AVAILABILITY OF BONDS TO MEET FEDERAL REQUIREMENTS FOR MINING, OIL AND GAS PROJECTS

OVERSIGHT HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

OF THE

COMMITTEE ON RESOURCES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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OVERSIGHT HEARING ON "AVAILABILITY OF BONDS TO MEET FEDERAL REQUIREMENTS FOR MINING, OIL AND GAS PROJECTS"

Tuesday, July 23, 2002
U.S. House of Representatives
Subcommittee on Energy and Mineral Resources
Committee on Resources
Washington, DC

The Subcommittee met, pursuant to call, at 10:04 a.m., in room 1334 Longworth House Office Building, Hon. Barbara Cubin [Chairman of the Subcommittee] presiding.

Mrs. CUBIN. The oversight hearing by the Subcommittee on and Mineral Resources will come to order.

The Subcommittee is meeting today to hear testimony on availability of bonds to meet Federal requirements for mining, oil and gas projects. Under Committee rule 4(g) the Chairman and the ranking member can make opening statements but all these other members that you see here today will have to put their statements into the record unless someone else comes, in which case the unanimous consent I am sure, would love to hear their opening remarks.

STATEMENT OF HON. BARBARA CUBIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WYOMING

Mrs. CUBIN. The Subcommittee meets today to examine the availability of surety bonds to meet Federal financial assurance requirements for mining and oil and gas projects. Operators in these industries are often required to post financial guarantees either to ensure their compliance with Federal statutes or to protect the public interest and assure compliance with payment obligations, reclamation performance and compliance with environmental standards.

Coal miners must secure the terms and conditions of Federal coal leases, including rental, royalty and bonus bid payment obligations as well as reclamation and performance obligations. Hard rock miners must provide financial assurances for closure and reclamation operations.

Oil and gas companies must provide financial assurances that they will meet their obligations at the end of the lease operations to plug abandoned wells, remove platforms and other facilities and clear the lease site or the sea floor.

During the last decade, Federal land management agencies have generally increased the amount and expanded the scope of financial assurances that they require. Federal agencies have also reduced the type of instruments acceptable for financial assurances when for all practical purposes the only alternative to a surety bond is cash or cash equivalence.

During the 1990's when Federal regulators were increasing requirements for financial assurances, the surety industry was very profitable. New players attracted to the surety market battled existing players for market share. As a result, underwriters reduced rates and were quite flexible with the type of bond issued.

However, the surety industry had a significant underwriting loss in the year 2000. This loss combined with the softening of the economy that began in the latter part of the year caused several bankruptcies in the surety industry. Since 2000, underwriters and reinsurers have continued to exit the surety market, causing a significant decline in capacity.

This crisis continues to worsen as existing surety bonds are being canceled and rates are increasing, sometimes as much as 500 percent, and more collateral is being required. Presently, there is generally no market for surety bonds with any risk of exposure over 5 years.

This problem is not restricted to mining and to oil and gas production. Surety bonds are not being written for such markets as workers compensation, either. Given the present situation, mining and oil and gas companies cannot obtain surety bonds, but the companies can be forced to tie up millions of dollars in cash or cash equivalents to meet their financial assurance obligations.

The use of large sums of cash in this manner is a very inefficient use of capital. Only the largest, most financially secure companies can afford to utilize capital in this manner. But they have far more attractive opportunities to employ that scarce capital.

The result is that it is no longer attractive to investors to develop natural resources in cases where they must post cash or cash equivalents to meet Federal financial assurance requirements.

As a result, competition in the marketplace and available supplies of domestic resources could be greatly reduced.

[The prepared statement of Mrs. Cubin follows:]

Statement of Hon. Barbara Cubin, a Representative in Congress from the State of Wyoming

The Subcommittee meets today to examine the availability of surety bonds to meet federal financial assurance requirements for mining and oil and gas projects. Operators in these industries are often required to post financial guarantees either to ensure their compliance with federal statutes or to protect the public interest and assure compliance with payment obligations, reclamation performance and compliance with environmental standards. Coal miners must secure the terms and conditions of federal coal leases, including rental, royalty and bonus bid payment obligations, as well as reclamation and performance obligations. Hardrock miners must provide financial assurances for mine closure and reclamation operations. Oil and gas companies must provide financial assurances that they will meet their obligations at the end of lease operations to plug abandoned wells, remove platforms and other facilities and clear the lease site sea floor.

During the last decade, federal land management agencies have generally increased the amount and expanded the scope of financial assurances that they require. Federal agencies have also reduced the type of instruments acceptable for financial assurances to the point where, for all practical purposes, the only alternative to a surety bond is cash or cash equivalents.

During the 1990's, when federal regulators were increasing requirements for financial assurances, the surety industry was very profitable. New players attracted to the surety market battled existing players for market share. As a result, underwriters reduced rates and were quite flexible in the types of bonds issued to meet financial assurance requirements and the type of guarantee or collateral that supported the a company's commitment to the underwriter issuing the bonds. However, the surety industry had a significant underwriting loss in 2000. This loss combined with the softening of the economy that began in the latter part of the year caused several bankruptcies in the surety industry.

Since 2000, underwriters and reinsurers have continued to exit the surety market causing a significant decline in capacity. The crisis continues to worsen as existing surety bonds are being cancelled, rates are increasing—some as much as 500%—and more collateral is being required. Presently, there is generally no market for surety bonds with any risk of exposure over 5 years. This problem is not restricted to mining and oil and gas production. Surety bonds are not being written for such markets as workers compensation either.

