

United States Senate
WASHINGTON, DC 20510

March 8, 2016

The Honorable Gene L. Dodaro
Comptroller General of the United States
U.S. Government Accountability Office
Washington, D.C. 20548

Dear Comptroller Dodaro:

Under Section 509 of the Surface Mining Control and Reclamation Act (SMCRA), the Secretary of the Interior (“the Secretary”) and States with approved regulatory programs under Section 503 of SMCRA may accept reclamation performance bonds from coal mining companies, subject to a financial test detailed in regulation (30 CFR 800.23), without separate surety.

SMCRA does not require the acceptance of these bonds, known as self-bonds, and some states do not allow their use. Nevertheless, our understanding is that companies currently operating coal mines under SMCRA permits have posted an aggregate of \$3.6 billion of self-bonds across multiple states to cover their performance bond obligations. Several of these companies, including Alpha Natural Resources and Arch Coal, have recently entered bankruptcy under chapter 11 of the Bankruptcy Code.

Wyoming actions

In the case of both companies, the State of Wyoming, under what it claims is exclusive authority¹ under SMCRA, has entered into agreements to categorize a small portion of the outstanding self-bonds (15 percent and 19 percent, respectively) as “superpriority” claims against the companies’ collateral in federal bankruptcy proceedings. In exchange, despite the clear failure of both companies to meet the financial test for self-bonding established by the Department, the State has agreed to allow the companies to continue operating mines under their existing SMCRA permits. These agreements leave \$743 million in outstanding self-bonds unsecured.

Meanwhile, Alpha Natural Resources succeeded in obtaining approval from the Bankruptcy Court for the Eastern District of Virginia to pay 15 executives \$12 million in bonuses this year. The company is separately seeking to reduce medical, life insurance, and retirement benefits for its workers.

At a recent hearing before the Senate Committee on Energy and Natural Resources, the Secretary said that she thinks “there’s a very significant problem and risk to the taxpayer with the high-profile bankruptcies that have taken place recently with coal companies.” The Department recently issued “ten-day notices” to the State of Wyoming with respect to both companies and filed concerns and reservations of rights in both bankruptcy proceedings.

¹ See, for example, 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 at 3, In re: Arch Coal, Inc., No. 16-40120 (Bankr. E.D. Mo., Feb. 22, 2016).

These recent developments and the scale of other companies' self-bonding, including \$1.47 billion posted by Peabody Energy (another potentially financially challenged company), have led us to conclude that the Department and Congress should revisit SMCRA's self-bonding authorization. As previous reports by your agency and others have detailed, there are numerous reasons why reclamation self-bonding is inherently problematic.

Inherent problems with self-bonding

In principle, there may be private sector activity for which self-bonds or self-insurance are appropriate policies, such as mitigating risk for poorly understood or catastrophic events that the private surety market won't otherwise cover. But coal mining is not subject to such risks.

Instead of collateral or a third-party surety, the integrity of a self-bond relies solely on the value of the firm's underlying financial status. Many firms that specialize in natural resource extraction lack diversified lines of business that can dilute the risk of market downturns. Self-bonds issued by these firms may carry a higher risk of default. Because the current eligibility test for self-bonding evaluates a firm's historic and current financial condition, it also fails to account for rapidly changing market conditions—a common feature of commodity markets.

Beyond the heightened risk of allowing self-bonds in an extractive industry, the policy also places an inappropriate obligation on natural resource regulators. The core competency of federal and state regulators is generally not financial analysis. Yet accepting self-bonds places the burden of evaluating private companies' financial health on the government.

Furthermore, once market conditions do decline, self-bonding has the perverse outcome of discouraging a shift to a stronger form of financial assurance because the shift would occur at the weakest financial moment for the firm. This precise dynamic is occurring today with coal mining companies.

