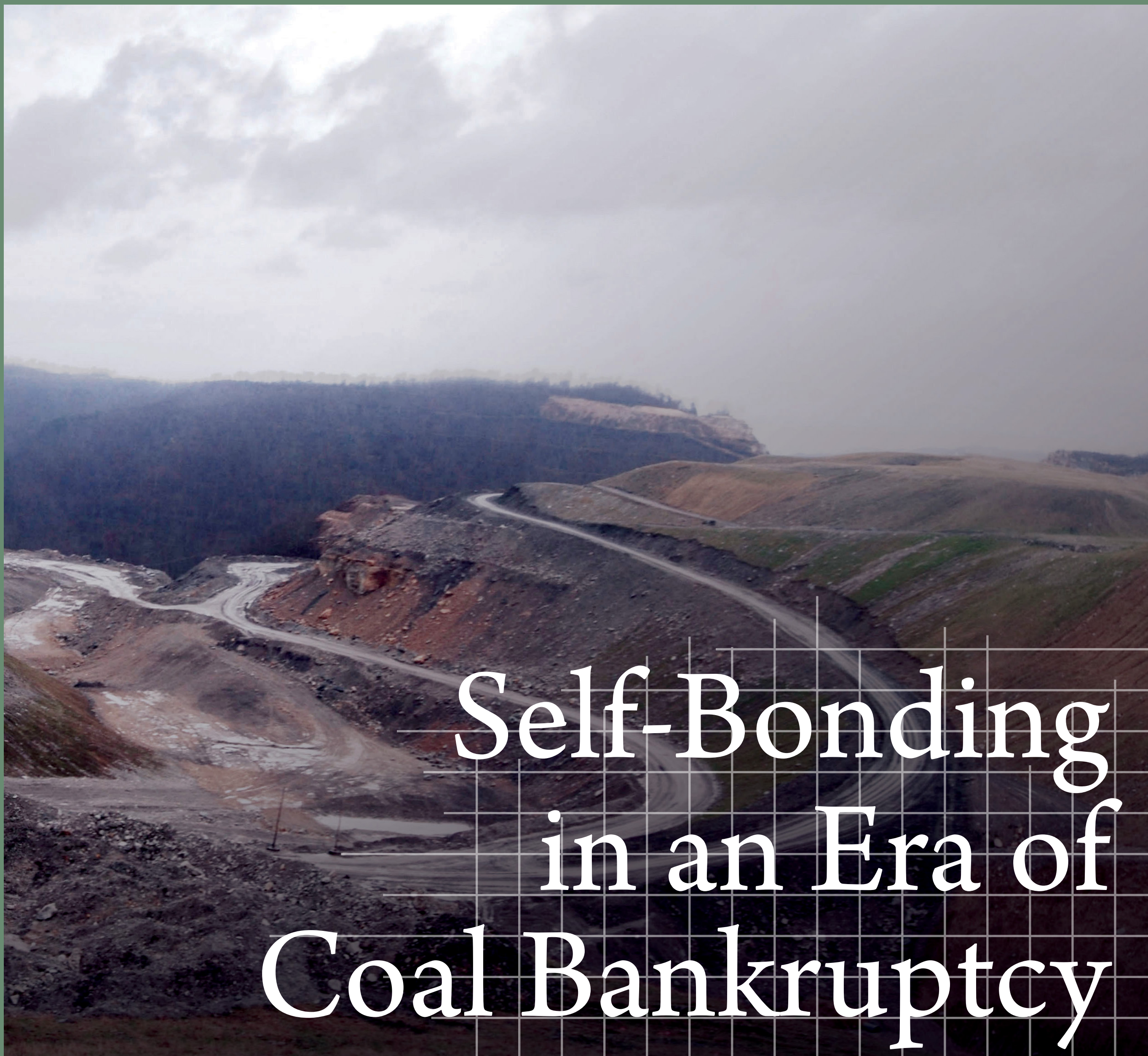
Photo © Kate Wellington



Self-Bonding in an Era of Coal Bankruptcy

Recommendations for Reform

Institute *for* Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW

August 2016
Jayni Foley Hein
Ben Snow
Sean Stefanik
Lauren Webb

Institute for Policy Integrity
New York University School of Law
Wilf Hall, 139 MacDougal Street
New York, New York 10012

The authors thank Shannon Anderson, Peter Morgan, Jason Schwartz, and Richard Revesz for their useful comments on this report. This report does not necessarily reflect the views of NYU School of Law, if any.

Executive Summary

We are witnessing an era of coal bankruptcies. The rise of inexpensive natural gas, reduced demand for coal exports, and steady action to reduce domestic greenhouse gas emissions, among other factors, has placed pressure on coal company profits and called into question the business model of undiversified coal companies. Between August 2015 and May 2016, three of the largest coal companies in the United States declared Chapter 11 bankruptcy, including Peabody Energy Corporation, the world's largest private-sector coal company.[1]

Federal law requires coal companies to reclaim and restore land and water resources that have been degraded by mining. But at many sites, reclamation occurs slowly, if it all. As the coal industry experiences financial distress and coal companies declare bankruptcy, the viability of future reclamation work is endangered. Without decisive action by policymakers, taxpayers may be saddled with the financial burden of funding costly environmental reclamation after coal mining ceases.

The Surface Mining Control and Reclamation Act ("SMCRA") requires mining companies to post performance bonds to ensure the successful completion of reclamation efforts should they become insolvent.[2] These bonds are intended to cover the cost of reclamation in the event a coal company fails to complete the required work itself. However, under current law, regulators have discretion to accept "self-bonds," which allow coal companies that satisfy certain financial conditions to operate without posting any surety or collateral—in effect, offering only their promise to pay once mining operations have concluded.

The total value of self-bonded reclamation obligations in the United States is sizable: according to the Office of Surface Mining Reclamation and Enforcement's ("OSMRE") own calculations, outstanding self-bond obligations currently total $3.86 billion nationwide, of which $2.4 billion is held by coal companies currently in bankruptcy.[3] When a coal company enters bankruptcy, the government may be unlikely to recover the full value of the self-bond.

To qualify for self-bonding, coal companies must meet certain financial health requirements that were intended to limit the availability of self-bonding to companies at low risk of default. But the current regulatory regime fails to meet this goal. First, existing regulations do not account for parent-subsidiary corporate structures. A subsidiary mining company may meet the financial health requirements and qualify for self-bonding even though its parent company does not. If the parent company files for bankruptcy, the subsidiary's assets may be required to satisfy the parent company's debts; meanwhile, the subsidiary may still be permitted to operate under a self-bond even though its assets are effectively unavailable to government regulators. Second, regulators do not routinely evaluate the financial health of self-bonded companies on a sufficiently frequent basis. As a result, when indicators of financial distress become apparent, regulators are often caught in a bind: the company no longer qualifies for self-bonding, but requiring the company to post alternative bonds or collateral may drive it into bankruptcy, further jeopardizing the company's ability to meet reclamation obligations.

The ideal solution would be for Congress to amend SMCRA to abolish self-bonding or to significantly tighten its requirements. But given the current political environment in Congress, this solution may not be forthcoming. This report, therefore, proposes reforms that are achievable within the current statutory framework. These reforms are designed to help OSMRE and state regulatory agencies better assess coal companies' financial health and take steps to curtail self-bonding:

- OSMRE should issue guidance to state regulators on implementing and enforcing its current regulations—including the power to deny requests for self-bonding.
- OSMRE should require self-bonded companies to update financial records with the regulatory agencies on at least an annual basis, and require state regulators to make an annual affirmative finding based on that information that an operator still qualifies for self-bonding, or revoke self-bonding approval and demand bond substitution.
- OSMRE should require state regulators to collect financial information about both the applicant and its parent entity, and report this information to OSMRE. OSMRE should serve as a central repository of information, to avoid problems of double-pledging assets.
- OSMRE and state regulatory agencies should coordinate with the Department of the Interior's Bureau of Land Management ("BLM") to evaluate the financial health of parent corporations so that BLM can consider outstanding reclamation obligations and bonding status before it approves a new coal lease, lease extension, or lease modification.

In short, barring a legislative end to self-bonding, OSMRE should impose more stringent obligations on coal companies and work with state regulators in order to avoid saddling taxpayers with the cost and burden of unfunded coal reclamation.

