



*Sent via electronic and first-class mail*

December 16, 2015

Todd Parfitt, Director  
Kyle Wendtland, Administrator  
Wyoming Department of Environmental  
Quality  
Land Quality Division  
200 West 17th Street, Garden Level  
Cheyenne, WY 82002  
[todd.parfitt@wyo.gov](mailto:todd.parfitt@wyo.gov)  
[kyle.wendtland@wyo.gov](mailto:kyle.wendtland@wyo.gov)

Jeffrey Fleischman  
Division Manager, Denver Field Division  
Office of Surface Mining  
150 East 'B' St., Rm. 1018  
Casper, WY 82602  
[jfleischman@osmre.gov](mailto:jfleischman@osmre.gov)

RE: Citizen complaint and request for inspection and enforcement action regarding Arch Coal, Inc.'s mining operations in Wyoming

Dear Sirs:

In accordance with Sections 517(h) and 521(a) of the Surface Mining Control and Reclamation Act ("SMCRA"), the Western Organization of Resource Councils and the Powder River Basin Resource Council (collectively the "Resource Councils") submit the following citizen complaint and request for inspection and enforcement action regarding ongoing surface coal mining operations of Arch Coal, Inc. ("Arch Coal") and its subsidiaries Thunder Basin Coal Company and Arch Western Resources, LLC. ("Arch Western Resources") (collectively ("Arch")) that violate the federal Surface Mining Control and Reclamation Act ("SMCRA") and Wyoming's Environmental Quality Act ("WEQA"). As discussed below, the Resource Councils have reason to believe that Arch Coal and its subsidiaries are conducting surface coal mining operations in Wyoming without sufficient reclamation bonding as required by SMCRA and the WEQA.

## **Requested Relief**

The Resource Councils request that the Department of Environmental Quality (“DEQ”) issue a notice of violation to the operator and that the notice require the operator to take appropriate remedial action including posting substitute financial assurance. We also request that DEQ send a notice letter to Arch demanding that any financing agreements the company obtains as part of its restructuring efforts set aside sufficient funds to allow for the substitute bonds for the entire reclamation obligation. This demand would apply to any agreements the company is reaching with its creditors prior to a bankruptcy filing, any initial filings in a bankruptcy proceeding that sets aside financial assets for reclamation obligations,<sup>1</sup> and any restructuring plan filed as part of a bankruptcy proceeding.

However, it should be noted that until Arch posts the necessary bond substitutes, the company is in noncompliance with SMCRA and the WEQA. As such, DEQ should not approve any permit renewals, modifications, additional increments, or incidental boundary revisions (IBRs) for Arch mines so long as self-bonds are the only financial assurance available for the mining operation.

By this letter, the Resource Councils are notifying both DEQ and the Office of Surface Mining Reclamation and Enforcement (“OSM”) of this complaint. Should DEQ fail to issue a notice of violation to the operator within 10 days, the Resource Councils request that OSM conduct an inspection and take appropriate enforcement action as described above.

The Resource Councils hereby waive their rights to confidentiality and request the right to accompany the inspector on any inspection of the mine site if such a field inspection is held. You can reach our organizations at the address and telephone number listed below.

In accordance with 30 C.F.R. § 842.12(d), the Resource Councils request that OSM or DEQ report the results of any inspection within 10 days from the date of the inspection, or if OSM or DEQ chooses not to inspect, to explain the reasons for that decision, within 15 days from the date that this letter is received.

### **Arch Coal is Violating SMCRA’s Bonding Requirements because the Company – and Its Subsidiaries – No Longer Qualify for Self-bond Status**

SMCRA provides:

The regulatory authority may accept the bond of the applicant itself without separate surety when the applicant demonstrates to the satisfaction of the regulatory authority the

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<sup>1</sup> *E.g.*, the \$100 million set aside in the Alpha bankruptcy proceeding as part of the company’s DIP financing.

existence of a suitable agent to receive service of process and a history of financial solvency and continuous operation sufficient for authorization to self-insure or bond such amount or in lieu of the establishment of a bonding program, as set forth in this section, the Secretary may approve as part of a State or Federal program an alternative system that will achieve the objectives and purposes of the bonding program pursuant to this section.

30 U.S.C. § 1259(c). Under this authority, Wyoming has elected to allow alternative bonding, specifically self-bonding. However, similar to SMCRA, the WEQA provides that self-bonds *may* be accepted only if the operator demonstrates “a history of financial solvency” and only if “the objectives and purposes of [the WEQA]” are being fulfilled. W.S. § 35-11-417(d).