Given the present situation, mining and oil and gas companies that cannot obtain a surety bond can be forced to tie up millions of dollars in cash or cash equivalents to meet their financial assurance obligation. The use of large sums of cash in this manner is a very inefficient use of capital. Only the largest, most financially secure companies can afford to utilize capital in this manner, but they have many far more attractive opportunities to employ scarce capital. The result is that it is no longer attractive to investors to develop natural resources in cases where they must post cash or cash equivalents to meet federal financial assurance requirements. As a result, competition in the market place and available supplies of domestic resources could be greatly reduced.

Mrs. CUBIN. The Chair now recognizes Mr. Kind, the Ranking Democratic Member, for his opening statement.

STATEMENT OF HON. RON KIND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. KIND. Thank you, Madam Chair. I will be brief. I want to thank Mr. Fulton for your presence and testimony today as well as the other panel of witnesses. We look forward to reading your submitted testimony.

I am not sure how long I will be able to stay, since we have some other obligations this morning. But I think this is a very important hearing that we are having this morning. I thank the Chair for recognizing the importance of the availability of surety bonds generally, but also in a cost effective manner for industry, more specifically in light of modern times and the current market conditions and some of the bankruptcies that we are now seeing in the private market.

Last fall, when announcing the Department of Interior's decision to undo the Clinton Administration's more stringent regulations for hard rock mining on Federal lands, Secretary Gail Norton chose to maintain their bonding regulations. In a letter to Congress explaining her decision, she stated that keeping the more progressive rules for bonding reclamation initiated under the former Bush administration, I think at that time was Bush 41 that we are talking about, would more than adequately protect the public interest.

Adhering to the "polluter pays" principle, she stated, and I quote, "stringent financial guarantee requirements, the so-called bonding provisions, will ensure that the full cost of any mine reclamation or environmental damage are borne by the mining operator and not the U.S. taxpayer."

Now, I am disturbed, however, that the administration quietly forms a task force to meet and consult with the industries it should be regulating and excludes from those initiative meetings the groups that would be most impacted by government action, namely the effected States, local governments and communities that have to live with the adverse effects of irresponsible mining as well as public interest, environmental, and tax payer groups.

Perhaps today, Mr. Fulton, you can shed a little bit of light in regards to the composition of the task force type of work that you have been doing, who in particular you have been meeting with to date and who you anticipate meeting in the future.

Nevertheless, at a time when corporate malfeasance is having such a devastating effect on the American economy and psyche, it seems incomprehensible that this administration would so cavalierly overlook the public interest in its zeal to make life easier for the mining and energy sectors.

I have no doubt that there are mining and oil and gas corporations having difficulty securing and even affording surety bonds, given the history of mining and oil and gas development. It is not surprising that surety companies facing increasing losses would reconsider the level of risk associated with these activities and adjust their premiums to reflect that concern.

Yet, instead of looking for ways to relieve the industry of reasonable requirements to protect the public and the environment, the administration and this Committee should be stressing the need to maintain an adequate level of financial assurance to prevent deceptive corporate under-estimates of liabilities and to ensure that the public and the environment are not placed at risk by corporate ventures.

Simply put, cleaning up after mining or energy production ends should be a cost of doing business, not something to slough off onto the American taxpayer.

Again, I thank the Chair for holding this hearing, and Mr. Fulton and the other witnesses for your testimony.

I look forward to hearing your testimony. Thank you.

Mrs. CUBIN. Thank you, Mr. Kind.

Before I recognize our first witness, I ask unanimous consent to enter into the record the written testimony from the Northwest Mining Association. Hearing no objection, it is so ordered.

[The information referred to follows:]

NORTHWEST MINING ASSOCIATION

EST. 1895

July 19, 2002

Honorable Barbara Cubin, Chair
Committee on Resources
Subcommittee on Energy & Mineral Resources
1626 Longworth House Office Building
Washington, DC 20515-6208

Re: Availability of Bonds to Meet Federal Requirements for Mining, Oil and Gas Projects

Dear Representative Cubin:

The Northwest Mining Association (NWMA) applauds the Chairwoman for holding this hearing on the availability of bonds to meet federal requirements for mining, oil and gas projects. On behalf of our 2,000 members in 42 states, we have followed this issue closely. We also have commented extensively on the Bureau of Land Management's recent 43 CFR 3809 Rulemaking, which includes new financial assurance regulations.

Unfortunately, there is a disconnect between the new financial assurance requirements in the October 2001 final 3809 rule, and the reality of the financial assurance and reclamation bonding markets in the U. S. Even before the September 11 terrorist attacks, some mining companies were unable to obtain reclamation or surety bonds at any price. Numerous bonding companies have withdrawn from this market and no longer offer surety or reclamation bonds for mine reclamation. This problem has been exacerbated by the events of September 11 and the recent bankruptcy filings of Enron, W. R. Grace, K-Mart and Global Crossing, and the tremendous financial impact of those events on the insurance and surety industry. The likelihood of any new entries into the mine reclamation bonding market is minimal at best.

The bonding market only will tighten, and the possibility of several bonding companies seeking protection of the bankruptcy laws is very real. In fact, NWMA is aware of a mining company with a mine in Nevada where the bonding company is now in bankruptcy, leaving the mine without bonding. This company has not been able to obtain a new bonding source, despite the fact that all manner of creative bonding approaches have been investigated. The result is that today, for this company and many others, only cash or cash equivalent instruments are available to meet the current bonding requirements. This scenario is likely to spread and will soon impact all mining companies, regardless of size or financial condition.