Overview of Coal Company Self-Bonding

The Federal Statutory and Regulatory Regime

Federal law requires coal companies to reclaim the land affected by their mining operations to a condition capable of supporting the uses which it was capable of supporting prior to any mining.[4] Reclamation work involves the expenditure of funds to restore land and water resources that have been degraded by the adverse effects of mining practices—for example, by managing waste materials, reconstructing and stabilizing drainage features, reconstructing slope stability, and re-establishing vegetation.[5] Each mining operation is governed by a site-specific reclamation plan that aims to facilitate ecosystem reconstruction and the development of a safe and stable landscape.[6]

Reclamation costs are often sizable, totaling hundreds of millions of dollars for some mining operations.[7] To ensure that regulators will be able to complete reclamation in the event a mine operator forfeits its permit, federal law requires mining companies to provide specified financial assurances. The Surface Mining Control and Reclamation Act (SMCRA)[8] establishes a cooperative federal-state regime in which the federal government, through OSMRE in the Department of the Interior, sets minimum standards and retains some oversight authority. After their programs are approved by OSMRE, states have primacy for enforcing the requirements of SMCRA.[9]

SMCRA requires mining companies to post performance bonds, which protect against the risk that a company may have a reduced incentive to reclaim land after its mining operations have concluded. Bonds must "cover that area of land . . . on which the operator will initiate and conduct surface coal mining."[10] The amount required for bonds is determined on a case-by-case basis, depending on the reclamation requirements and "the probable difficulty of reclamation" due to geographic and geological factors, but must "be sufficient to assure the completion of the reclamation plan if the work had to be performed by the regulatory authority" and must not be less than $10,000.[11]

By tying the value of the bond to the total cost of reclamation, SMCRA theoretically ensures that reclamation work can be completed without imposing costs on taxpayers. However, regulators have discretion in many cases to accept "self-bonds," which do not require separate surety, but rather rely on the applicant's financial health. Under self-bonding, some companies operate mines without setting aside assets or arranging for third-party guarantees that regulators can draw upon in the event that a mining company becomes insolvent, or otherwise refuses to complete its reclamation plan. The relevant statute states: "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… a history of financial solvency and continuous operation sufficient for authorization to self-insure or bond such amount" as would otherwise be required in the form of a guaranteed bond.[12]

Implementing regulations promulgated by OSMRE establish the minimum requirements for self-bonding. However, states may impose additional requirements or may choose not to allow self-bonding at all. State programs must be "no less stringent" than the federal statute, and "no less effective" than federal regulations.[13]

A company is currently permitted to self-bond its reclamation obligations pursuant to federal regulations if it meets each of the following conditions:

- The company has continuously operated for at least five years;[14]
- The company meets *one* of the following financial criteria—
    - The company's most recent bond issuance was rated "A" or higher by either Moody's Investor service or Standard and Poor's Corporation;[15]
    - The company has a tangible net worth of at least $10 million, a ratio of total liabilities to net worth of 2.5 times or less, *and* a ratio of current assets to current liabilities of 1.2 times or greater;[16]
    - The company has at least $20 million of fixed assets in the United States *and* a ratio of total liabilities to net worth of 2.5 times or less and a ratio of current assets to current liabilities of 1.2 times or greater;[17]
- The company submits specified financial documents, including audited statements for the most recently completed fiscal year, unaudited statements for completed quarters in the current fiscal year, and additional unaudited information as requested by regulators.[18]
- The total value of self-bonds guaranteed by the guarantor, including guaranteed self-bonds, does not exceed twenty-five percent of the guarantor's tangible net worth in the United States.[19]

Even when a company satisfies these criteria, a regulator retains the authority to deny a self-bond based on additional factors.[20]

Federal regulations permit self-bonding obligations to be satisfied by a parent entity (a "parent guarantee"), provided that the parent meets each of the conditions described above "as if it were the applicant."[21] If a subsidiary with a parent guarantor fails to complete the reclamation plan, the guarantor is liable under the indemnity agreement for the full cost of land reclamation, not to exceed the initial bond amount.[22] Non-parent guarantees are also permitted under the same conditions, for instance from a utility that buys coal from a mine mouth facility. In addition, the mining company itself is required to have continuously operated for at least five years, and regulators may require the mining operator to submit its own financial information "in order to determine the financial capabilities of the applicant."[23]

Once a self-bond is approved, regulators "may require self-bonded applicants, parent and non-parent corporate guarantors to submit an update of the information required under paragraphs (b)(3) and (b)(4) of this section [pertaining to the credit ratings, net worth, and asset/liability ratios] within 90 days after the close of each fiscal year following the issuance of the self-bond or corporate guarantee."[24] Per the current federal regulations, regulators are thus empowered—but not required—to request updated financial information on an annual basis under existing regulations.

Finally, if the financial health of a mining company or its guarantor changes at any time such that the enumerated requirements to-self bond are no longer satisfied, "the permittee shall notify the regulatory authority immediately and shall within 90 days post an alternate form of bond in the same amount as the self-bond."[25] If the permittee fails to post an adequate substitute bond "the operator shall cease coal extraction and . . . shall immediately begin to conduct reclamation operations" and cannot resume mining operations until an acceptable bond is posted.[26] This language is not discretionary—mining operations are not permitted until an acceptable replacement bond is in place.

The Role of State Regulators

Although federal legislation sets a regulatory floor, states are free to establish their own regulatory bodies to fulfill the Surface Mining Control and Reclamation Act's mandate and impose more stringent requirements, including for self-bonding.[27] OSMRE must approve the state regime before delegating to the regulatory agency; most states have successfully created state agencies that fulfill SMCRA's mandate.[28] States are also obligated to amend their regulations if OSMRE increases the stringency of federal regulations.[29] As discussed above, states are *not* required to allow self or alternative bonding methods, and many states, including Tennessee[30] and Ohio, require full third-party surety bonds for some or all mining operations within their borders. Other states—such as Kentucky, Virginia, and West Virginia—utilize additional alternative bonding programs such as pooled bonding.[31]

The Current Extent of Self-Bonding Obligations

If available, self-bonding is an attractive option for qualifying mine operators because it frees up cash or other assets that would otherwise be necessary to collateralize a company's reclamation obligations. As a result, some mining companies are liable for hundreds of millions of dollars in reclamation obligations secured only by the company's ongoing financial health and ability to pay. In 2014, for example, Cloud Peak Energy received approval from the Wyoming Department of Environmental Quality to replace $200 million in surety bonds with self-bonds, which Cloud Peak estimated would save approximately $2 million in annual premiums.[32]

The total value of self-bonded reclamation obligations is sizable, totaling nearly $2.8 billion across just four U.S. companies: Peabody Energy Corp., Alpha Natural Resources, Inc., Arch Coal, Inc., and Cloud Peak Energy Inc. (three of which are currently in bankruptcy).[33] Peabody, for example, has guaranteed approximately 73% of its total reclamation obligations through self-bonds, totaling more than $1.15 billion;[34] however, it's reported net worth at the end of 2015 was only $870 million.[35]

Table 1. Reclamation Obligations by Company

Company	Self-Bonds	Other Reclamation Bonds
Peabody Energy*	$1,150,000,000	$592,000,000
Alpha Natural Resources**	$676,100,000	$399,000,000
Arch Coal*	$485,500,000	$237,200,000
Cloud Peak Energy*	$200,000,000	$433,900,000

* Current as of December 31, 2015
** Current as of December 31, 2014 [2015 SEC filing is forthcoming]

Self-bonding or guarantees by a parent or non-parent corporation are currently permitted in at least 15 states,[36] and self-bonds comprise more than 50% of reclamation obligations in at least five states: Colorado (57%), Indiana (56%), New Mexico (70%), North Dakota (69%), and Wyoming (63%).[37] Other reports suggest that the total proportion of reclamation obligations secured by self-bonds may be even higher.