Arch Coal and its subsidiaries are in violation of these requirements because (1) Arch no longer has a “history of financial solvency” that allows the company to self-bond; and (2) the purposes of SMCRA and the WEQA are not being fulfilled by allowing the company to continue to self-bond because the public is left at risk for covering the liability of the companies, should they default on obligations through, during, or following an impending bankruptcy proceeding. As such, DEQ – or in its stead OSM – should require Arch to substitute additional financial assurance for its self-bonds within ninety days as required under state and federal regulations.<sup>2</sup> Additionally, if Arch files for bankruptcy within this ninety day period, the regulators must continue to enforce their compliance order through this outside enforcement proceeding, along with any enforcement necessary inside the bankruptcy proceeding.<sup>3</sup>

While the Resource Councils are unable to verify if Arch Western Resources itself meets the financial tests set forth in state and federal regulations,<sup>4</sup> we are able to verify that the parent corporation, Arch Coal, does not qualify for self-bonding. The following chart displays relevant financial information filed by Arch Coal with the United States Securities and Exchange Commission (“SEC”) that demonstrates that Arch Coal does not qualify to self-bond, based on the 2014 year-end audited financials (the financial statement that DEQ uses to determine eligibility for self-bonding):

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<sup>2</sup> The only acceptable bond substitutes allowed under the rules are “a corporate surety, cash, governmental securities, or federally insured certificates of deposit, or irrevocable letters of credit.” Wyo. Land Quality Rules and Regulations (“LQRR”), Chap. 11 § 5(a).

<sup>3</sup> As has been the case with Alpha Natural Resources, Arch might argue that such enforcement actions are prevented because of stay provisions in the federal bankruptcy code. However, enforcement of requirements for financial assurance under environmental laws falls within the police and regulatory exception to the automatic stay. 11 U.S.C. § 362(b)(4); *Safety-Kleen, Inc. v. Wyche*, 274 F.3d 846, 865-66 (4<sup>th</sup> Cir. 2001).

<sup>4</sup> The Resources Councils submitted a Public Records Act request to DEQ in January 2015 for correspondence between Arch Western Resources and DEQ, but the agency has yet to respond to that request.

Arch Coal Inc. Financial Data and Computed Ratios from 2014 Year-End Audited Financial Statement filed with SEC		
<b>Total Liabilities</b> (\$000s)	<b>Net Worth</b> (\$000s)	<b>Total Liabilities to Net Worth</b> (violation > 2.5)
\$6,761,569	\$1,668,154	4.05
<i>Source:</i> Arch Coal Annual Report on Form 10-K, filed with SEC February 27, 2015. Pp. F-7: <a href="https://www.sec.gov/Archives/edgar/data/1037676/000104746915001419/a2223254z10-k.htm">https://www.sec.gov/Archives/edgar/data/1037676/000104746915001419/a2223254z10-k.htm</a>		

Because Arch Western Resources’ assets are pledged to Arch Coal, the two entities must be viewed in tandem and the financial condition of Arch Coal must be considered when determining whether Arch Western Resources qualifies for self-bonding to meet the full intent of SMCRA. Securities filings with SEC indicate that the assets of Arch Western Resources are pledged as collateral for Arch Coal’s secured corporate debt.<sup>5</sup> Thus, should Wyoming need to collect from the operator for reclamation liability it will almost assuredly be forced to collect from Arch Coal, as Arch Western Resources is merely an intermediate subsidiary. For this reason, the financial condition of Arch Coal – not Arch Western Resources – must be the driving determination of whether the operator qualifies for self-bond status. Because Arch Coal no longer meets the financial tests to allow self-bonding, DEQ – and in its stead OSM – *must* require bond substitution for its mines in Wyoming.

Moreover, irrespective of the specific financial tests, all of the Arch entities are no longer able to demonstrate a “history of financial solvency.” There is no shortage of public information about the likelihood that Arch Coal will file for bankruptcy soon, most likely on or before January 15, 2016,<sup>6</sup> including by Arch’s own admission:

<sup>5</sup> See Arch Coal, Exhibit 10.1 to Current Report on Form 8-K, Dec. 17, 2013: “Amendment Number Four to Amended and Restated Credit Agreement, dated as of December 17, 2013, by and among Arch Coal, Inc., as Borrower, the guarantors party thereto, the lenders party thereto, Bank of America, N.A., as term loan administrative agent, and PNC Bank, National Association, as Revolver Administrative Agent,” available at [https://www.sec.gov/Archives/edgar/data/1037676/000110465913090759/a13-26411\\_1ex10d1.htm](https://www.sec.gov/Archives/edgar/data/1037676/000110465913090759/a13-26411_1ex10d1.htm) (last accessed Dec. 11, 2015).