The K-Mart bankruptcy filing was precipitated by a failure of their bonding company (which failure was tied to the Enron bankruptcy). The news media has been filled with articles describing the collapse of the U. S. surety market since the Clinton/Babbitt 3809 regulations were published in November 2000 and the revised 3809 regulations were published in October, 2001. It must be noted that the difficulties in obtaining surety bonds is not unique to the mining industry, nor was it caused by the mining industry.

The result is that surety bonds are not available to the mining industry at any price. As the attached letters from more than 20 bonding/surety companies and two independent brokers evidence, the financial surety and bonding market simply has no interest in writing bonds for the mining industry, especially given the open-ended liability that attaches due to the manner that BLM is calculating the bond amount.

Set forth below are quotations from some of the attached letters:

> ...over the last few months there has been an almost unprecedented level of tightening in the surety and surety insurance market. Many companies are having difficulty placing or renewing reinsurance treaties and most are being faced with increases in pricing, more restrictive terms or both. . . . In this environment, assuming material, uncollateralized reclamation risk is not in our best interests. (email dated 2/26/01 from RLI Corp.)
>
> market conditions have a tightened a great deal in the last several months with rates and constraints or re-insurers impacting many aspects of the underwriting process. Additionally, our experience in this industry has been challenging. (letter dated 2/26/01 from Safeco Ins. Co.)
> The St. Paul is not a market for reclamation bonds for companies involved in precious metal mining. (email dated 1/29/01 from St. Paul Ins. Cos.)
>
> ...Zurich does not write long term surety guarantees such as reclamation and closure type bonds. I know of very few surety companies who will write this class of business even with collateral. The extended duration of the bond guarantee makes it very difficult to find a responsive surety market. (letter dated 1/26/01 from Zurich Ins. Co.)
>
> we are currently not interested in increasing our book of hard rock mining accounts an associated reclamation bonds. (letter dated 2/1/01 from AIG)
>
> Reclamation bonds as a class are very tough to underwrite and we normally limit our exposure to $100,000 on this class.(letter dated 1/26/01 from CBIC Ins. Co.)
>
> As a market we very selectively write this class of business, especially for hard rock mining operations due to the volatility in the commodity being mined. . . . Chubb would not be in a position to entertain this risk , even with collateral. (letter dated 1/29/01 from Chubb Ins. Co.)
>
> ...at the top of the list of bonds F&D does not wish to entertain, with or without collateral, are Mine Reclamation Bonds. (letter dated 1/25/01 from Fidelity and Deposit Cos.)
>
> Specifically, the current state of the precious metals industry precludes us from extending surety credit . . . for long term hazardous bonds (i.e., reclamation bonds).

NWMA believes that the basic problem is the focus on or attachment to "bonding," or traditional "surety," instead of "financial guarantees" or "financial assurance." The reality of today is that mining no longer fits the business plan of the financial surety and bonding industry. Our members are discovering that as bonds come up for renewal, the bonding companies are declining to renew the bonds, or are requiring premiums equal to or in excess

Honorable Barbara Cubin
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of the bond amount. One of our members recently was quoted a premium on renewal equal to 125% of the bond amount, making cash less expensive than a bond. In order to prevent a serious bonding train wreck, BLM must expand the types of financial instruments that meet the requirements of the new financial assurance regulations.

NWMA believes that unintended consequences are emerging as a result of the way in which BLM is currently envisioning and implementing the new 3809 financial guarantee program. The elimination of corporate guarantees has forced mine operators to seek to obtain reclamation surety bonds, or to provide other cash-equivalent forms of financial assurance. However, BLM's recently developed policy to expand the scope of reclamation bonding requirements to include bond coverage for contingencies, future uncertainties, and potential liabilities has made surety companies very reluctant, if not unwilling, to provide surety to the hardrock mining industry.

As indicated above, all of this has created a severe shortage of commercially available reclamation bonds, which has the very real potential to precipitate a bonding crisis. The hardrock mining industry is no longer able to obtain reclamation bonds at a reasonable, or in some cases, at any price. This is creating considerable hardship for the entire industry, and is particularly burdensome on small entities. Furthermore, companies are having to set aside substantial cash to meet the financial assurance requirements, which is no longer available to invest in operations or to do environmental reclamation work on the ground. BLM should modify the financial assurance regulations to ensure that limited cash resources are available for on-the-ground environmental work and not "locked up" in an unworkable financial assurance program.

BLM should allow continued use of corporate guarantees with appropriate guidelines and controls. BLM also should allow preservation of existing corporate guarantees; expanded use of state bond pools; risk based instruments; liens against real property; the value of metals in process in the heaps at the mine site; and any other financial instrument or thing of value that provides sufficient financial assurance to cover the reclamation and environmental liability obligations at the mine.

Thank you for the opportunity to submit this testimony.

Sincerely,

Laura Skaer

Laura Skaer
Executive Director

enclosure

Mrs. CUBIN. The first panel I would like to welcome, Mr. Tom Fulton, the Deputy Assistant Secretary of Land and Minerals Management for the Department of Interior. Mr. Fulton is well known to this Subcommittee. We do appreciate your many appearances over the years and appreciate the valuable information that you bring to us.

You are recognized to give us your full statement.

STATEMENT OF TOM FULTON, DEPUTY ASSISTANT SECRETARY, LAND AND MINERALS MANAGEMENT, DEPARTMENT OF INTERIOR

Mr. FULTON. Thank you, Madam Chair, Ranking Member Kind. Thank you for the opportunity to discuss actions the Department of Interior is undertaking to ensure that Federal bonding requirements necessary to protect the public's interest in its public lands can continue to be met.