Self-Bonds and Bankruptcy

The most significant risk associated with self-bonding is that self-bonds are not secured by any assets—in essence they are a bond to nothing, defeating the purpose of requiring financial assurances for "worst case" events like bankruptcy. In the event a mine operator enters bankruptcy, the government may not be able to recover the full value of a company's reclamation obligations because a self-bond is treated by the company like unsecured debt, which falls to the end of the collection line. This problem is exacerbated because the value of a typical coal company's main assets—mining equipment, the company's equity, leases and rights to mine, and coal itself—are all closely linked to the price of coal. As the price of coal declines, as it has in recent years,[38] many of the assets pledged toward reclamation costs lose their value, as well. As a result, the reclamation work necessary to fill in abandoned mines and return them to their natural state may not occur unless taxpayers absorb some of the cost.[39] Deteriorating financial conditions in the coal sector—and in particular, the recent bankruptcies of companies like Arch Coal, Patriot Coal, Peabody, and others—have drawn mounting attention to this problem.

Federal regulations governing self-bonding do not permit companies that fall below the designated financial thresholds to continue to self-bond.[40] If the applicant or guarantor's financial condition changes at any time during the period of the self-bond such that the requirements are no longer met, the permittee is required to notify the regulatory authority immediately and post an alternate form of bond within ninety days, or be forced to cease coal extraction.[41] However, in the case of the Alpha Natural Resources, the company filed for bankruptcy before the end of the 90 day compliance period, negating the effectiveness of the enforcement action.

Self-Bonding Enforcement Challenges

While SMCRA contains some financial health requirements that are designed to prevent financially vulnerable companies from being permitted to self-bond, as applied in practice, these provisions pose enforcement challenges.

First, regulators may not be able to accurately monitor the financial health of large and complex mining companies.[42] A subsidiary mining company may meet the financial health requirements and qualify for self-bonding although its parent does not.[43] If a parent entity enters bankruptcy, the subsidiary's assets are likely to be implicated in the bankruptcy proceedings because their assets are often pledged to the parent entity, even while the subsidiary company continues to technically meet the specified criteria for self-bonding. In the cases of Arch, Peabody, and Alpha, the mining subsidiaries joined the parent entity in bankruptcy. Some reports suggest that Cloud Peak is the only large mining company with outstanding self-bonds that currently meets the financial requirements for self-bonding at the parent level.[44]

Second, even if indicators of financial distress are apparent, regulators might be reluctant to require mining companies to cease operating if they are unable to obtain a surety bond, or if acquiring a surety bond will force the company into greater financial distress.[45] If a mining company continues to operate, it can at least generate some revenue to offset the ongoing costs of reclamation. But if regulators force the company to shut down its operations, they might thereby reduce the company's liquidity and push it company into bankruptcy, at which point the company may be unlikely to pay the full value of the bond.[46] The Executive Director of the Interstate Mining Compact Commission describes this decision as a Catch-22: "[I]f the state chooses to insist on alternative financial assurances or collateral as a result of the company's diminished financial situation, the threat to the company's financial solvency would only increase."[47]

Current regulations regarding the financial health of companies that self-bond are not being strictly enforced.[48] According to outside analysis, Peabody's self-bonding obligations comprised more than 25% of the company's net worth, in violation of the federal requirement to limit self-bonds to 25% percent of the company's net worth[49], from at least 2003 through 2006, and again from 2012 to at least 2014.[50] Additional problems are visible in the bankruptcy proceedings of several prominent companies, including Alpha and Arch Coal, discussed below.

Case Study: Wyoming's Self-Bonding Woes, and Lessons from Texas

In Wyoming, as much as $2.25 billion in reclamation obligations are guaranteed by self-bonds.[51] Peabody Energy, which filed for bankruptcy on April 13, 2016,[52] has over $700 million in self-bonded obligations in Wyoming alone.[53] Two other companies, Alpha and Arch Coal, have already filed for bankruptcy protection and hold $411 million and $458 million, respectively, in self-bonds within Wyoming.[54]

We first describe Wyoming's regulatory regime and then compare the ongoing bankruptcies of Alpha and Arch Coal with Texas's successful recovery of self-bonds just prior to and during Luminant Mining's bankruptcy.

Wyoming's Regulatory Regime

The state-federal cooperative agreement with Wyoming charges the Wyoming Department of Environmental Quality (WYDEQ) with the regulation of surface coal mining and reclamation pursuant to SMCRA.[55] Wyoming has primary enforcement responsibility, including during joint inspections by itself and OSMRE. However, OSMRE retains the right to take any enforcement actions necessary to ensure compliance with SMCRA, and Wyoming must "obtain the concurrence of the Department [of Interior]" before releasing any operator from any obligation under a bond.[56] OSMRE's enforcement and oversight authority in Wyoming is especially critical given the reliance of mining operations in Wyoming on federal lands and coal resources.

Wyoming's self-bonding regime by-and-large tracks the federal requirements,[57] but imposes some additional requirements based on past performance.[58] If the operator, or its guarantor, relies on its bond issuance rating, it must have received a rating of "A" or higher on each bond issuance action over the preceding five years.[59] If the operator or guarantor qualifies under ratio requirements, the ratio requirements must have been met the previous year and for the four years preceding that.[60] The ratio requirements are more lenient if the operator or guarantor offers personal property as collateral.[61]

The Bankruptcies of Alpha Natural Resources and Arch Coal

Alpha Natural Resources, Inc. and its subsidiary, Alpha Coal West, Inc., (collectively "Alpha") and Arch Coal, Inc. ("Arch Coal") both recently struck deals with the WYDEQ that threaten reclamation efforts in Wyoming.

On May 26, 2015, WYDEQ ordered Alpha to obtain replacement bonds worth approximately $411 million in place of existing self-bonds for the Belle Ayr and Eagle Butte Mines in Wyoming. Not long after this order, Alpha filed for Chapter 11 bankruptcy protection. WYDEQ and Alpha then entered into an agreement, approved by a federal bankruptcy court,[62] in which WYDEQ would "stay any enforcement action regarding self-bonding until reorganization of Alpha's debts could be finalized," in exchange for a $61 million superpriority claim in any bankruptcy proceedings—a far cry from the $411 million pledged for reclamation through self-bonds.[63] Under this agreement, Alpha can continue extracting coal in

Wyoming, even though WYDEQ believes its finances to be inadequate for self-bonding.[64] Additionally, Wyoming agreed to approve permit renewals and other permit actions for the company, in spite of bonding deficiencies.

As a result, and pursuant to its authority to enforce SMCRA, OSMRE filed a "ten-day notice" letter with WYDEQ, stating that "Alpha coal may be in violation . . . because it may have allowed the bond amount to fall below the amount necessary to assure that the operator will faithfully perform all requirements [for bonding and reclamation]."[65] Although the bankruptcy judge approved the settlement over environmental organizations' objections,[66] OSMRE may still pursue regulatory enforcement.[67] WYDEQ responded to the ten-day notice and asserted that the agreement with Alpha was appropriate under SMCRA.[68] In particular, WYDEQ argued that "Alpha remains liable under the existing self-bond, indemnity, and corporate guarantee agreements, as further secured by the settlement agreement, for the entirety of its reclamation obligations in Wyoming."[69] It also drew comparisons between this agreement and a similar agreement between Alpha and the West Virginia Department of Environmental Protection, which was upheld by a bankruptcy court.[70]

Wyoming made a similar deal with Arch Coal, which also filed for Chapter 11 bankruptcy, agreeing not to pursue any enforcement action related to Arch Coal's self-bonds, in exchange for $17 million in secured financing and a $75 million superpriority claim: only 16 percent of the estimated $458 million in reclamation obligations.[71] Following bankruptcy, Arch Coal is still required to provide new bonds for its remaining $393 million reclamation obligation.[72]

The Arch Coal agreement was approved in federal bankruptcy court on February 23, 2016, despite criticism from OSMRE and environmental groups.[73] In response to a citizen complaint filed by a local landowners' group in December 2015, on January 21, 2016, OSMRE formally requested information about Arch Coal's self-bonding status. Even after the bankruptcy filing, WYDEQ responded on February 22, 2016 and asserted that Arch Coal's subsidiary, Arch Western Resources, continues to meet the requirements for self-bonding, notwithstanding Arch Coal's poor financial condition.[74] Moreover, the WYDEQ argued that, "if approved by the court, the agreement between Wyoming and Arch provides additional security . . . and a commitment that upon exiting the bankruptcy Arch will post substitute bonds sufficient to cover the full amount of its reclamation obligations in Wyoming."[75]

Although WYDEQ asserts that these deals will not affect reclamation claims, others are skeptical.[76] In any event, pursuant to SMCRA, self-bonding should not be available to companies that are going through or have recently gone through bankruptcy. SMCRA requires a "history of financial solvency," which should prevent qualification for self-bonds.[77] And pursuant to existing regulations, if the financial health of a mining company or its guarantor changes at any time such that the enumerated requirements to self-bond are no longer satisfied, "the permittee shall notify the regulatory authority immediately and shall within 90 days post an alternate form of bond in the same amount as the self-bond."[78] If the permittee fails to post an adequate substitute bond "the operator shall cease coal extraction and . . . shall immediately begin to conduct reclamation operations" and cannot resume mining operations until an acceptable bond is posted.[79] Therefore, a company entering bankruptcy should lose its self-bonding status, and regulators can and should exercise their discretion to deny new requests for self-bonding from companies emerging from bankruptcy.

