial health
 - Nevada reports success with new system of checklists and other requirements
- New Fee system
 - Establish a fee for Self-bonded companies
 - This fee will finance a Third-party auditor to regularly evaluate financial health for self bonded companies

Possible Solutions for Self Bonding Concerns

- Require Third Party Guarantee
 - Guarantee must not come from a company within the same corporate family as the bonded company
- Sight Draft
 - A bill of exchange that is payable at sight
 - Allows the money to be collected immediately upon presentment to the drawee named in the instrument

Bond Pools

An Alternative Bonding Mechanism

- Bond pools have seen renewed attention
 - Largely due to recent court decisions like West Virginia Highlands Conservancy, Inc v Huffman
- About 6 states utilize a bond pool currently
- Several states are in the process of restructuring their system
 - Reorganizing funding mechanisms- severance tax rate, operator contributions, etc.
- Unanticipated Acid Mine Drainage is a growing concern for Bond pools
 - Especially due to court decision in PA that the entire bond pool is liable for the full amount of any one operator's long-term water treatment obligations

Bond Pool - Ohio

- Ohio Bond Pool is funded through:
 - Severance tax on extracted coal
 - Determined by balance in the Pool at the end of Ohio's biennium
 - Recently reduced to 12¢
 - Civil penalties
 - Money from liens and fines
- Eligible companies electing to participate must:
 - post \$2500/acre bond or performance security
 - pay the fluctuating severance tax

Bond Pool – Kentucky

Kentucky Reclamation Guaranty Fund

- KRGF recently established in response to OSM Part 733 letter
- New protocols increasing bond by 60% deemed inadequate
- So, KRGF created to act as a “back stop”
- It is a mandatory reclamation account, covering reclamation costs for forfeited coal mining sites when bond is inadequate

Bonding Packages

- Agencies and Companies considering “packages” of financial assurance instruments
 - Combination of mechanisms can be matched to appropriate phases of reclamation
- Short Term - Earthwork, revegetation, demolition
 - Match with Surety Bonds or Guarantees- low risk short term
- Long Term - long term monitoring/maintenance, water treatment
 - Match with Trust Funds- appreciation over time

Bonding Requirements for Permit Transfers

- Landholding companies looking for a way to leave some financial assurance in place post-bond release
- Due to water quality issues arising after bond release, leaving landowners on the hook
 - Particularly concerned with Selenium
 - Largely due to recent CWA lawsuits brought by environmental groups

Developments in West Virginia

- Rhino Eastern LLC v Clarke et. al (WVDEP)
- WVDEP approves permit transfer to Rhino though they are not as well capitalized.
- But, WVDEP requires increased bond amount
 - Through rule 11.2e (WVCSR § 38-2-11.2e)
- Rhino disputes bond increase, brings suit
- Parties compromise: no increase in bond BUT Agreed Order spells out financial restrictions for Rhino to ensure their continuing viability

Developments in West Virginia

- OVEC v. Fund 8 Domestic
 - Environmental groups sue Fund 8 (large landholding company) over CWA violations
- Two defunct mines allegedly discharging selenium
 - Both sites previously granted phase 3 bond release, so landowner is remaining liable party
- Liable for daily \$37,500 CWA penalty

Other Bonding Concerns

- Bond Forfeitures
 - Where insufficient funds are left following forfeiture
 - Especially those associated with bankruptcies and the potential for alternative enforcement
- Tracking Letters of Credit
 - As a result of bank mergers and closures
- Difficulties with updating/increasing bond amounts
- Incentivizing coal operators to seek bond release
- Expenses associated with Full-cost bonding
- Increasing complexity of administering bonding programs
 - Especially regarding risk analysis

CERCLA

- Comprehensive Environmental Response, Compensation, and Liability Act 42 U.S.C. 9601 et seq.
- Superfund
 - Cleanup of hazardous waste sites
 - Costs borne by those responsible
- Remedial
- Potentially Responsible Parties (PRPs)

CERCLA 108(b) Financial Responsibility

- “To the maximum extent practicable, the [Administrator] shall cooperate with and seek the advice of the commercial insurance industry in developing financial responsibility requirements.
- Financial responsibility may be established by any one, or any combination, of the following: insurance, guarantee, surety bond, letter of credit, or qualification as a self-insurer.
- In promulgating requirements under this section, the [Administrator] is authorized to specify policy or other contractual terms, conditions, or defenses which are necessary, or which are unacceptable, in establishing such evidence of financial responsibility in order to effectuate the purposes of this Act.”

CERCLA Hardrock Financial Assurance Rulemaking

- Coordination with other Federal/State FA requirements
 - FA required by federal land managers
 - FA required under state mining and environmental protection rules
- Calculation of federal FA
 - What costs should be covered?
 - Flat amount or site specific?
 - Adequacy of existing FA
 - When must they post FA
 - Which mechanisms can be used?
- Preemption: CERCLA Section 114

Conclusion

- Reclamation bonding has always dealt with challenges, and there will be new challenges going forward
- States with primary regulatory authority in this area have been vigilant in tracking critical changes to the reclamation bonding arena
- State regulators **MUST** continue to stay one step ahead of economic, financial, and corporate health factors that define the landscape for the future

Questions?