<sup>6</sup> See Tim Loh, *Arch May File for Bankruptcy in ‘Near Term’ as Debt Mounts*, *Bloomberg Business*, Nov. 9, 2015, available at <http://www.bloomberg.com/news/articles/2015-11-09/arch-posts-12th-consecutive-loss-as-liquidity-weighs-on-lenders> (last accessed Dec. 11, 2015); Dow Jones, *J.P. Morgan: Chapter 11 Could Come for Arch, Peabody in 2016*, available at <http://bankruptcynews.dowjones.com/Article?an=DJFDBR0120151210ebcalxdkf&cid=32135012&ctype=ts&pid=310&ReturnUrl=http%3a%2f%2fbankruptcynews.dowjones.com%2fArticle%3fan%3dDJFDBR0120151210ebcalxdkf%26cid%3d32135012%26ctype%3dts%26pid%3d310> (last accessed Dec. 11, 2015).

As a result of extremely challenging current market conditions, Arch believes it will require a significant restructuring of its balance sheet in order to continue as a going concern in the long term. We are currently in active dialogue with various creditors with respect to a restructuring of our balance sheet. There can be no assurance that these efforts will result in any such agreement. If an agreement is reached and we pursue a restructuring, it may be necessary for us to file a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code in order to implement this agreement through the confirmation and consummation of a plan of reorganization approved by the bankruptcy court in the bankruptcy proceedings. We may also conclude that it is necessary to initiate Chapter 11 proceedings to implement a restructuring of our obligations even if we are unable to reach an agreement with our creditors and other relevant parties regarding the terms of such a restructuring. In either case, such a proceeding could be commenced in the near term.<sup>7</sup>

Demonstrating the likelihood of a bankruptcy filing is that on December 15, 2015, Arch Coal missed an interest payment of approximately \$90 million dollars due to holders of several of its debt instruments, choosing instead to exercise a thirty-day grace period. Financial analysts view this as a clear indication of an impending bankruptcy filing.<sup>8</sup>

A company that has admitted to investors that it may file bankruptcy, and has in fact taken steps that indicate it may do so within a specified period, is by definition financially insolvent. A company voluntarily enters bankruptcy only when it is no longer able to service its debt and meet its financial obligations, i.e. when it is no longer financially solvent.

If and when Arch Coal does file for bankruptcy, there is little doubt that Arch Western Resources would also file, as its assets (e.g., coal mines in Wyoming) are pledged as collateral for Arch Coal's secured corporate debt. For instance, in a recent Application for Qualification of Indentures filed with SEC, Arch Coal disclosed that: "The Company [Arch Coal, Inc.] and each of its subsidiaries are affiliates of each other. Set forth below are the direct and indirect subsidiaries of the Company. Except as otherwise noted, the capital stock or other equity interests of these subsidiaries is wholly-owned, directly or indirectly, by the Company."<sup>9</sup>

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<sup>7</sup> See Arch Coal, Quarterly Report on Form 10-Q, Nov. 9, 2015, at 45, available at [https://www.sec.gov/Archives/edgar/data/1037676/000110465915076941/a15-17988\\_110q.htm](https://www.sec.gov/Archives/edgar/data/1037676/000110465915076941/a15-17988_110q.htm) (last accessed Dec. 11, 2015).

<sup>8</sup> See Amrutha Gayathri, *Arch Coal to delay bond interest payment as bankruptcy looms*, Reuters, Dec. 15, 2015, available at <http://www.cnbc.com/2015/12/15/reuters-america-update-2-arch-coal-to-delay-bond-interest-payment-as-bankruptcy-looms.html> (last accessed Dec. 15, 2015) (quoting BB&T Capital Markets as saying an Arch Coal bankruptcy "filing looks like a near certainty").

<sup>9</sup> Arch Coal, Form T-3, July 2, 2015, at 7, available at [http://www.sec.gov/Archives/edgar/data/1022356/000110465915049671/a15-15061\\_1t3.htm](http://www.sec.gov/Archives/edgar/data/1022356/000110465915049671/a15-15061_1t3.htm) (last accessed Dec. 11, 2015).

Notably, Arch Western Resources was listed on the table included in the filing following that statement<sup>10</sup> and was a signatory to the filing.<sup>11</sup>

While its corporate structure is slightly different, Arch is no different than other coal companies that have filed for bankruptcy in the past year. Filings for parent companies Alpha Natural Resources, Patriot Coal, and Walter Energy have all included subsidiary companies,<sup>12</sup> especially those carrying significant assets. In the case of Arch, the assets of Arch Western Resources, specifically the Black Thunder Mine operated by Thunder Basin Coal Company, make up a significant portion of Arch's total assets. The Black Thunder Mine produces roughly 10% of the nation's coal,<sup>13</sup> and no other Arch mine comes even close to its annual production or profit.<sup>14</sup> In addition, because Arch Western Resources is pledged as collateral to Arch Coal's senior secured debt, it is highly likely that any bankruptcy proceeding would, by necessity, include Arch Western Resources, if only as a matter of equity to Arch's creditors.