Lessons from Texas: the Luminant Mining Bankruptcy

Despite the difficulty associated with requiring a potentially troubled company to provide a financial bonding instrument, it has been done successfully in the past. Texas regulators' experience with Luminant Mining's imminent bankruptcy represents a successful preservation of reclamation goals in the face of financial distress.

News reports regarding Luminant Mining's potential bankruptcy first surfaced in October 2012.[80] Energy Future Holdings Company (EFH), Luminant's parent company, was experiencing financial difficulty.[81]

As detailed in an October 2013 report prepared by the Institute for Energy Economics and Financial Analysis,[82] Luminant's asset and liability representations to Texas regulators regarding its self-bonding obligations were inconsistent with financial reports filed by the parent company.[83] Luminant's representations to Texas regulators assumed that its assets were "decoupled" from the parent company's network of debt. In other words, the company's filings ignored the fact that its assets were already pledged to its parent company's creditors—creating the possibility that nothing would be left to cover its reclamation obligations if Luminant itself went bankrupt. This approach elided the risk that Luminant's assets would be entirely unavailable to regulator, to guarantee its reclamation obligations.[84] In other words, Luminant was not sufficiently liquid in order to cover its reclamation obligations, and had roughly $1 billion in uncovered reclamation costs.[85]

The Railroad Commission of Texas, which regulates surface coal mining operations in the state, acted quickly. It required Luminant to submit quarterly statements to the Commission certifying continued compliance with the relevant financial requirements beginning around July 2013—about eight months after news reports initially indicated that its parent was experiencing financial difficulty.[86]

In April 2014, Luminant notified the Commission that its parent guarantor was entering bankruptcy, and that it no longer met the financial requirements for self-bonding.[87] The Commission then successfully obtained replacement collateral for $1.1 billion in reclamation obligations through the bankruptcy process—specifically, by obtaining a carve-out from an existing superpriority lien on "substantially all of the assets of" the parent company and its subsidiaries, which is senior to other creditors.[88] The bankruptcy court approved the carve-out through an order on June 6, 2014. The assets that were pledged as collateral included a nuclear power plant in Texas, several coal facilities, thirteen lignite mines, gas assets, and other assets, including nuclear fuel and mineral interests.[89] The total assets securing the $1.1 billion collateral commitment were valued at roughly $10.7 billion,[90] providing a significant cushion in the event of asset depreciation.

Comparing Texas's successful management of Luminant's crisis with Wyoming's current predicament makes clear that early detection of financial distress is critical to a functioning self-bonding system.[91] When Luminant first began bankruptcy proceedings, the company held unencumbered assets sufficient to obtain replacement collateral. In contrast, by the time WYDEQ acted, Alpha and Arch Coal were not in a position to provide replacement collateral. In the case of Alpha, Wyoming's request came three months before the company declared bankruptcy,[92] and a similar request by West Virginia came only two weeks beforehand[93]—in other words, the requests were "essentially imposed by the state at a time when the company could no longer afford it."[94] By this stage, state agencies may be reluctant to force the company to cease coal operations, as that may increase the likelihood of bankruptcy and reduce the likelihood that the coal company will be able to fund reclamation.[95] A second difference was that Energy Future Holdings, Luminant's parent company, secured a large bankruptcy loan, placing it in a better position during bankruptcy proceedings.[96]

Recommendations

The following recommendations seek to curtail the unnecessary approval of self-bonding by state regulators, and improve enforcement and information gathering by regulatory agencies. Many of these recommendations are achievable within the current statutory and regulatory framework, and emphasize exercising discretion to reject self-bonding, and requiring more frequent and thorough financial reporting by coal companies. Additional recommendations would require amending regulations through rulemaking. The fifth recommendation—abolishing or severely restricting self-bonding—would require legislative action.

1. OSMRE should issue guidance to state regulators on implementing and enforcing its current regulations—including the power to deny requests for self-bonding, including for companies emerging from bankruptcy.

OSMRE should immediately issue guidance to clarify and affirm that regulators have discretion to reject requests for self-bonding, even if minimum financial standards are satisfied. SMCRA and existing regulations make clear that *even if* financial tests are met, regulators can deny applications if self-bonding will not fulfill the purpose of SMCRA or state implementing laws.[97] OSMRE highlighted this point in the Federal Register notice describing its final federal self-bonding regulations, stating that "regulatory authority discretion to allow or disapprove a self-bond application on a case-by-case basis is an important part of the self-bonding program" and "the regulatory authority should consider its own experience with local operations when making a final decision on whether to allow a self-bond."[98]

OSMRE should assist state regulatory authorities that wish to phase out self-bonding by clarifying that regulators retain the authority to deny applications for self-bonds even where all enumerated criteria are satisfied. OSMRE should clarify that: (1) state regulators retain discretion to deny applications for self-bonding; (2) the financial tests outlined in the federal regulations should be relied upon by regulators only if they accurately assess the current—and expected future—financial status of a company, which may be difficult to assess in the current climate of coal bankruptcies; (3) a regulator's decision about self-bond qualifications can be re-evaluated at any time; and (4) regulators should deny requests for self-bonding from companies emerging from bankruptcy, as they have failed to demonstrate a history of financial solvency and continuous operation, as called for in SMCRA.[99]

2. OSMRE should require self-bonded companies to update financial records with the regulatory agencies on at least an annual basis, and require state regulators to make an annual affirmative finding based on this information that a company still qualifies for self-bonding, or revoke approval and demand bond substitution.

As discussed above, early notice that a company is at risk of becoming unable to self-bond increases the likelihood that state regulators will be able to ensure the company can still fulfill its reclamation obligations. Under current regulations, if the applicant or guarantor's financial condition changes so that they no longer qualify for self-bonding, the permittee is required to notify the regulatory authority immediately and post an alternate form of bond within ninety days.[100] However, there is no additional penalty if a permittee fails to notify the agency immediately, and there is no obligation for permittees to notify the regulatory authority if they anticipate being ineligible for self-bonding in the near future.

OSMRE and state regulatory authorities should impose an affirmative obligation on companies to report financial information demonstrating their financial health on at least an annual basis. In addition, state regulators should be required to make an annual affirmative finding based on that information as to whether the operator still qualifies for self-bonding. If a regulator finds that a company does not still qualify, it should immediately revoke self-bonding approval and demand bond substitution.[101]

Moreover, we recommend that companies be required to file additional financial documents that assist the regulatory authority in judging the financial health of companies. In particular, we recommend that both the operator and the guarantor, if different companies, file annually: (1) a comparative balance sheet for the next five years, (2) a comparative income sheet showing all revenue and expenses for the next five years, (3) a report, completed following the most recent fiscal year, containing a third-party accountant's audit opinion of the relevant documents, and (4) the companies' most recent credit rating, if any. Several of these documents are required of companies when they apply for a self-bond in Wyoming.[102] This information could be provided at a relatively low cost by companies by having them report at the same time they must file an annual 10-K report with the Securities Exchange Commission. Additionally, we recommend that OSMRE and state regulatory authorities make this information public.

These requirements are permitted pursuant to SMCRA,[103] and are consistent with existing federal regulations.[104] However, state regulators currently have discretion whether to request this financial information, or not. OSMRE should amend its existing regulation to *require* state regulatory agencies to: (1) collect this financial information on an annual basis, for both applicants and their parent companies; (2) make an affirmative finding based on this information that a company still qualifies for self-bonding, or immediately revoke approval and demand bond substitution; and (3) report this information to OSMRE.

