

Commonwealth of Pennsylvania
District Mining Operations
October 23, 2002

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SUBJECT: Conventional "Full Cost" Bonding
Conversion Assistance
Land Reclamation Guarantee Program
Final Report

Background

For almost 60 years Pennsylvania's law has regulated surface mining, and has required some degree of land reclamation. For most of the same period it has also required bonds, in varying amounts and formats, to ensure that the required land reclamation is completed. These bonds were required to be filed prior to commencement of mining, and to be conditioned "...that the permittee shall faithfully perform all of the requirements..." (SMCRA § 4(d); CSL § 315(b)).

The Federal Surface Mining Conservation and Reclamation Act (SMCRA) provides for two different bonding methods. In the first form, now called conventional bonding, the amount of the bond is the total cost to the regulatory authority to complete the approved reclamation plan. In the second bonding method, the amount of the bond is an amount established for an alternate bonding system (ABS). This alternate program must achieve the objectives and purpose of SMCRA.

Since 1981 Pennsylvania has used an ABS for surface mine permits. The details of this program were established in an August 1, 1981 letter from Secretary of the Department of Environmental Resources Clifford Jones to all surface mine operators. The basic plan required a \$3,000 per acre bond for actual mining areas and another \$1,000 per acre bond for support activities, such as sediment controls, topsoil storage, ditches, and haul roads. Higher rates were imposed when the maximum thickness of rock overlying the coal exceeded certain depths (e.g., when the cover was between 85 feet and 115 feet thick, the rate was \$4,000 per acre). When reclamation activities were completed these bonds were released. In addition, a statewide bond pool funded through the collection of a non-

refundable, non-releasable reclamation fee, was created. In 1981 the reclamation fee was set at \$50 per acre. The fee was increased to \$100 per acre on August 7, 1993. If a forfeiture occurred, money from the bond pool was used to supplement the posted bonds to cover the Department's cost to reclaim the site.

On July 30, 1981, before Pennsylvania achieved primacy, the ABS was challenged. The Pennsylvania Federation of Sportsmen's Clubs, the Sierra Club, Trout Unlimited, the Audubon Society, the Loyalsock Watershed Association, Wyona Coleman, and Paul Jurovcik petitioned Commonwealth Court for a Review in the Nature of a Complaint in Equity and Preliminary Injunction. On April 27, 1988 the suit was settled when the parties entered into a court-approved consent decree.

On October 1, 1991, OSM notified Pennsylvania that it believed the ABS was not as effective as the federal requirement. Pennsylvania worked diligently with OSM regarding their concerns over the ABS. However, on May 31, 1995, OSM again notified the Commonwealth about concerns over the adequacy of the ABS. Throughout these discussions, conventional bonding was recognized as an option available to Pennsylvania.

In 1996 the Department initiated an internal review of the solvency of the bond pool with the intention of determining if the bond rate guidelines were in need of adjustment. During this review various shortcomings of the ABS were noted. Foremost among these shortcomings was an actual deficit in the available funds in comparison to the outstanding reclamation obligation of the pool. Additionally, there is a lack of parity between different categories of mining operations. Consequently, in the event of forfeiture, the contributions to the bond pool by some operators are not proportionate with contributions from others. For example, the Commonwealth's cost to reclaim a coal refuse disposal site, originally bonded at \$1,000 per acre, averages more than \$20,000 per acre. Conversely, a surface mine, originally bonded at \$3,000 per acre, may cost the Commonwealth less than \$7,000 per acre to reclaim. Parity is also lacking within categories of mining. Operations with large open pit areas are proportionally much more expensive to reclaim than the average mine site. However, both pay the same reclamation fee and both use the same per acre bond rates.

Additionally, OSM has changed its interpretation of federal requirements. It now dictates that ABS bond pools must cover the entire costs for treating water on forfeiture sites in perpetuity, without limitation. Continuation of the current ABS in the long term plus a decline in the number of active operators and increasing annual costs for treating water on forfeited sites means fewer and fewer operators will be paying higher and higher fees into the bond pool. Eventually this cycle would bankrupt the ABS.