Previous GAO investigations

As you know, the Government Accountability Office (GAO) has a long record of examining financial assurance requirements and practices in many industries, including the fate of financial assurance under the Bankruptcy Code. In 1988, GAO interviewed coal mining regulators in four Appalachian states and found that the states discouraged the use of self-bonding because of the need to closely monitor companies to assure they continued to meet a financial eligibility test.²

In a 2005 report that several of our colleagues and Senator Cantwell requested about financial assurance required by the Environmental Protection Agency (EPA) under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and Resource Conservation and Recovery Act, GAO stated:

The mechanisms that pose the greatest financial risk to the government—the corporate financial test, the corporate guarantee, and some insurance products—also require specialized expertise to oversee. Concerns have been raised, both within EPA and by others, that the corporate financial test and the corporate guarantee offer EPA minimal

² GAO, *Surface Mining: Cost and Availability of Reclamation Bonds*, GAO/PEMD-88-17 (Washington, D.C., Apr. 8, 1988).

long-term assurance that the company with environmental liability will be able to fulfill its financial obligations.³

In a 2006 letter to EPA, its own Environmental Financial Advisory Board echoed GAO's views.⁴

In 2001, in what should be an instructive example for the Office of Surface Mining Reclamation and Enforcement (OSMRE), BLM finally prohibited the use of corporate guarantees for hardrock mining in the wake of bankruptcies such as Galactic Resources in Colorado and Arimetco in Nevada. Even after this prohibition, GAO has repeatedly found that financial assurances for hardrock mines on federal lands are inadequate.

For example, in a 2005 report, GAO found that corporate guarantees that had been grandfathered in after BLM's 2001 prohibition totaled \$204 million, nearly all in the State of Nevada. The Nevada BLM state office at the time rated corporate guarantees as "not effective" for minimizing losses to the federal government.⁵ In follow-up testimony three years later, GAO found that BLM's financial assurances were still \$61 million short.⁶

In 2011, GAO declared enhancing financial assurances and bonding one of seven key management challenges for the Department.⁷ GAO underscored this point in testimony the same year, pointing out that between 1997 and 2008, four key reclamation and cleanup agencies (BLM, the Forest Service, EPA, and OSMRE) had spent at least a total of \$2.6 billion to reclaim abandoned hardrock mines on federal, state, private, and Indian lands.⁸ Taxpayers may face even larger liability for coal mines.

The GAO again investigated the topic of inadequate financial assurance in 2012, finding that millions of dollars in CERCLA financial assurances for phosphate mines in Idaho was in the form of potentially risky corporate guarantees.⁹

Most recently, in December 2015, GAO issued a report describing problematic bonding waivers issued by the Bureau of Ocean Energy Management for the decommissioning costs of offshore oil and gas infrastructure.¹⁰

³ GAO, *Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations*, GAO-05-658 (Washington, D.C.: Aug. 17, 2005).

⁴ EPA Environmental Financial Advisory Board, Letter to EPA Administrator Stephen Johnson, "Re: EFAB initial findings concerning use of the financial test and corporate guarantees to meet financial assurance requirements under RCRA programs" (Jan. 11, 2006).

⁵ GAO, *Hardrock Mining: BLM Needs to Better Manage Financial Assurances to Guarantee Coverage of Reclamation Costs*, GAO-05-377 (Washington, D.C.: Jun. 20, 2005).

⁶ GAO, *Hardrock Mining: Information on Abandoned Mines and Value and Coverage of Financial Assurances on BLM Land*, GAO-08-774T (Washington, D.C.: Mar. 12, 2008).

⁷ GAO, *Department of the Interior: Major Management Challenges*, GAO-11-424T (Washington, D.C.: Mar. 1, 2011).

⁸ GAO, *Abandoned Mines: Information on the Number of Hardrock Mines, Cost of Cleanup, and Value of Financial Assurances*, GAO-11-834T (Washington, D.C.: Jul. 14, 2011).

⁹ GAO, *Phosphate Mining: Oversight Has Strengthened, but Financial Assurances and Coordination Still Need Improvement*, GAO-12-505 (Washington, D.C.: May 4, 2012).

¹⁰ GAO, *Offshore Oil and Gas Resources: Actions Needed to Better Protect Against Billions of Dollars in Federal Exposure to Decommissioning Liabilities*, GAO-16-40 (Washington, D.C.: Dec. 18, 2015).

Request

Given this recent and extensive body of work, we request that you initiate two new investigations: (1) a comparison of authorizations to self-bond (and related practices, including self-insurance, that rely on corporate guarantees) across federal programs that govern resource extraction; and (2) a performance audit of self-bonding under SMCRA, including an examination of the practice under States with programs approved under section 503 of SMCRA and the status of the market for conventional reclamation bonds such as surety bonds.

The results of these investigations will help policymakers evaluate the future of financial assurances for coal and other resources.

Thank you for your consideration.

Sincerely,



Maria Cantwell
United States Senator



Richard J. Durbin
United States Senator