Furthermore, we recommend that OSMRE amend its regulations to explicitly require a history of financial solvency and continuous operation for a five-year period. While SMCRA calls for a "history of financial solvency *and* continuous operation,"[105] OSMRE's existing regulations only explicitly require continuous operation, which creates a potential loophole—especially for companies emerging from reorganization bankruptcy.[106] The regulations should also require a history of financial solvency for this five-year period.[107]

3. OSMRE should require state regulators to collect financial information about both the applicant and its parent entity, and report this information to OSMRE. OSMRE should serve as a central repository of information, to avoid problems of double-pledging assets.

OSMRE should require state regulators to provide OSMRE with information regarding companies' self-bonding applications and financial status, including information about parent entities' health. OSMRE should consolidate and disseminate this information to states in order to prevent double-pledging of assets and excessive self-bonding.

Regulations require that the total value of self-bonds used by a guarantor not exceed twenty-five percent of the guarantor's tangible net worth in the United States.[108] However, this requirement is not easily implemented in practice. For one, some coal mining companies "double pledge" the financial health of the company holding the self-bond through a parent-subsidiary structure. A subsidiary is created that holds substantial assets, e.g., the coal mines, but the parent corporation retains the debt.[109] This makes the subsidiary seem financially healthy enough to qualify for self-bonding, when in fact the subsidiary and its assets also guarantee the parent company's indebtedness.[110] Therefore, the assets relied upon to qualify for self-bonding will not necessarily be available to any state regulator in the event of forfeiture. In addition, companies may attempt to exceed the twenty-five percent requirement by self-bonding in multiple states. Absent a central coordinator to accurately measure companies' aggregate self-bonding levels, state regulators may approve self-bonding in excess of twenty-five percent of net worth. According to one report that examined SEC filings, both Peabody Energy and Arch Coal were in violation of the 25 percent limit in 2014.[111]

OSMRE should require state regulators to report information regarding companies' self-bonding applications and financial status, including information about parent companies' health. OSMRE should consolidate and disseminate this information to states in order to prevent double-pledging of assets and risky self-bonding. Because federal and state regulators have the discretion to refuse self-bonding even when a company may qualify,[112] this information can be particularly useful.

However, some coal companies have argued that their financial information, including information on the financial health of their parent entity, is confidential. For example, Colorado's response to OSMRE's ten-day notice regarding Peabody's self-bonding compliance was heavily redacted when provided to the public.[113] Still, this does not prevent state regulators from reporting net worth, ratios of assets to liabilities, and other critical information to OSMRE, to help determine whether a company meets the financial requirements for self-bonding. Moreover, the very fact that coal companies may shroud their true liabilities through veiled corporate structures should give regulators pause before approving requests for self-bonding—particularly when surety or collateral bonds are available substitutes. Self-bonding is, at heart, a benefit provided to qualifying companies. If a company is unwilling to share its financial information, then it should be prepared to forego this benefit and instead avail itself of one of the multiple other available bonding instruments.

In short, OSMRE should require state regulators to report information regarding companies' self-bonding applications and financial status, including information about parent companies' health, and should serve as a central repository of information.

4. OSMRE and state regulatory agencies should coordinate with the Department of the Interior's Bureau of Land Management ("BLM") to evaluate the financial health of parent corporations and so that BLM can consider outstanding reclamation obligations and bonding status before it approves a new coal lease, lease extension, or lease modification.

OSMRE and state regulatory agencies should coordinate with the Department of the Interior's Bureau of Land Management ("BLM") to evaluate the financial health of coal companies and their parent entities, and so that BLM can consider outstanding reclamation obligations and bonding status before approving a new coal lease, lease extension, or lease modification. Interior should also revise its coal leasing eligibility criteria to include proof of that a coal lease applicant is in compliance with bonding and reclamation requirements.[114]

As described above, self-bonding is less secure than requiring coal companies to post surety bonds or collateral bonds, and poses risks to the public in the event that these companies enter into bankruptcy. In an era of coal bankruptcies and mounting unfunded reclamation, Interior should proactively limit the risk that taxpayers may be saddled with the burden of paying for costly reclamation.

Interior should revise its coal lease eligibility criteria to include evidence that a coal lease applicant is in compliance with all bonding and reclamation requirements. This can be done through a rulemaking to revise its basic coal lease eligibility criteria.[115] For example, regulations already require than any prospective lessee is in compliance with federal acreage limitations;[116] it would be reasonable to add a requirement that any lessee be in compliance with bonding and reclamation requirements.

Interior should identify a method by which BLM, OSMRE, and state regulatory agencies can share information about the financial health of coal companies, so that BLM has this information when considering whether to approve a new coal lease, lease extension, or lease modification. Prompting such information sharing could entail a new regulation, or could be achieved through a memorandum of understanding.

5. Congress should amend SMCRA to eliminate or severely restrict self-bonding.

Given the many difficulties with self-bonding detailed in this report and in the work of several other organizations, Congress can help OSMRE better fulfill its mandate under SMCRA by amending the Act to eliminate or severely restrict self-bonding. Other performance bonds, including sureties and collateral, provide a more stable guarantee that land will be reclaimed in accordance with statutory and regulatory requirements.

SMCRA requires that an alternative bonding system, such as self-bonding, will only be approved where it "will achieve the objectives and purposes of the bonding program pursuant to this section."[117] It likewise mandates that "[t]he amount of the bond 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."[118] The purpose of the statute is to ensure sufficient and effective reclamation of mined lands. Yet, the self-bonding regime has not accomplished this goal. Congress should amend SMCRA to eliminate self-bonding or significantly tighten its requirements.

This is particularly appropriate in light of the financial difficulties that the coal industry is experiencing. OSMRE itself acknowledges that "[l]ow domestic and global demand for coal, plentiful low-cost shale gas and fuel switching and coal power plant retirements by utilities, the highest coal stockpile inventories in 25 years, unsuccessful business decisions, and projections of declining coal demand have created significant challenges for the coal industry."[119] And the U.S. Energy Information Administration projects that "In 2016, coal production is expected to decrease by more than 100 MMst for the second consecutive year, with a forecast annual decline of 168 MMst (19%), which would be the largest decline in terms of both tons and percentage since data collection began in 1949."[120] Many mine operators in the United States face a significant risk of insolvency, making a Congressional end to self-bonding in its current form appropriate.

Short of eliminating self-bonding or otherwise amending SMCRA through legislation, which may be unlikely in the near-term, OSMRE should continue to recommend that state regulators withdraw approval self-bonds, particularly for companies who have failed to demonstrate robust, ongoing financial health. OSMRE and BLM should also consider the other recommendations outlined in this report.

Conclusion

This report proposes reforms that are designed to help OSMRE and state regulatory agencies better assess coal companies' financial health and take steps to curtail self-bonding. Barring a legislative end to self-bonding, OSMRE should impose more stringent obligations on coal companies and proactively work with state regulators to avoid saddling taxpayers with the cost and burden of unfunded coal reclamation.

Endnotes

[1] Bryan Dewan, *The World's Largest Private Coal Company Just Filed for Bankruptcy*, Think Progress (Apr. 13, 2016), http://thinkprogress.org/climate/2016/04/13/3768908/worlds-largest-coal-company-bankrupt/.

[2] 30 U.S.C § 1259.

[3] Office of Surface Mining Reclamation and Enforcement, Notice of Availability of Petition to Initiate Rulemaking and Request for Comments on the Petition, 81 Fed. Reg. 31,880, 31,881 (May 20, 2016).

[4] 30 U.S.C. 1265(b).

[5] *See generally* 30 C.F.R. § 816.102 (outlining backfill and grading requirements, including achieving the approximate original contour, minimizing erosion and water pollution, supporting post-mining land use, and disposing of processing waste and underground development waste); 30 C.F.R. § 816.111 (outlining revegetation requirements).

[6] The Wyoming State Director of the Bureau of Land Management, for instance, issued a reclamation policy in March 2009 that includes ten specific requirements that must be addressed in each reclamation plan. These requirements must be satisfied before a reclamation bond is released. U.S. Department of the Interior, Office of Surface Mining Reclamation & Enforcement, *Handbook for Calculation of Reclamation Bond Amounts*, http://www.osmre.gov/LRG/docs/directive882.pdf.