In October 1999 the Pennsylvania Federation of Sportsmen's Clubs, the Pennsylvania Chapter Sierra Club, Pennsylvania Trout, Inc., Tri-State Citizens Mining Network and Mountain Watershed Association, Inc. filed suit in Federal District Court against both the Department and OSM. Among other things, the suit alleged the ABS does not meet the objectives and purpose of federal SMCRA. Also in October 1999 Pennsylvania announced its decision to implement a conventional bonding system. The change

represented the first major overhaul of the bonding mechanism in 17 years. The conventional bonding system was developed using principles from the OSM *Handbook for Calculation of Reclamation Bond Amounts* and from a 1989 DEP study called *Alternate Bonding – Final Report of the BMR Bond Work Group*.

The conventional bonding system is based on the mine operator's description of the maximum amount of reclamation needed during the term of the permit. The proposed dimensions of the mining activity and the bond rate guidelines are used to calculate the necessary bond amount. Bond rate guidelines were developed using actual bid costs submitted for abandoned mine land and forfeited mine site reclamation contracts and other appropriate sources. The calculated bond amount represents the cost to the Commonwealth for hiring a contractor to complete the permitted reclamation plan to regulatory standards. It reflects the Commonwealth's maximum responsibilities under the approved operations and reclamation plan for land reclamation. An annual report is required to be submitted by the permittee detailing the current status of the mining operation. Compliance with the bond guidelines will also be verified with each routine mine site inspection. This will result in a more or less continuous review of the adequacy of the bonding for that site.

Conversion Assistance Program

In implementing the Conventional Bonding system the Department recognized that mine operators contemplating a new mining operation would be able to factor the revised bond guidelines into their decision making process. Active operations currently bonded under the ABS and new permit applications already under review, however, would also be required to upgrade to the conventional bonding system. There were concerns about the ability of these mine operators to convert to conventional bonding. These operators had already made financial and operational commitments based on their bonding capacity and the ABS. Likewise, the surety providers made decisions to provide bonds on existing permits based on the risk they were willing to take at that time.

For operations where the conventional bond calculation will be significantly greater than the bond posted under the ABS, operators may be unable to comply with the mandatory bond adjustment. Those operators would be faced with the uncertainty of a negotiated settlement with the Department regarding bonding and reclamation liability or risk being forced out of business. The choice for the surety industry would be difficult. They could either provide more bonds than their risk assessment dictated or risk forfeiture of the existing bond. The risk to the Commonwealth would be that forfeiture of existing inadequate bonds would further increase the deficit of the current ABS fund.

To help the industry address these risks the Department developed the Conversion Assistance Program. Using the data developed during the bond pool evaluation the Pennsylvania Legislature appropriated \$12.5 million to fund the program. \$5.5 million was deposited into the current ABS to make the fund solvent for all outstanding forfeiture

reclamation projects currently on the books. The remaining \$7 million financed the actual Conversion Assistance Guarantees. Based on the historic rate of bond forfeitures, the amount of forfeited bonds that have been collected, the cost of reclamation to the Department, and the number of sites operating under the ABS, this amount would cover up to \$70,000,000 in bond exposure.

Permittees whose bonding obligation increased in converting from the ABS to the Conventional Bond would be eligible for a Department issued Land Reclamation Financial Guarantee (LRFG) in a sum-certain amount equal to the increase in bonds dictated by the conversion from the existing ABS to the conventional bonding system. Financial guarantees under the Conversion Assistance Program would serve all the purposes of a bond under SMCRA and the Clean Streams Law (CSL).

The following additional conditions were also placed on the Conversion Assistance Program:

- Guarantees written under this program are not available to cover an operator's obligations for treating post-mining polluting discharges. Permits for which the Department has determined there exists an obligation for treating a post-mining discharge do not qualify for assistance unless the permittee and Department have a binding agreement to establish financial provisions for post-mining treatment costs. If a post-mining discharge develops on a participating site, the operator will immediately be required to post another financial mechanism to guarantee long-term treatment.
- The Land Reclamation Financial Guarantee is the first bond released from the permit, and the permittee must demonstrate that any surety, financial institution or person with an interest in any surety or collateral bond consents to the release of the land reclamation financial guarantee before all other bonds.
- The permittee must pay a premium of 1.5% per year of the amount of the financial guarantee.

Implementation

The conversion process began in August of 2001 with the finalization of Technical Guidance Document #563-2504-001, "*Conventional Bonding for Land Reclamation – Coal*". A deadline for completion of the project was set for June 30, 2002.