In order to protect the public's lands, Congress has enacted laws requiring companies to demonstrate that they have sufficient financial resources to perform the reclamation and cleanup of the site after completion of exploration, mining and production activities. These laws are outlined in my written testimony.

The Bureaus under the Assistant Secretary for Land and Minerals Management, BLM, Office of Surface Mining and the Minerals Management Service, may require a reclamation Surety Bond or proof of other financial security prior to approving a plan of operation or issuing a lease or permit.

For example, for on-shore oil and gas leasing a minimum bond of $10,000 must be posted before any surface disturbing activities related to drilling can begin. Note that this is a floor and not a ceiling. This bond is intended to help insure compliance with all the lease terms, including protection of the environment.

In some cases, as in Alaska, bond pools have been established by States to meet these requirements. Additionally, OSM and Minerals Management Service allow for self-bonding and third-party guarantees, while insurance is often required for unanticipated or catastrophic events.

Earlier this year, the Department learned that due to significant losses in the surety industry post September 11th, surety companies might stop writing new bonds, impose stricter underwriting criteria, set higher premiums for surety bonds or increase collateral requirements.

Any of these conditions could adversely affect the oil, gas or mining industry's ability to get bonds to operate on those public lands. Each Bureau is now analyzing its bonding regulations to ensure they adequately protect the public interest.

For instance, the BLM is evaluating comments including some on the lack of available surety bonds on its 3809 regulations. As a part of BLM's efforts to implement the President's national energy policy, the Bureau is working to complete final rules on bonding liability for onshore oil and gas operations.

The Office of Surface Mining, in May of this year, published an advanced notice of proposed rulemaking seeking comments on issues relating to bonding and other financial assurance mechanisms for treatment of long-term acid or toxic mine drainage.

The comment period is being extended through October of this year in response to stakeholder request. The Minerals Management Service is studying the costs associated with the removal of older, offshore platforms to gauge if current bonding requirements are sufficient.

In response to the concerns of the availability of reclamation bonds, Secretary Norton formed a bonding task force comprised of the Bureaus under the Associate Secretary for Land and Minerals management, as well as the Secretary's immediate office and the Office of the Solicitor to examine the scope and severity of the bonding issue and to develop recommendations to address identified problems.

As Chairman or this task force, I see an excellent opportunity to apply the guiding principles of the Secretary's four "C's," consultation, cooperation and communication in the service of conservation.

Using the Four C's, we hope to forge a more collaborative relationship with State, local and tribal governments, environmental organizations, as well as the surety and mining industries regarding land use reclamation policies of mineral development industries.

This will lead us toward our goal of managing our public lands in an appropriate manner, while providing adequate environmental protection and reclamation, including financial guarantees.

The task force has identified current levels of extractive activities for Department of Interior administered programs and has estimated current financial guarantees for exploration and mining activities. This information is in my written testimony.

The task force has also begun meeting with interested parties in relation to those challenges. So far we have met with members of the surety and mining industry who have not only made us aware of their concerns, but also have given us suggestions on how to tackle problems related to surety availability.

We greatly value their insights into the problem and ideas for satisfactory solutions. The task force will continue its communication with interested stakeholders, including environmental organizations, citizens groups and State and local governments. Meetings with these groups are planned between now and the end of August.

At the conclusion of these meetings, the task force will report to the Secretary on the scope and extent of the problem, concerns, insights and ideas of stakeholders and recommendations for resolution of problems identified through communication with those stakeholders and other interested parties.

The plan for the task force is to submit its report by the fall.

Madam Chairman, this concludes my comments and I would be pleased to answer any questions the Committee might have.

Thank you.

[The prepared statement of Mr. Fulton follows:]

Statement of Tom Fulton, Deputy Assistant Secretary for Land and Minerals Management, U.S. Department of the Interior

Madam Chairman and Members of the Subcommittee, thank you for the opportunity to discuss with you actions the Department of the Interior is taking to ensure that federal bonding requirements, necessary to protect the public's interest in public lands, can continue to be met.

In order to protect the public lands, Congress has enacted several laws (and Federal agencies have developed regulations) requiring companies to demonstrate that they have sufficient financial resources to perform the reclamation and clean up of the site after completion of exploration, mining, and production activities. The Department of Interior's bureaus may require a reclamation surety bond or proof of other financial security prior to approving a plan of operation or issuing a lease or permit. For example, for onshore oil and gas leasing a minimum bond of $10,000 must be posted before any surface-disturbing activities related to drilling can begin. This bond is intended to help ensure compliance with all the lease terms including protection of the environment.

Earlier this year, the Department learned that due to significant losses in the surety industry after September 11, surety companies might stop writing new bonds, impose stricter underwriting criteria, set higher premiums for surety bonds, or increase collateral requirements. Any of these conditions could adversely affect the oil, gas or mining industry's ability to get bonds and operate on public lands.

DOI's Bonding Task Force

In response to these concerns, Secretary Norton formed a Bonding Task Force comprised of the bureaus under the Assistant Secretary for Land and Minerals Management [Bureau of Land Management (BLM), Office of Surface Mining (OSM), and Minerals Management Service (MMS)], the Secretary's Immediate Office (Alaska), and the Office of the Solicitor, to examine the scope and severity of the bonding issue and to develop recommendations to address identified problems.

As Chairman of this Task Force, I see an excellent opportunity to apply the guiding principles of Secretary Norton's 4 C's—Communication, Consultation, and Cooperation, all in the service of Conservation. Using the 4 C's, we hope to forge a more collaborative relationship on extractive industries" land use reclamation policies with State, local, and Tribal governments, environmental organizations, as well as the surety and mining industries. This will lead us toward our goal of managing our public lands in an appropriate manner, while providing adequate environmental protection and reclamation (including financial guarantees).