[7] *See infra* Table 1; *see also* Duane E. Gronhovd & Donald F. Scott, *Reclamation Costs of Strip-Mined Land in Western North Dakota*, Agricultural Econ. Report No. 133 (1979), http://library.ndsu.edu/tools/dspace/load/ ?file=/repository/bitstream/handle/10365/5224/farm_37_01_02.pdf?sequence=1 (estimating the cost of reclamation to be as high as $6,500 per acre mined in 1979 dollars).

[8] 30 U.S.C. § 1201 et seq.

[9] *Bragg v. W. Virginia Coal Ass'n*, 248 F.3d 275 (4th Cir. 2015).

[10] 30 U.S.C. § 1259(a) ("After a surface coal mining and reclamation permit application has been approved but before such a permit is issued, the applicant shall file with the regulatory authority . . . a bond for performance payable, as appropriate, to the United States or to the State, and conditional upon faithful performance of all the requirements of this chapter and the permit. The bond shall cover that area of land within the permit area upon which the operator will initiate and conduct surface coal mining and reclamation operations within the initial term of the permit.").

[11] *Id.* ("The amount of the bond required for each bonded area shall depend upon the reclamation requirements of the approved permit; shall reflect the probable difficulty of reclamation giving consideration to such factors as topography, geology of the site, hydrology, and revegetation potential, and shall be determined by the regulatory authority. The amount of the bond 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 and in no case shall the bond for the entire area under one permit be less than $10,000.").

[12] 30 U.S.C. § 1259(c) (emphasis added).

[13] 30 C.F.R. § 730.5.

[14] 30 C.F.R. § 800.23(b)(2).

[15] *Id.* § 800.23(b)(3)(i).

[16] *Id.* § 800.23(b)(3)(ii).

[17] *Id.* § 800.23(b)(3)(iii).

[18] *Id.* § 800.23(b)(4)(i)–(iii).

[19] 30 C.F.R. § 800.23(d). In cases where the guarantor is either the applicant itself or its parent company, the statute applies this requirement only to self-bonds for surface coal mining and reclamation operations. *Id.* Where it is the applicant's self-bond, guaranteed self-bonds are not included in the calculation. *Id.*

[20] 30 U.S.C. § 1259(c).

[21] *Id.* § 800.23(c)(1).

[22] *Id.* § 800.23(c)(1)(i). An indemnity agreement is a standard risk transfer mechanism. In the context of self-bonding, the corporate guarantor (the parent company) assumes the risk that the principal debtor (the subsidiary company/mining operator) will default on its reclamation obligations. In the event that the subsidiary enters bankruptcy or is otherwise unable to pay for reclamation, the corporate guarantor is liable for the cost of reclamation as though it were the original principal debtor.

[23] *Id.* § 800.23(c)(2).

[24] *Id.* § 800.23(f).

[25] 30 C.F.R. § 800.23(g).

[26] 30 C.F.R. §§ 800.23(g); 880.16(e)(2).

[27] *E.g.*, 30 U.S.C. § 800.4(d) ("The regulatory authority may accept a self-bond if the permittee meets the requirements of § 800.23 *and any additional requirements in the State or Federal program.*") (emphasis added). Because states are free to impose additional requirements, it is worthwhile to consider pursuing change at both the federal and state level. For example, although eleven states do allow self-bonding as permitted under the Act, some states do not allow self-bonding, or require third-party guarantees.

[28] Tennessee, Washington, and Georgia continue to rely on the OSMRE.

[29] SMCRA requires that federal approval be withdrawn if the state program is no longer in compliance with the "procedures, guidelines, and requirements established" under SMCRA, including the regulations enacted by the Department of Interior. 30 U.S.C. § 1235(d) ("[T]he Secretary *shall withdraw such approval* and authorization if he determines upon the basis of information provided under this section that the State program is not in compliance with the procedures, guidelines, and requirements established under subsection (a) of this section." (emphasis added)).

[30] The federal OSMRE oversees the surface mining program in Tennessee.

[31] U.S. Government Accountability Office, Surface Coal Mining: Financial Assurances for, and Long-Term Oversight of, Mines with Valley Fills in Four Appalachian States, GAO-10-206 (Jan. 2010), http://www.gao.gov/assets/310/300079.pdf.

[32] Cloud Peak Q2 2014 Earnings Call Transcript, http://seekingalpha.com/article/2356075-cloud-peak-energys-cld-ceo-colin-marshall-on-q2-2014-results-earnings-call-transcript?part=single.

[33] The data in the table are compiled from the Securities and Exchange Commission (SEC) filings of each company—specifically, the annual Form 10-K. These figures reflect company-wide reclamation obligations for all mining operations, which appears to include reclamation obligations for operations on both federal and state lands.

[34] Declaration of Amy B. Schwetz, Executive Vice President & Chief Financial Officer of Debtor Peabody Energy Corporation, In Support of First Day Motions of Debtors and Debtors in Possession, *In re* Peabody Energy Corp., No. 16-42529 (Bankr. E.D. Mo. 2016), https://mscusppegrs01.blob.core.windows.net/mmfiles/sitemedia/ch11/first%20day%20declaration.pdf.

[35] *Id.*; Wild Earth Guardians, *Guardians Complaint Spurs Peabody Coal Investigation* (Feb. 18, 2016), http://www.wildearthguardians.org/site/News2?page=NewsArticle&id=12359#.VvlrJxIgtE5.

[36] *See* Interstate Mining Compact Commission, Self-Bonding Survey (April 2014), http://imcc.isa.us/Self%20Bonding%20Survey.pdf (providing responses from the Interstate Mining Compact Commission's self-bonding survey of 20 states).

[37] Alexis Bonogofsky, Nat'l Wildlife Fed. et al., Undermined Promise II 11 (2015), http://www.underminedpromise.org/UnderminedPromiseII.pdf (citing to a self-bonding survey conducted by the Interstate Mining Compact Commission conducted at its 2014 annual meeting) (hereinafter "Undermined Promise II"). Other sources, however, suggest that the self-bonding rate may be even higher in some jurisdictions. *See, e.g.*, Leigh Paterson, *In Coal Country, No Cash in Hand For Billions in Cleanup*, Inside Energy (Nov. 14, 2015), http://insideenergy.org/2015/11/14/in-coal-county-no-cash-in-hand-for-billions-in-cleanup/ ("Inside Energy found that Wyoming has the highest rate of self-bonding at 76 percent.").

[38] *See, e.g.*, U.S. Energy Information Agency, Coal Production and Prices Decline in 2015 (Jan. 8, 2016), https://www.eia.gov/todayinenergy/detail.cfm?id=24472 (describing the decline in coal production levels beginning as early as 2008, as well as a recent decline in prices).

[39] *See, e.g.*, Patrick Rucker, *Reuters: Coal Industry's Self-Bonding Subsidy Leaves Taxpayers on the Hook for $3.6 Billion in Cleanup Costs*, Institute for Energy Economics and Financial Analysis (Dec. 9, 2015), http://ieefa.org/reuters-coal-industrys-self-bonding-subsidy-leaves-taxpayers-on-the-hook-for-3-6-billion-in-cleanup-costs/ ("Coal operator Alpha Natural Resources Inc. left behind more than $670 million in self-bond liabilities when it filed for bankruptcy in August and officials have not determined how best to protect taxpayers from that hit.").

[40] 30 C.F.R. § 800.23(g).

[41] 30 C.F.R. § 800.23(g); 30 C.F.R. § 800.16(e).

42 *See, e.g.*, Letter from Senators Maria Cantwell and Richard J. Durbin to Comptroller Gene L. Dorado (March 8, 2016), http://www.energy.senate.gov/public/index.cfm/files/serve?File_id=47C14E0B-8A9D-457F-A1DE-0B7135144E1B ("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.").

43 Bloomberg Intelligence, *Bonding Needs May Accelerate Coal Crunch* (Aug. 2, 2015), http://www.bloomberg.com/professional/blog/bonding-needs-may-accelerate-coal-crunch/ ("While Peabody Energy, Alpha Natural Resources and Arch Coal may not meet the requirements, they may apply for self-bonding through subsidiaries that have stronger credit ratios.").

