

WRITTEN TESTIMONY OF KYLE J. WENDTLAND
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BEFORE
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SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

HEARING ON:
“Environmental Justice for Coal Country: Supporting Communities Through the Energy Transition”

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Good Morning Chairman Lowenthal, Ranking Member Stauber, and members of the House Subcommittee on Energy and Mineral Resources. My name is Kyle J. Wendtland and I am the Administrator of the Wyoming Department of Environmental Quality (DEQ) Land Quality Division (LQD).

The mission of the Wyoming DEQ is “to protect, conserve and enhance the quality of Wyoming’s environment for the benefit of current and future generations”. As we carry out this mission, we do so with the understanding that it must be done in a manner that not only protects our natural resources but also strengthens the State’s economy. Administering an effective and responsible coal reclamation bonding program is a cornerstone to achieving both the mission of the agency, and for meeting the requirements of the Surface Mining Control and Reclamation Act (SMCRA) primacy agreement between the State of Wyoming and the Office of Surface Mining Reclamation and Enforcement (OSMRE). DEQ is committed to managing our reclamation liabilities in a manner that protects the State and provides for responsible coal resource development. This commitment is evidenced by the fact that Wyoming has not had a post-SMCRA coal forfeiture in its Title V program tenure.

SMCRA was adopted by Congress in 1977 and Wyoming’s Title V program was approved on November 26, 1980. Wyoming has over 40 years of experience in successful coal mine reclamation, coal reclamation bonding, and reclamation technology since the initial standup of the Title V program. Wyoming’s coal area surface mines are unique nationally and internationally in size and scale. Wyoming currently manages 28 coal operations. Since inception of the Title V program in 1980, 176,516 total acres have been disturbed and 92,933 acres are in Phase I, II, III, and Termination of Jurisdiction (TOJ) reclamation status. Currently 50,024 acres of the 92,933 acres (54%) are back in agricultural production. These numbers represent the ongoing contemporaneous reclamation and successful implementation of the Wyoming Title V program. Wyoming’s unreclaimed disturbance includes 36,990 acres of facilities and 46,593 acres of active disturbance. Together this disturbance represents \$2,014,496,904 of

reclamation bond liability. This bond liability includes the current disturbed acres, plus the next one year of projected disturbance acres, a margin of safety should a third party need to perform the final reclamation. Wyoming appreciates this opportunity to share its experience in addressing reclamation, and reclamation bond challenges.

Wyoming implements a full-cost reclamation bonding program. In order to provide a foundation for DEQ's reclamation bonding, it is helpful to understand how Wyoming calculates and sets its coal reclamation bonds. The bonds are calculated and adjusted annually as part of the required annual report for each coal permit. The bond calculations are based on a guidance document called Guideline 12, Standardization Reclamation Performance Bond Format and Cost Calculation Methods. Guideline 12 was originally developed by Wyoming DEQ in 1996 for the purpose of standardizing the reclamation performance bond format, cost calculations, and to provide consistent regulatory review standards. Guideline 12 is a living document, and undergoes annual updates based on market, environmental, and economic conditions. Guideline 12 is extensive and utilizes third party data (e.g. Info Mine, the CAT Handbook, and Machine Modular) to support and verify its cost tables. Wyoming takes great pride in its Guideline 12 as it is considered a benchmark document that is used by other states and Australia.

The reclamation bond is calculated initially by the operator using Guideline 12. The reclamation bond costs are structured as if a third party were required to complete the reclamation rather than the operator. This ensures there are sufficient funds available in the event of a forfeiture while also providing an incentive to the operator to complete the reclamation itself at a lower cost. The bond is submitted as part of the required annual report and is reviewed by DEQ technical staff. This submission and review process also includes an onsite "boots on the ground" annual inspection to field verify the proposed bond calculation. Once the final reclamation bond amount has been established, a DEQ Directors Bond Letter is issued with the updated reclamation bond requirement. The operator then has 45 days to make the appropriate adjustment to their bond instrument(s).

In 2014, Wyoming began the process of updating its coal reclamation bonding regulations. These updates were prompted by several factors including changing financial markets, more complex corporate structures, passage of federal legislation (e.g. Sarbanes-Oxley Act of 2002), banking reform, and a need to review and update rules that had remained largely unchanged since 1983. The need to update the bonding rules was reinforced by the coal industry bankruptcies of 2015 and 2016. Wyoming gained valuable experience during these bankruptcies and applied this information to the 2019 rule revisions. The final updated rules were approved by Wyoming's Environmental Quality Council and signed into Wyoming law by Governor Mark Gordon in May of 2019. It is with this experience Wyoming offers comments to the Subcommittee on the individual bond instrument options in use today. Wyoming's program utilizes: Letters of Credit; Self-bond; Surety; and Collateral bonds (e.g., cash or cash equivalent, negotiable bonds, irrevocable trust, and real property). Wyoming does not allow the use of personal property as an acceptable bond instrument.