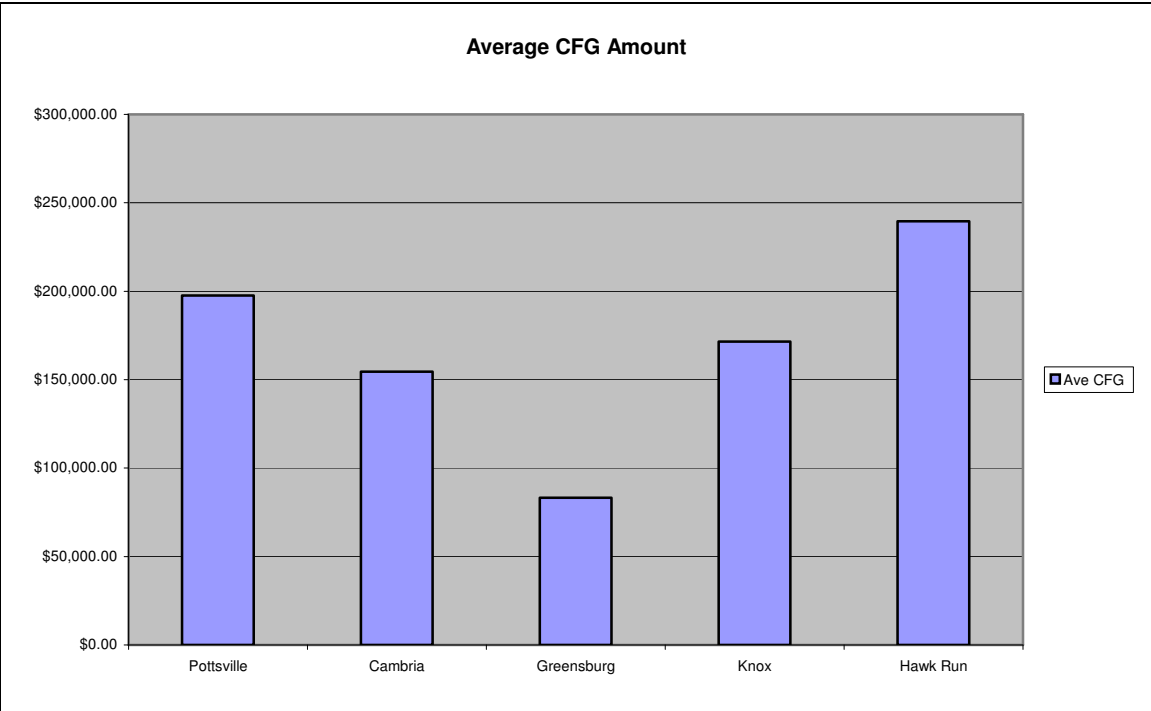
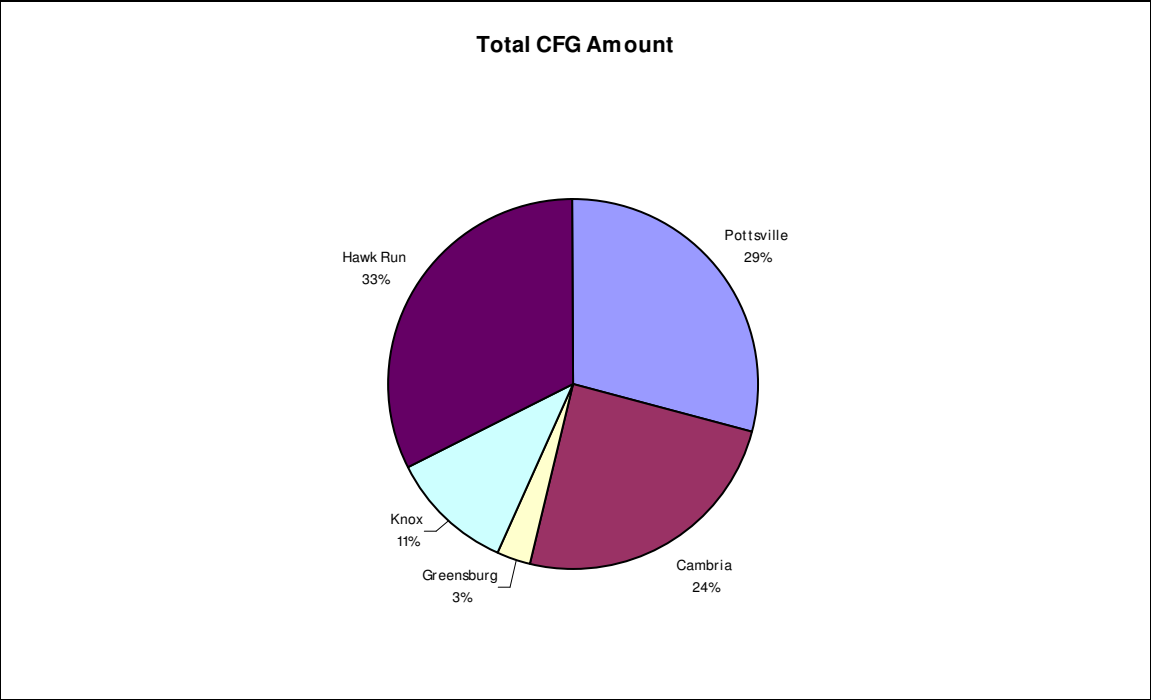
Since 1982 there have been no total failures of revegetation on re-topsoiled sites. Occasionally, an operator will return to the site for minor repairs but in nearly every case the Stage III bonds remaining on the site should be adequate to ensure that the reclamation plan is completed. Also, once Stage II has been achieved, the actual cost to the Commonwealth to hire a contractor to complete the reclamation plan should be minimal except for the possible cost to remove erosion and sediment controls. For these