44 *Id.*

45 Although federal regulations permit companies that fall out of compliance with the self-bonding requirements to either put forward an alternative bond (such as a surety) or cease operating, 30 C.F.R. § 800.23(g), it may not be possible to obtain a surety bond once a company is already in financial distress. The same factors that make a self-bond risky to taxpayers also create risks for surety companies, which may be unwilling to provide sureties in such circumstances—at least, not at a price that a failing mining company could afford. *See, e.g.*, Bloomberg Intelligence, *supra* note 43 (noting that "it may be a challenge to find a company willing to take on the credit risk related to providing reclamation bonds" for Alpha following Wyoming's determination that it no longer qualifies for self-bonding).

46 The West Virginia bankruptcy court in *In re Alpha Natural Resources* noted this reality while upholding a settlement agreement between West Virginia and Alpha Natural Resources: "If Debtors were to lose the litigation with West Virginia, they would be required to immediately post over $244 million in substitute bonds in order to continue mining in West Virginia." No. 15-33896-KRH, 2016 WL 270030 at *7 (Bankr. E.D. Va. Jan. 20, 2016). *See* also Bloomberg Intelligence, *supra* note 43.

47 Gregory E. Conrad, *Mine Reclamation Bonding—From Dilemma to Crisis to Reinvention: What's a State Regulator to Do?* (Feb. 11, 2014), http://www.imcc.isa.us/EMLF%20Bonding%20Presentation%20Final.pdf.

48 Undermined Promise II, *supra* note 37.

49 *See* 30 C.F.R. § 800.23(d).

50 *Id.* at 17.

51 Paterson, *In Coal Country, supra* note 37.

52 Michael Corkery, *Peabody Energy Warns of Possible Bankruptcy Filing*, N.Y. Times (Mar. 16, 2016), http://www.nytimes.com/2016/03/17/business/dealbook/peabody-energy-warns-of-possible-bankruptcy-filing.html?_r=0. In October 2015, Fitch Ratings warned of this possibility and described Peabody Energy as having a "reasonable likelihood of default." FitchRatings, *Fitch: Higher Default Rates Expected for US Coal Sector* (Oct. 15, 2015), https://www.fitchratings.com/site/fitch-home/pressrelease?id=992355.

53 Leigh Paterson, *Peabody Energy May Be in Violation of Coal Regs in Three States*, Inside Energy (Feb. 17, 2016), http://insideenergy.org/2016/02/17/peabody-energy-may-be-in-violation-of-coal-regs-in-three-states/.

54 Debtors' Motion for Interim and Final Orders, In re Alpha, ECF No. 27 (Jan. 11, 2016); Western Organization of Resource Councils, *Arch Coal Files for Bankruptcy* (Jan 11. 2016), http://www.worc.org/worc-statement-on-arch-bankruptcy/.

55 30 C.F.R. § 950.20, Art. I.

56 30 C.F.R. § 950.20.

57 *See supra* notes 9–21 and accompanying text (listing the requirements to qualify for self-bonding under the federal regime).

58 Self-bonding is authorized by Wyo. Stat. § 35-11-417(d) ("The council may promulgate rules and regulations for a self-bonding program for mining operations under which the administrator may accept the bond of the operator itself without separate surety when the operator demonstrates to the satisfaction of the director the 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 this amount.").

59 Chapter 11, § 2(A)(vii)(A).

60 § 2(B)&(C) ("(B) The operator has a tangible net worth of at least 10 million dollars and a ratio of total liabilities to net worth of 2.5 times or less, and a ratio of current assets to current liabilities of 1.2 times or greater. The two ratio requirements must be met for the past year, and documented for the four years preceding the past year. . . . (C) The operator's fixed assets in the United States total at least 20 million dollars, and the operator has a ratio of total liabilities to net worth of 2.5 times or less, and a ratio of current assets to current liabilities of 1.2 times or greater. The two ratio requirements must be met for the past year and documented for the four years preceding the past year.").

61 § 2(ii)(A)&(B) (requiring that an operator offering personal property as collateral to support a self-bond have a "ratio of total liabilities to net worth of 3.0 times or less, and a ratio of current assets to current liabilities of 1.0 times or greater").

62 *In re Alpha Nat. Res., Inc.*, No. 544 B.R. 848 (Bankr. E.D. Va., 2016). Alpha struck a similar deal with the West Virginia Department of Environmental Protection, posting a $15 million letter of credit as a collateral bond and granting a superpriority claim worth $24 million to replace $244,375,833 worth of self-bonds. *Id.* at 853–54.

63 *Id.* at 853.

64 Similarly, Alpha reached a settlement with West Virginia regulators that will provide the state with a $15 million letter of credit and a $24 million superpriority claim for $244 million in self-bonding obligations (16 cents on the dollar). The Bankruptcy court noted that OSMRE did not voice an objection to either settlement. As a result of OSMRE's failure to object, the court held that "[i]t is simply not for this Court to raise the prospect of" violations of federal law as a basis for rejecting either settlement. *In re Alpha*, 544 B.R. at 859.

65 *Id.*

66 The environmental parties were found to lack standing in the case.

67 In re Alpha, 544 B.R. at 859 ("[N]othing in the Settlement Order precludes OSM from raising violations of SMCRA or other federal regulations at any time going forward in this bankruptcy case.").

68 Letter from Kyle Wendtland, Administrator, Wyoming Department of Environmental Quality, to Jeffrey Fleischman, Denver Field Division Chief, Office of Surface Mining (Feb. 12, 2016), http://deq.wyoming.gov/media/attachments/Land%20Quality/Bonding/DEQ-Alpha-Natural-Resources-Ten-Day-Notice-Response.pdf.

69 *Id.* at 4.

70 In re Alpha Nat. Res., 544 B.R. 848, 858–59 (Bankr. E.D. Va. 2016).

71 Benjamin Storrow, *Arch Coal Files for Bankruptcy Protection*, Casper Star Tribune (Jan. 11, 2016), http://trib.com/business/energy/arch-coal-files-for-bankruptcy-protection/article_5d71b417-9e59-50b4-b3f1-e063c0a5a611.html. For an earlier report, see Dustin Bleizeffer, *State Strikes Deal to Secure 18.5% of Arch's Bond Obligation*, WyoFile (Feb. 12, 2016), http://www.wyofile.com/blog/state-strikes-deal-to-secure-18-5-of-archs-bond-obligation/.

72 Tracy Rucinski, *Arch Coal Agrees to Deal With Wyoming for Temporary Cleanup Relief*, St. Louis Post-Dispatch (Feb. 10, 2016), http://www.stltoday.com/business/local/arch-coal-agrees-to-deal-with-wyoming-for-temporary-cleanup/article_75053a0f-ff20-55ba-9501-28172ab3f5fd.html.

73 In January 2016, OSMRE formally questioned the agreement and Arch Coal's questionable self-bonding status with a Ten-Day Notice letter. WYDEQ defended the deal: "[I]f approved by the court, the agreement between Wyoming and Arch provides additional security . . . and a commitment that upon exiting the bankruptcy Arch will post substitute bonds sufficient to cover the full amount of its reclamation obligations in Wyoming. Letter from Kyle Wendtland, Administrator, Wyoming Department of Environmental Quality, to Jeffrey Fleischman, Denver Field Division Chief, Office of Surface Mining (Feb. 22, 2016), https://assets.documentcloud.org/documents/2717793/DEQ-Arch-Coal-Ten-Day-Notice-Response-Letter.pdf.

74 *Id.* at 2. This is an example of technical compliance with the regulations through the use of a subsidiary that appears to be healthier financially than the corporation as a whole.

75 *Id.*

76 *See, e.g.*, Benjamin Storrow, *Alpha Natural Resources Announces Restructuring Plan*, Casper Star Tribune (Mar. 8, 2016), http://trib.com/business/energy/alpha-natural-resources-announces-restructuring-plan/article_0fb0f13b-3c85-5bf3-b18f-0f629cf5df80.html ("Notably absent [from the restructuring plan] was a plan to resolve the [Alpha's] reclamation liabilities in Wyoming, where Alpha maintains $411 million in unsecured cleanup costs . . . .").

77 30 U.S.C. § 1259(c).

78 30 C.F.R. § 800.23(g).