The three Interior bureaus—BLM, OSM, and MMS—all require financial guarantees in the form of surety bonds, cash or cash equivalents. In some cases, as in Alaska, bond pools have been established by States to meet these requirements. OSM and MMS allow for "self-bonding" and "third-party guarantees," while insurance is often required for unanticipated or catastrophic events.

Let me briefly describe the bonding requirements in applicable laws administered by the Department of the Interior:

- The Mining Law (the General Mining Law of 1872, 30 U.S.C.A. sec. 22–45) applies to "locatable minerals" such as precious metals and gemstones. While the law does not require bonds, the Department of the Interior requires 100 percent of the estimated reclamation cost to be secured by a bond.
- The Mineral Leasing Act of 1920 (30 U.S.C.A. sec. 181–287) applies to coal, oil, gas, phosphate, sodium, potassium, and other minerals and requires adequate bonds for bonus bids, onshore oil and gas surface and down hole operations and pipeline rights-of-way. By regulation, fixed bond amounts per lease for onshore oil and gas exploration are required.
- The Materials Act of 1947 (61 Stat. 681, as amended) applies to sand, gravel, and other common materials and does not require bonds for smaller sales and sales from community pits, although the land must be reclaimed as required by the sale contract or when mining is completed; the cost of reclamation is added to the cost of the material sold by the BLM. For larger sales the BLM may require a bond.
- The Outer Continental Shelf Lands Act of 1953 (67 Stat. 462), as amended (43 U.S.C. 1331, et seq.) applies to offshore oil and gas and allows for bonds. By policy, bonds are required to guarantee offshore end-of-lease activities such as plugging wells and platform removal.
- The Surface Mining Control and Reclamation Act of 1977 (30 U.S.C.A. sec. 1201–1328) applies to surface coal mining on public and private lands and requires performance bonds sufficient to cover 100 percent of the estimated reclamation cost.
- The Federal Land Policy and Management Act of 1976, as amended (43 U.S.C. 1701, et seq.), allows the Secretary to require a bond for Title V rights-of-way such as power lines or communication facilities.
- The Oil Pollution Act of 1990 (33 U.S.C.A. sec. 2701–2761) requires a showing of financial capability, which is frequently met with an insurance policy.

Each Bureau is now analyzing its bonding regulations to ensure they adequately protect the public interest. For example, the BLM is evaluating comments, including some on the lack of available surety bonds, on its final Surface Management regulations known as 3809. As part of the BLM's efforts to implement the President's National Energy Policy, the Bureau is working to complete final rules on bonding liability for onshore oil and gas operations. OSM, in May 2002, published an advance notice of proposed rulemaking seeking comment on issues related to bonding and other financial assurance mechanisms for treatment of long-term acid/toxic mine drainage. The comment period is being extended through October in response to stakeholder requests. MMS is studying the costs associated with removal of older offshore platforms to gauge if current bond requirements are sufficient.

The Task Force also has identified current levels of extractive activities for Department of the Interior-administered programs, and has estimated current financial guarantees for exploration and mining activities. This information follows my written statement.

The Task Force has also begun meeting with interested parties in relation to the challenges we face. So far we have met with members of the surety and mining industries who not only made us aware of its concerns but also gave us suggestions on how to tackle problems related to surety availability. We greatly value its insights into the problem and ideas for satisfactory solutions.

The Task Force will continue its communication with interested stakeholders, including environmental organizations, citizen groups, and State and local governments. Meetings with these groups are planned to be held between now and the end of August. At the conclusion of these meetings, the Task Force will report to the Secretary on the scope and extent of the problem, the concerns, insights and ideas of stakeholders, and recommendations for resolution of problems identified through communication with stakeholders and other interested parties. The plan is for the Task Force to submit its report by the fall.

Madam Chairman, this concludes my statement. I would be pleased to answer any questions that you may have.

Appendix A:

Current levels of extractive activity administered by the Department of the Interior

- 21,500 onshore “producible” oil and gas leases (out of a total of 48,600 leases)
- 7,500 offshore oil and gas leases
- 300 federal coal leases
- 203,000 mining claims
- About 80,000 producible, service, or temporarily abandoned onshore oil and gas wells
- Over 100 orphan wells
- 4,000 offshore platforms/facilities
- 23,000 active or temporarily abandoned offshore wells
- 8,500 inspectable units subject to Surface Mining Control and Reclamation Act
- 1,000 mining law plans of operations

Appendix B:

Face value of financial guarantees held by the Department of the Interior

- BLM about 12,500 bonds for about $2.01 billion
- MMS about 725 operations bonds for about $0.75 billion
- MMS about 40 companies with $240 million in monetary appeals bonds and 17 self-bonded companies with $48 million
- OSM about $570 million in estimated performance bonds

Non–DOI Financial Guarantees:

The face value of non–DOI-held financial guarantees, especially the amount of bonds held by individual states, is difficult to estimate. For example, state primacy under the Surface Mining Control and Reclamation Act (SMCRA) means that 24 States [each with its own program including 8 with Alternative Bonding Systems (ABS)] cover most of the bonding associated with surface coal mining in the United States. We do not have data on financial guarantees held by individual states.

Mrs. CUBIN. I will start the questioning actually by making a statement. I think it is universally accepted by all Members on both sides of the aisle that we want proper reclamation and we want it done in as timely a fashion as possible.

I think where the disagreement comes is how to accomplish that and how to weigh the efficiencies of doing that and the cost. Having said that, we all recognize that this bonding and surety issue is a problem. Could you tell me briefly what the bonding requirements are that are dictated by legislation and the requirements that are set by regulations?