The following description of each bond instrument Wyoming utilizes is provided to help inform the discussion:

Letters of Credit: There are two basic types of Letters of Credit: irrevocable, and standby. A standby Letter of Credit is unfunded until drawn. Wyoming removed standby letters of credit from consideration and only accepts a fully funded Irrevocable Letter of Credit that is payable to the DEQ in

part or in full upon demand. The letter must meet the requirements of W.S. 13-3-402 which states “Except as otherwise provided, no bank shall permit any person, firm, partnership, association or corporation to become indebted at any time to the bank in an amount exceeding twenty percent (20%) of the amount of the capital stock of the bank actually paid in and unimpaired, plus twenty percent (20%) of its unimpaired surplus fund plus, twenty percent (20%) of its unimpaired undivided profits.” The application of this standard mitigates the risk of the Letter of Credit in the event of a bank failure.

Self-bond: Self-bond has received considerable attention following the coal bankruptcies that have occurred since 2015. The history of self-bonding is important as it has direct relevance to today’s industry and reclamation Surety bond market space. As previously noted prior, the size and scale of Wyoming’s area surface mines are unique. This is why early in the development of Wyoming’s Powder River Basin (PRB) the self-bonding instrument was incorporated into the approved Title V coal program in 1983. At that time, self-bonding became the preferred and economical financial instrument for securing reclamation bonds for these large area surface mines.

The self-bonding regulations adopted by OSMRE (30 CFR 800.23) require an operator to qualify based on a five-year continuous operation history and one of three basic options;

- 1) a credit rating of A or higher;
- 2) 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; or
- 3) the applicant's fixed assets in the United States must total at least \$20 million, and the applicant 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.

Wyoming’s original self-bond regulations mirrored the OSMRE self-bond provisions. Careful review of these self-bond requirements revealed that the self-bond regulations needed to be updated. Key items of concern were the time lag created in receiving year-end annual audited financial reports in relation to the annual report filing, and that the self-bond review was limited to on balance sheet assets and liability calculations only. The SMCRA and State rules did not contemplate large off balance sheet credit revolvers and liabilities at the time of creation. The principal concerns were that large off balance sheet credit revolvers do not appear on the balance sheet until such time as the credit revolver is drawn and becomes a liability. In addition, the complexity of the relationships between the ultimate parent entity and its subsidiaries was not clearly addressed in the existing federal self-bond regulations. It also became clear that during a potential forfeiture, cash on hand to protect physical assets and preserve value would be limited if the reclamation bond was 100% self-bond.

Consequently, Wyoming modified its self-bond regulations based on risk, and established three tiers of credit rating qualifications. The long term credit ratings are:

- 1) “Aa3” or higher as issued by Moody’s or “AA-” or higher as issued by Standard and Poor’s Corporation, or “AA-” or higher as issued by Fitch Ratings. In this scenario, the operator is capped at 75% maximum self –bond and the remaining 25% of the required bond must be comprised of an alternate acceptable bond instrument(s);
- 2) “A2” or higher as issued by Moody’s or “A” or higher as issued by Standard and Poor’s Corporation, or “A” or higher as issued by Fitch Ratings. In this scenario, the operator is capped at 70% maximum self –bond and the remaining 30% of the required bond must be comprised of an alternate acceptable bond instrument(s);

3) “Baa2” or higher as issued by Moody’s or “BBB” or higher as issued by Standard and Poor’s Corporation, or “BBB” or higher as issued by Fitch Ratings. In this scenario, the operator is capped at 50% maximum self-bond and the remaining 50% of the required bond must be comprised of an alternate acceptable bond instrument(s).

These qualifications are a requirement of both the ultimate parent and the subsidiary entity in the corporate tree. By requiring both the applicant and the parent guarantor to satisfy a third party credit rating test, and requiring that all self-bond applicants regardless of their financial rating cover a minimum of 25 percent of their total bond obligation through a separate bond instrument, Wyoming’s self-bond provisions are protective and effective. The application of these requirements has proven that Wyoming’s regulations are more stringent and protective than the federal SMCRA provisions. This is evidenced by the fact that corporate entities that qualified for self-bond under the federal SMCRA provisions prior to the 2015 bankruptcies would not qualify under the Wyoming 2019 revised regulations. Wyoming’s adjustments to the self-bond requirements create a risk-based assessment using credit ratings and increases overall security by requiring all self-bonds to be paired with alternative bond instruments. With these adjustments to self-bond, the assessment of risk is based on independent third party credit rating and is diversified through the use of the self-bond cap and alternative bond instrument use. Wyoming is therefore, confident in its ability to have adequate notice and replacement of a self-bond before an operator would move to a Chapter Eleven or Seven bankruptcy and forfeiture.