79 *Id.*

80 *See, e.g.*, Elizabeth Souder, *Analysts: TXU Luminant Bankruptcy Possible in the Next Year*, Dallas Morning News (Oct. 6, 2012), http://www.dallasnews.com/business/energy/20121006-analysts-txu-luminant-bankruptcy-possible-in-next-year.ece.

81 *Id.*

82 Tom Sanzillo, Institute for Energy Economics & Financial Analysis, Energy Future Holdings and Mining Reclamation Bonds in Texas (Oct. 2013).

83 *Id.* at 2–3.

84 *Id.* at 15–16.

[85] *Id.*

[86] Dave Fehling, *Texas puts Luminant Mining under Closer Financial Scrutiny*, NPR State Impact (July 8, 2013), https://stateimpact.npr.org/texas/2013/07/08/texas-puts-luminant-mining-under-closer-financial-scrutiny/. Energy Future Holdings first disclosed its discussions of bankruptcy and restructuring with its creditors in its 2013 filings to the Securities and Exchange Commission. Press Release, Sierra Club, *As Energy Future Holdings Nears Bankruptcy, Local Groups Appeal for Public Hearing of Mining Bonds* (Mar. 20, 2014), http://content.sierraclub.org/press-releases/2014/03/energy-future-holdings-nears-bankruptcy-local-groups-appeal-public-hearing.

[87] Railroad Commission of Texas Hearings Division, *Order Accepting Blanket Collateral Bond for Luminant Mining Company LLC's Statewide Surface Mining and Reclamation Obligations,* SMRD Docket No. C14-0015-SC-00-E (June 17, 2014), http://www.rrc.state.tx.us/media/20674/c14-0015-d-c.pdf.

[88] *Id.* at 8. Several court orders pertaining to the bankruptcy authorized Luminant's parent company to enter into agreements, including a senior secured superpriority debtor-in-possession credit agreement, in order to finance its ongoing post-petition activities on a superpriority basis. One order created a carve-out from the superpriority liens pursuant to the Debtor in Possession Agreement that was dedicated to comply with the Railroad Commission's self-bonding requirements. *Id.*

[89] *Id.* at 9.

[90] *Id.*

[91] *See* Undermined Promise II, *supra* note 37 at 16 ("Protection of the public interest requires that self-bonding due diligence go beyond simply verifying compliance with the designated financial solvency tests. Instead, an assessment of the encumbrance of self-bond guarantors' assets should be taken by the regulators in the face of the heavy debt loads carried by major coal operators. As demonstrated by the Railroad Commission of Texas, this deeper due diligence led to a more comprehensive understanding of the financial position of Luminant Mining and its affiliates, and led to a revocation of Luminant Mining's self-bonds.").

[92] Benjamin Storrow, *Wyoming Tells Coal Company It No Longer Meets Bonding Requirements*, Casper Star Tribune (May 29, 2015), http://trib.com/business/energy/updated-wyoming-tells-coal-company-it-no-longer-meets-bonding/article_d6d154f8-9b6f-5861-bc24-1186842d6c8f.html.

[93] Daniel Tyson, *W. Va. Revokes Alpha's Self-Bonding Status*, Bluefield Daily Telegraph (Aug. 13, 2015), http://www.bdtonline.com/news/w-va-revokes-alpha-s-self-bonding-status/article_e4debc70-41c3-11e5-b08f-9bd113148947.html. Alpha initially informed the West Virginia Department of Environmental Protection (DEP) in late February, 2015 that it failed to satisfy the required assets-to-liabilities ratio based on its 2014 fourth quarter earnings report. DEP monitored the situation, but did not take action until July—two weeks before the eventual bankruptcy—because Alpha came back into compliance based on its earnings statements from the first quarter of 2015. *Id.*

[94] Chadbourne, *The Coal Industry: Emerging Issues in Bankruptcy Cases* (Sept. 2015), http://www.chadbourne.com/Coal_Industry_Emerging_Issues_Bankruptcy_Cases_projectfinance.

[95] The West Virginia bankruptcy court in *In re Alpha Natural Resources* noted this reality while upholding a settlement agreement between West Virginia and Alpha Natural Resources: "If Debtors were to lose the litigation with West Virginia, they would be required to immediately post over $244 million in substitute bonds in order to continue mining in West Virginia." No. 15-33896-KRH, 2016 WL 270030 at *7 (Bankr. E.D. Va. Jan. 20, 2016).

[96] Peg Brickley, *Energy Future Holdings Wins Approval of $5.4 Billion Bankruptcy Loan*, The Wall Street Journal (June 6, 2014), http://www.wsj.com/articles/energy-future-holdings-wins-approval-of-5-4-billion-bankruptcy-loan-1402089972.

[97] *See* 30 U.S.C. § 1259(c).

[98] Dept. of the Interior, Office of Surface Mining Reclamation and Enforcement, Final Rule: Bond and Insurance Requirements for Surface Coal Mining and Reclamation Operations Under Regulatory Programs; Self-Bonding, 48 Fed. Reg. 36418, 36428 (August 10, 1983).

[99] *See* 30 U.S.C. § 1259(c).

[100] 30 C.F.R. § 800.23(g); 30 C.F.R. § 800.16(e).

[101] *See* 30 U.S.C. § 1271.

[102] Wyo. Admin. Code § ENV LQC Ch. 11 § 2(a)(vi) (listing required documents to demonstrate a history of financial solvency).

[103] 30 U.S.C. § 1235(d).

[104] 30 C.F.R. § 800.23(f) ("A regulatory authority *may* require self-bonded applicants, parent and non-parent corporate guarantors to submit an update of the information required under paragraphs (b)(3) and (b)(4) [pertaining to the credit ratings, net worth, and asset/liability ratios] of this section within 90 days after the close of each fiscal year following the issuance of the self-bond or corporate guarantee." (emphasis added)).

[105] 30 U.S.C. § 1259(c).

[106] *See* 30 C.F.R. § 800.23(b)(2).

[107] The statute refers to a "history of financial solvency and continuous operation" but it is important to note that these are two independent requirements as a company can be financially insolvent and still operating (like in a Chapter 11 bankruptcy proceeding).

[108] 30 C.F.R. § 800.23(d).

[109] Tom Sanzillo et al., Institute for Energy Economics and Analysis, Peabody's Strategies for Survival Ignore Market Realities and Risk Backfiring 18–19 (Feb. 2016), http://ieefa.org/wpcontent/uploads/2016/02/Peabodys-Strategies-for-Survival-Ignore-Market-Realities-and-Risk-Backfiring-FEB-2016.pdf.

[110] *Id.*

[111] Undermined Promise II, *supra* note 37 at 17. In 2014, self-bonding by Peabody was approximately 49.9% of net worth. *Id.* Self-bonding for Arch Coal narrowly exceeded the requirement at 27.5% in 2014. *Id.*

[112] These states include Ohio, Colorado, Illinois, North Dakota, and West Virginia, among others. *Id.*

[113] Of the document's 61 pages, 44 are completely blacked out. *See* https://www.dropbox.com/sh/c82rskrwuiin877/AABblNNba8SOvCoFdvmTYY-ta/DRMS%20TDN%20Response%20-%20REDACTED.pdf?dl=0 **. Peabody did use an affiliated company, Peabody Investments Corporation, to obtain self-bonds, and this financial information remained private. Peabody refused to disclose it to the public. Patrick Rucker, *Coal Giant Peabody Faces Federal Scrutiny Over Clean-up Insurance*, Reuters (Jun 4, 2015), http://www.reuters.com/article/us-usa-coal-bonding-idUSKBN0OK26F20150604.

[114] *See* 30 U.S.C. § 184.

[115] *See, e.g.* 43 C.F.R. §§ 3102.1, 3102.5-1.

[116] 43 C.F.R. § 3102.5-1(b).

[117] 30 U.S.C. § 1259(c).

[118] *Id.* § 1259(a).

[119] 81 Fed. Reg. 31,880.

[120] U.S. EIA, Short-Term Energy Outlook (July 2016), https://www.eia.gov/forecasts/steo/pdf/steo_full.pdf.

Institute *for*
Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW

Institute for Policy Integrity
New York University School of Law
Wilf Hall, 139 MacDougal Street, New York, New York 10012
policyintegrity.org