Mr. FULTON. Yes. There are quite a few laws that dictate how extractive industries perform on public lands. They include the Mining Law, which does not require a bond, but the Department and the Secretary require 100 percent of the reclamation costs be secured by a bond.

The Mineral Leasing Act of 1920, in addition to the Materials Act of 1947, the Outer Continental Shelf Lands Act, and SMCRA, The Surface Mining Control and Reclamation Act. That law does require in its provisions 100 percent reclamation.

FLPMA, the Federal Land Policy Management Act also has provisions for reclamation for rights of way and communications facilities.

Then the Oil Pollution Act of 1990 requires a showing of financial capability.

So, there are several Federal laws on the books as well and among them as a group often require bonding through their legislation and others that have a regulatory effect.

Mrs. CUBIN. And what are the regulations that evolve from that legislation?

Mr. FULTON. Well, for instance, as Mr. Kind alluded to, the 3809 regulations which were promulgated in the last administration and the Secretary, through a policy decision, required that the reclamation provisions be as strong, that she does not want taxpayers burdened with the cost of reclamation.

Mrs. CUBIN. The reason I ask the question is because a later witness will testify that the financial assurances and acceptable forms of assurances among the BLM, MMS and OSM are different. Could you explain to me some of those differences and the reason that there is a difference?

Mr. FULTON. For instance, under SMCRA, coal mining has to have a bond for reclamation, whereas offshore oil and gas often Minerals Management Service requires basically a self-bonding. So, it varies by bureau and by industry and by type of operation. The task force is looking at those differences across those bureaus, but I'm not sure we would effect a one-size-fits-all solution.

Rather, I believe we would want to follow the bottom line the Secretary gave us which is multiple uses and appropriate use of our Federal lands, but reclamation should not involve taxpayer expense.

Mrs. CUBIN. OK, going back to your statement that one size fits all, it is probably, in your opinion, not the best policy for these assurances.

Explain to me then, say for example, within the coal industry, when sometimes coal leases are sold and the entire price for the lease is paid, I believe, it is over four installments. Sometimes, at purchase, after the first payment a coal company doesn't have to get a bond or a surety instrument for the purchase price and sometimes they do. Do you understand the question?

Mr. FULTON. Yes. I am not sure what the answer is. We could get a written reply to your question. Is there a specific example that you are referring to?

Mrs. CUBIN. I know in the past, although not in the recent past, that companies have been required to have a surety, which they have done in terms of cash. So, they are tying up $350 million plus in cash because they can't get a bond or a surety instrument.

I am aware that that has happened with a Kennecott purchase recently, the Jacobs Ranch in Wyoming. I wonder why this purchase is singled out when other purchases are not singled out and what will happen if that practice continues is that everyone will just bid a lower price.

If they know they are going to have to have hundreds of millions of dollars tied up in bonding or financial sureties, cash, they will bid lower. The Federal Government gets less money. The States get less money, just because that is tied up.

I think really that is a foolish, foolish thing to do. I certainly hope the task force will be looking at that.

I do have more questions that I want to ask you, but my time has expired, so I will recognize Mr. Kind, realizing that he has to go, and then we will do a second round.

Mr. KIND. Thank you, Madam Chair and thank you, Mr. Fulton, for your testimony here today. I think this is a very serious issue in regards to the availability of surety bonds. I hope that we are going to be able to work in conjunction with one another in order to delve into this subject matter.

I am sure everyone here is familiar with the controversy or cloud under which Vice President Cheney's Energy Task Force operated in regards to access to information of who he met with, what was discussed, things like that that helped shape the administration's policy.

I would certainly hope we can get off on the very best foot in regards to the Bond Task Force, so you let the sunshine in and that the import is expansive and that you open up the Bonding Task Force to a myriad of individuals and players including local and community leaders and others that have an interest in this important subject.

Having said that, just looking for a little bit of background, a little bit of detail in regards to formation of a task force. When exactly was that task force formed?

Mr. FULTON. I am not exactly sure. It happened when the Secretary was introducing the Minerals Management Service Director, Johnny Burton, to an offshore oil and gas group. At the end of the introductory remarks, the first question from the audience was, "What about this bonding problem?"

That coming with concerns that were being raised in the hard rock mining industry and additionally in the coal industry led her to contact Assistant Secretary Rebecca Watson and ask for the task force to be set up. I can't remember exactly what day that was, but we can get that for you.

Mr. KIND. How long ago was that, approximately?

Mr. FULTON. It was April, I think.

Mr. KIND. Could you submit to the Committee just for our reference the names and titles of Department of Interior employees who are currently serving on the task force?

Mr. FULTON. Certainly.

Mr. KIND. That would be very helpful. How often does the task force meet?

Mr. FULTON. Irregularly.

Mr. KIND. How often have you met so far?

Mr. FULTON. We have had a meeting with the mining industry. We had a meeting with the surety industry. We had a briefing for Hill staff and we have met on an ad hoc basis several times internally to just try to gather information of the size and scope of our own surety activities inside the Department of Interior.

Mr. KIND. Where are the meetings held?

Mr. FULTON. The meetings that were with the mining industry were at the mining building. The meeting with the surety industry was in their building.

Mr. KIND. Could we obtain a list of those who attended the meetings?

Mr. FULTON. Sure, I think—

Mr. KIND. That would be helpful. Apparently, in reviewing some of the written testimony that was submitted today, Ms. Lynn Schubert, who is President of the Surety Association of America emphasized in her written testimony that she has met with the task force on a number of occasions and is working closely with you to develop a set of recommendations for Secretary Norton.