reasons, it was decided to focus the conversion efforts on those sites with the most costly reclamation obligation, open surface mining pits.

In determining the scope of the conversion process the District Offices conducted an initial evaluation of over 2700 inspectable units. Of this initial number, there were 805 active operations with open pits or some other feature that indicated a need to revise the bond. All 805 were notified of the requirement to submit the Conventional Bonding calculations. The requirement to submit the calculation was waived on 118 of these sites after it was determined that the sites would be backfilled prior to the June 30th deadline. 4 sites were later determined to not meet the submittal requirements and were dropped from the program. These 4 sites will be conventionally bonded when the actual permits are issued. On 20 sites the operator did not submit the calculations, mostly due to pending litigation issues.

Of the 664 sites where a Conventional Bond calculation was completed, 234 had their bonds lowered, 64 had the bond amounts remain the same, and 366 were required to increase their bond amount. 324 of the 366 permits with increasing bond amounts requested a Conversion Assistance Land Reclamation Financial Guarantee. The total amount requested by all operators combined was approximately \$60.2 million. The breakdown by district is summarized below:

District	Total CFG	No CFG	Ave CFG	Largest CFG
Pottsville	\$17,384,797.69	88	\$197,554.52	\$2,100,000.00
Cambria	\$15,359,242.08	94	\$154,512.84	\$1,540,010.00
Greensburg	\$1,832,230.42	22	\$83,283.20	\$357,150.00
Knox	\$6,279,391.00	37	\$171,578.14	\$800,800.00
Hawk Run	\$19,299,029.00	83	\$239,523.79	\$1,811,925.00
	\$60,154,690.19	324	\$184,754.82	



There are 147 operators participating in the Conversion Assistance program. The 14 operators who have more than \$1 million in Guarantees are listed below:

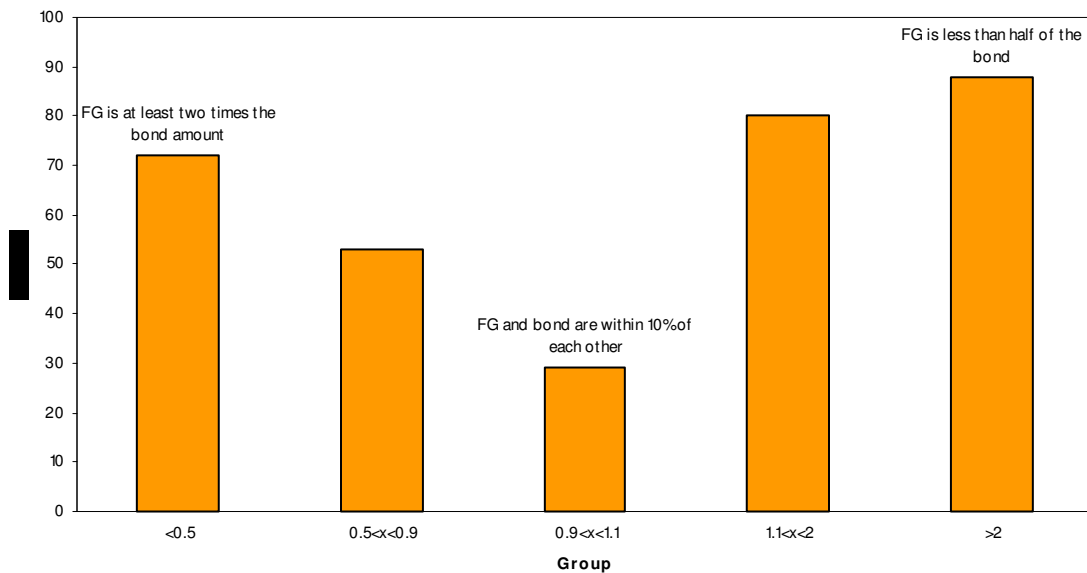
Permittee

Total for Permittee

RIVER HILL COAL CO INC	\$5,854,798.00
SKY HAVEN COAL INC	\$5,436,018.00
READING ANTHRACITE CO	\$5,260,604.00
CRONER INC	\$2,782,906.00
COONEY BROS COAL CO	\$2,760,398.00
HOFFMAN MINING INC	\$2,503,583.00
STRISHOCK COAL CO	\$2,487,805.00
LEHIGH COAL AND NAVIGATION CO	\$2,100,000.00
HARRIMAN COAL CORP	\$2,100,000.00
WAROQUIER COAL CO	\$1,578,560.00
MB ENERGY INC	\$1,516,964.00
RFI ENERGY INC	\$1,241,000.00
PBS COALS INC	\$1,050,094.00
PHILA CITY TRUSTEE GIRARD ESTATE	\$1,031,759.10
	\$37,704,489.10

For the sites using the conversion assistance, the total of the conventional bond amounts (either surety or collateral) posted by the operator prior to or during the conversion is a bit less (\$55,043,699.39) than the amount of conversion assistance issued by the Department (\$60,154,690.19).

Ratio of Existing Bond to Approved Financial Guarantee



The payment to participate in the conversion assistance program is 1.5% of the amount of the assistance amount. Payments are made on an annual basis with the permit issuance date as the anniversary date. For the first year of the conversion assistance program, from October 2001 through September 2002, the permittees paid approximately \$900,000

in premiums for the approved guarantees. It is anticipated that this number will remain constant for the first few years of the program then will slowly decline as reclamation is completed and the Guarantees are released. There will also be a decline in revenues as some operators fail to meet their regulatory obligations and the Guarantees are declared forfeit.

Monitoring and Compliance

All of the 118 sites where the permittee was not required to submit the conversion calculations because they were to be backfilled by the June 30, 2002 deadline have been inspected to verify their status. In those few cases where the operation was not regraded, orders have been, or will shortly be issued requiring the operator to complete the backfilling or submit the conventional bond calculations. The Conversion Assistance Program is no longer available in those instances where the operator would choose to post the conventional bond amount.

15 of the 20 sites that failed to submit the initial calculations have been addressed through the signing of a Consent Order & Agreement. In one of the 5 remaining cases an order has been issued for the operator to either post the conventional bond calculated by the District Office or cease mining and initiate reclamation. The remaining 4 are being evaluated to determine the appropriate action to be taken.

Special Conditions have been inserted in each conventionally bonded permit delineating the maximum Operational Area authorized to be affected by mining at any one point in time, requiring that the operator verify the dimensions of the various components of the operational area on an annual basis, detailing the other requirements of the conventional bonding program and outlining the obligations for Conversion Assistance bond release and premium payments.

A database has been established to track the status of Land Reclamation Financial Guarantees and the payment of LFRG premiums. Reminder reports and a Notice of Violation form have been developed to facilitate the management of this program.

Given both the method of bond calculation and the operational area concept it is imperative that the reclamation activities on a site maintain the same pace as the mining. Effective monitoring of an operation requires that the inspection staff compare the dimensions of the various components of the operational area used to calculate the bond with the dimensions found on the site. The inspection staff will monitor the compliance with the Operational Area special condition during the routine site inspections. To assist them in this task they are being provided with laser range finders, Global Positioning (GPS) units and other tools as necessary.

In the event of a forfeiture, LFRG funds will be made available to assure reclamation, up to the current value of the guarantee.