Surety bond: As Wyoming updated and tightened its self-bond regulations a natural shift toward surety bonding occurred. This transition also carries risk, as the diversification is no longer spread across different financial instruments, but is now primarily diversified by using multiple individual surety company providers. The surety company issues an individual reclamation bond based on financial risk similar to self-bond. In order to address this risk it is important to understand how the individual surety bonds are capitalized. For example, where a company has a higher risk profile, the surety provider is likely to increase one or all of the supporting financial elements that include: collateral; premium; and reinsurance. Currently under the provisions of SMCRA, States are not permitted to see the agreement between the operator and the individual surety. The ability to review these agreements would improve the quality of review and more accurately assess the risk level of the individual bond.

A surety bond is a contract between three parties – the principal (the operator), the surety company, and the obligee (the State requiring the bond) in which the surety financially guarantees to an obligee that the principal will act in accordance with the terms established by the bond. In Wyoming’s surety bond regulations, Wyoming sets the terms established in the bond. In addition, a surety company must first meet the requirements of the State Insurance Commission, and secondly the underwriting requirements of U.S. Treasury Circular 570 to be certified. The underwriting limitations of Treasury Circular 570 are applied on a per bond basis and may require coinsurance or reinsurance depending on the level of bond risk. Wyoming also applies these provisions when an individual surety bond is in excess of a surety company’s underwriting limit. These measures mitigate the excess risk associated with exceeding the threshold limit of the surety should the bond being offered exceed the underwriting limit listed on the Circular 570 site. However, this mitigation of risk does not adequately account for the additional risk placed on the State through the issuance of multiple reclamation surety bonds by the same surety company to the same operator across one state and/or multiple states.

As with self-bonding, total elimination of risk cannot be achieved. However, application of the Treasury Circular 570 underwriting requirements does mitigate risk to the extent currently possible.

Collateral bonds: Collateral bond refers to the operator pledging an asset or a property as a security to the state for its reclamation obligation. If the borrower fails to reclaim on time, the State acquires the asset or property that the borrower pledged as collateral. Collateral bonds are broken into several financial instruments. These include:

- 1) Cash or cash equivalents such as Certificates of Deposit;
- 2) Negotiable Bonds such as Government issued securities or Municipal Bonds;
- 3) Irrevocable trust to hold securities;
- 4) Personal property; and
- 5) Real property

The first three instruments are self-explanatory and straight forward in their application. Following the adoption of Wyoming's updated 2019 bonding rules, Wyoming no longer accepts personal property such as equipment for a collateral reclamation bond. In Wyoming's experience, the cost in resources to value and annually re-value personal property such as equipment is cost prohibitive, especially given that lower risk bonding instruments are available for the same or lower cost.

However, property such as real estate as applied in Wyoming has merit. Agriculture is the oldest and a principle industry in Wyoming. In the Powder River Basin, 87% of the permitted coal mine area is composed of private surface lands with underlying federal mineral (Split Estate). This is an important distinction as the term "Federal Lands" does not always equate to public surface lands. For the majority of Wyoming coal operations the term "Federal Lands" applies to the mineral estate only. The surface lands are private. Coal operators in Wyoming have purchased large ranch properties that include the current mine operations as well as additional ranch property that may or may not be part of the mining operation. In Wyoming, private ranch land carries significant stable agricultural value and the majority of the coal operations are composed of private surface lands across the State.

Recognizing the value of both undisturbed and reclaimed ranch land, Wyoming's updated 2019 rules includes a provision for accepting real property as part of a reclamation bond. The requirements for accepting real property collateral include: a fair market valuation by a certified appraiser or qualified agent that is approved by the Land Quality Division Administrator; a legal description of the real property; evidence of ownership; a mortgage agreement executed by the operator in favor of the DEQ that is recorded and constitutes a perfected, first lien security interest, and the operator must provide three fair market valuations (low, medium, and high) with a new evaluation of the property's value completed every three years. The real property collateral option further diversifies the available bond instruments and thereby mitigates risk of the collateral provided.

Wyoming's process for developing the new coal financial assurance rules included meaningful engagement of all stake-holders and incorporates several different and diverse financial instruments. This broad stakeholder engagement resulted in better rules, more comprehensive regulation, and reduced risk to the State. The final rules were endorsed by all parties including industry, NGO organizations, and the public.

In summary, Wyoming's experience with coal bonding, regulatory changes, and recent bankruptcies has highlighted several notable points:

- 1) Aside from cash, all reclamation bonding instruments have risk;
- 2) Diversification helps to mitigate overall reclamation bonding risk;
- 3) Promoting diversification by supporting a portfolio of multiple financial instruments provides useful flexibility to all markets;
- 4) Sound and thoughtful regulatory structure like Wyoming's 2019 rule updates can mitigate some of the excess risk of the individual bond instruments.
- 5) Stakeholder engagement prior to and during development of a regulatory framework secures consideration of more diverse and protective financial instruments; and
- 6) Cooperative federalism between the state and OSMRE ensures that the needs of individual states are met while adhering to the protective framework of SMCRA and the goal of reclamation of the Title V programs.

Thank you for the opportunity to testify today and I look forward to answering any questions you might have.