Is this a correct portrayal by Ms. Schubert?

Mr. FULTON. Well, we certainly did meet with the surety industry and I believe she was also at the mining industry meeting.

Mr. KIND. Have any of the outside groups including the Surety Association submitted any documents or paperwork to the task force?

Mr. FULTON. We have encouraged everyone who has some ideas that might be of assistance to give us whatever they have to help us understand this as best we can.

Mr. KIND. Could we have access to those documents? Is there any way of submitting copies to us or providing access to what has been submitted thus far?

Mr. FULTON. I believe that would be possible.

Mr. KIND. Have you met with any State or community leaders thus far at the task force meetings?

Mr. FULTON. Not yet. We are attempting to set up a meeting.

Mr. KIND. It is anticipated then?

Mr. FULTON. Yes.

Mr. KIND. How about any taxpayer groups or NGO groups? Are you anticipating meeting with them as well to discuss the bonding issue?

Mr. FULTON. Yes, right.

Mr. KIND. I have no doubt that Secretary Norton is sincere in her desire not to have any of these costs shift to the taxpayers. I think there is common interest from all of us here to ensure that that does not happen.

Can you inform the Committee today that there is no intent or interest to weaken the bonding requirements that Secretary Norton came out and spoke so forcefully in favor of as recently as last fall?

Mr. FULTON. Well, the Secretary's directive to the task force was that multiple use where appropriate should be encouraged to conduct its business on public lands but that clean up should not involve taxpayer expense.

Mr. KIND. Well, we will look forward to working closely with you and see what further meetings are held. As I indicated, I think this is a very important issue for us to delve into in light of the current market place and the difficulty that is increasing, being able to obtain this type of bonds.

Again, I appreciate your testimony here today.

Thank you, Madam Chair.

Mrs. CUBIN. Thank you, Mr. Kind.

The Chair now recognizes Mr. Markey for either an opening statement or 5 minutes of questions, and knowing you, you can handle them both.

Mr. KIND. But no singing.

Mrs. CUBIN. Yes. Please don't sing.

STATEMENT OF HON. EDWARD J. MARKEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. MARKEY. Thank you, Madam Chair. This hearing on the availability of bonds to meet Federal requirements for mining, oil and gas projects is very timely, coming as it does when the nation's trust of corporations is at an all-time low and when the administration is calling for increased extraction of natural resources from our public lands.

Providing protection to the environment and rehabilitating damaged lands is a legitimate cost of business, costs that the public have the right to know are guaranteed and that investors have a right to know are liabilities of the company.

Corporate guarantees are not enough in this era of corporate irresponsibility. There is an unfortunate legacy of orphaned mines and oil and gas wells in our nation forcing the taxpayers to bear the burden of reclamation if they are reclaimed at all.

Taxpayers deserve more concrete assurances that money will be available for cleanup and restoration when the projects are finished. Now this is not just an energy sector issue. It is a business issue. When a businessman wants assurances that something will be done in the future, he asks for a bond or other types of financial guarantees.

Just look at the front page of today's Washington Post sports page. It is the lead story. It says, "Support for sale of tracks is shaky. Maryland Commission members want buyers' bond. Two members of the Maryland Racing Commission are planning to ask for a bonded guarantee on promised upgrades to Pimlico and Laurel Park by Magna Entertainment before the $117 million sale of the State's top thoroughbred tracks from Joe DeFrancis."

"'There is going to have to be some kind of security interest put up,' said Commission Member, Terry Saxton, 'something more than just their word is needed if it is going to get done. We have been burned before. We will need more than verbal assurances of what will be done and we will need a timetable.'"

Well, that is all that we ask of the energy companies using public lands; that they provide financial guarantees for reclamation after their work is finished. That is how businesses work. All we are asking is that we run America like a business.

President Bush and Vice President Cheney said, they were going to run America like a business, and so far they have run it like a business.

What we are asking for here now is the same kind of guarantees that would be required in the private sector.

I recently released a General Accounting report on the requirements of restoring lands after oil production ceases on Alaska's North Slopes.

The GAO estimated that on the North Slope alone as much as $6 billion was required for dismantlement, removal and restoration. Unfortunately, existing bonds will cover only a fraction of that clean up.

The State of Alaska only requires each oil company to set aside a maximum of $200,000 for all wells and $500,000 for all of its oil and gas leases. The report raises two major public policy issues that need to be corrected in both the oil and gas industry and the mining industry.

First, companies are refusing to publicly disclose their liabilities, a troubling accounting issue that needs to be addressed before it is sprung on unsuspecting investors, workers and the public.

Second, the GAO report is an indictment of existing, of vague financial assurances so inadequate that the public interest in restoring these lands may never be redeemed.

I have sent letters to Secretary Norton and SEC Chairman Pitt requesting their attention to these matters, but I believe these issues are so important that we need to ensure that we address them in today's hearing.

So, with billions of dollars of liability that has not yet been bonded by the oil and gas industry, we have important issues to address and I hope that as a matter of policy we establish those requirements here in Congress.

I yield back the balance of my time.

[The prepared statement of Mr. Markey follows:]

Statement of Hon. Edward J. Markey, a Representative in Congress from the State of Massachusetts

This hearing on the "Availability of Bonds to meet Federal Requirements for Mining, Oil and Gas Projects" is very timely, coming as it does when the nation's trust of corporations is at an all time low and when the Administration is calling for increased extraction of natural resources from our public lands. Providing protection to the environment and rehabilitating damaged lands is a legitimate cost of business—costs that the public have the right to know are guaranteed and that investors have a right to know are liabilities of the company. Corporate guarantees are not enough in this era of corporate irresponsibility. There is an unfortunate legacy of orphaned mines and oil and gas wells in our nation, forcing the taxpayers to bear the burden of reclamation, if they are reclaimed at all. Taxpayers deserve more concrete assurances that money will be available for cleanup and restoration when the projects are finished.