Therefore, Arch Western Resources should be deemed financially insolvent and therefore be disqualified from being able to use self-bonds to meet its financial assurance obligations under SMCRA and the WEQA.

Additionally, with the likelihood of Arch's impending bankruptcy, it is clear that the purposes of the WEQA and SMCRA are not being met by allowing Arch to continue to self-bond. Now is the time to protect the public interest and ensure the purposes of the Act are being met.

One of SMCRA's fundamental requirements is that reclamation bonds "shall be sufficient to assure the completion of the reclamation plan if the work had to be performed by the regulatory authority in the event of forfeiture." 30 U.S.C. § 1259(a).<sup>15</sup> Here, we know that if Arch forfeits its obligations, federal and state regulators would likely only obtain pennies on the

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<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 55.

<sup>12</sup> *See, e.g.* Alpha Natural Resources bankruptcy filing, available at <http://www.kccllc.net/alpharestructuring>.

<sup>13</sup> *See* [www.archcoal.com/aboutus/BT%20Brochure.pdf](http://www.archcoal.com/aboutus/BT%20Brochure.pdf)

<sup>14</sup> Production from Black Thunder accounted for approximately 76% of Arch Coal's total coal sales in 2014. *See* Arch Coal, SEC Annual Report on Form 10-K, Feb. 27, 2015, at 14, available at: <https://www.sec.gov/Archives/edgar/data/1037676/000104746915001419/a2223254z10-k.htm> (last accessed Dec. 14, 2015).

<sup>15</sup> *See also* W.S. § 35-11-117(a): "The purpose of any bond required to be filed with the administrator by the operator shall be to assure that the operator shall faithfully perform all requirements of this act . . ."

dollar – or perhaps nothing at all – because of the lower priority of Arch’s self-bonds relative to its other more senior and secured debt.

This was forewarned by OSM in the promulgation of self-bonding regulations in 1983:

In the event of bankruptcy, the regulatory authority would probably be in the position of an unsecured creditor. Typically, the regulatory authority would have to go through bankruptcy proceedings to secure payment on the indemnity agreement. Bankruptcy proceedings are often lengthy and involved, and the regulatory authority could have to settle on less than 100% payment on the indemnity agreement.<sup>16</sup>

For these reasons, OSM made it clear that self-bonding is designed to be used only for companies with a small risk of bankruptcy:

The purpose of establishing a self-bond program is to recognize that there are companies that are financially sound enough that the probability of bankruptcy is small. A self-bond is allowed both because there are enough assets to allow reclamation in case of bankruptcy and because there is little probability of bankruptcy.<sup>17</sup>

The very purpose of SMCRA was to provide a clean-up fund for abandoned coal mines and to prevent abandonment for any mines permitted after the Act’s passage.<sup>18</sup> As such, bonding for reclamation work is a centerpiece of the law.

Therefore, by allowing Arch to continue to self-bond, regulators are thwarting the very purposes of the Act they are charged with implementing. As such, Arch no longer qualifies for self-bonding as a matter of law because under state and federal law, self-bonding programs “shall be consistent with the objectives and purposes of this act.” W.S. § 35-11-417(d); 30 U.S.C. § 1259(c).

For the above stated reasons, WDEQ should require bond substitution for Arch mines in Wyoming and demand that Arch ensure sufficient financing for such bond substitution as part of its restructuring efforts or through any bankruptcy proceedings. As discussed above, in the meantime, DEQ should not approve any permit renewals, modifications, additional increments,

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<sup>16</sup> See 48 Fed. Reg. 36418 at 36422 (Aug. 10, 1983).

<sup>17</sup> *Id.* at 36421.

<sup>18</sup> See *W. Virginia Highlands Conservancy v. Norton*, 161 F. Supp. 2d 676, 684 (S.D.W. Va. 2001) (“With mandated reclamation plans and reclamation bonds required by federal law to be adequate, SMCRA was a promise to remedy the abuses, protect the environment, and yet permit the recovery of mineral reserves with approved practices and regulatory oversight.”)

or incidental boundary revisions (IBRs) for Arch mines so long as self-bonds are the only financial assurance available for the mining operation.

Sincerely,

A handwritten signature in black ink, appearing to read "Shannon Anderson", with a long horizontal line extending to the right.

Shannon Anderson  
Powder River Basin Resource Council  
934 N. Main St.  
Sheridan, WY 82801  
(307) 672-5809  
[sanderson@powderriverbasin.org](mailto:sanderson@powderriverbasin.org)

*On Behalf of Powder River Basin Resource Council and the Western Organization of Resource Councils*