This is not just an energy sector issue. It is a business issue. When a businessman wants assurance that something will be done in the future he asks for a bond or other types of financial guarantees. Just look at the front page of today's Washington Post sports page.

"There's going to have to be some kind of security interest put up," said commission member Terry Saxon, a strong critic of Magna's management at other tracks, most notably Gulfstream Park in Florida. "Something more than just their word [is needed] if it's going to get done. We've been burned before. We will need more than verbal assurances of what will be done, and we will need a timetable."

That is all we ask of energy companies using public lands. That they provide financial guarantees for reclamation after their work is finished.

I recently released a General Accounting Report on the requirements for restoring lands after oil production ceases on Alaska's North Slope. The GAO estimated that on the North Slope alone as much as $6 billion was required for dismantlement, removal and restoration. Unfortunately, existing bonds will cover only a fraction of that cleanup—'the state [of Alaska] only requires each oil company to set aside a maximum of $200,000 for all its wells and $500,000 for all its oil and gas leases." The report raises two major public policy issues that need to be corrected in both the oil and gas industry and the mining industry. First, companies are refusing to publicly disclose their liabilities, a troubling accounting issue that needs to be addressed before it is sprung on unsuspecting investors, workers and the public. Second, the GAO report is an indictment of existing federal and state permitting processes that are so vague and the financial assurances so inadequate that the public interest in restoring these lands may never be redeemed. I have sent letters to Secretary Norton and to SEC Chairmen Pitt, requesting their attention to these matters but I believe these are important issues to present in today's hearing.

The testimony of Mr. Jim Kuipers will show us that the problems are the same, if not worse, in the mining industry. As he says in his statement, the three largest copper and the three largest gold mining companies operating in the United States have a potential un-guaranteed liability of $9 billion. Even when companies are accruing money for eventual reclamation and closure costs, the amount is only a fraction of the potential total liability. Drawing on Mr. Kuipers example, the Phelps Dodge Corporation had accrued $135 million by 2001 for reclamation but their potential liabilities could exceed $3 billion.

The bottom line is that corporations should have to provide "rock-solid" guarantees that they can restore the public land after their operations are done. If they cannot provide the assurances up front, then they should not be permitted to develop public lands. The taxpayers should not have to assume the risk of paying the clean-up costs if the companies responsible cannot find the next gold mine or oil well to pay for the cleanup of their previous work. Furthermore, investors and the public have every right to know site-specific information about reclamation costs, so that they can judge the adequacy of a company's assets in meeting these liabilities. I look forward to exploring with today's witnesses ways the federal government can develop a coherent strategy for assuring funds are available for restoration and reclamation of public lands when mining and oil and gas production is complete.

Mrs. CUBIN. Thank you, Mr. Markey.

I would like to refer to a letter from the GAO in response to a letter written by the Senator Murkowski asking for clarifications on some of the things that were put in that GAO study and ask unanimous consent to enter this document into the record.

[The letter referred to follows:]

GAO
Accountability * Integrity * Reliability

Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

July 17, 2002

The Honorable Edward J. Markey
House of Representatives

Dear Mr. Markey:

This correspondence responds to your July 16, 2002, letter requesting specific information related to our recent report entitled ALASKA'S NORTH SLOPE: Requirements for Restoring Lands After Oil Production Ceases (GAO-02-357). Those questions and our answers follow.

1. Does the GAO still stand behind its report?

Yes, we firmly stand behind the contents of the North Slope report. It represents a comprehensive and definitive assessment of North Slope restoration issues and the applicability of these issues to any development on federal lands. However, as you can understand, we cannot be expected to stand behind others' characterizations of the report. In that regard, in the coming days, we hope that the report will be allowed to stand on its own considerable merits.

2. Does the GAO believe the report supports the assertion that "What will happen when the North Slope production is over isn't even worth discussing?"

We do not share this view. Our report states that it is important to ensure that federal lands on Alaska's North Slope are properly restored after oil and gas activities cease. Toward this end, we recommended that the Department of the Interior issue specific dismantlement, removal, and restoration requirements to implement its restoration goal and ensure the availability of funds needed to achieve that goal. The Department of the Interior agreed with the recommendations.

3. Does the GAO believe that its report supports the view that the cost of dismantlement, removal, and restoration on the North Slope could actually cost billions, perhaps as much as $6 billion, while the financial assurances provided through bonding are only a fraction of that amount?

Our report states that while there is no definitive estimate for the cost of performing dismantlement, removal, and restoration on the North Slope, available evidence suggests that the total liability is in the billions of dollars. Our report also says that current bonding requirements will only cover a small portion of this potential liability.

4. **Does the GAO believe that the oil companies currently operating on the North Slope refused to disclose their own estimates of the cost of DR&R on the North Slope when they were asked by the investigative arm of Congress to provide that information?**

Our report states that none of the five oil companies with a substantial ownership interest in oil production on the North Slope were willing to provide their estimated dismantlement, removal, and restoration liabilities for their operations. It also states that they were not obligated to do so. In this regard, in accordance with generally accepted accounting principles, these oil companies do estimate, record, and report their future dismantlement, removal, and restoration liabilities in their annual financial statements for their entire operations.

5. **Does the GAO believe that the BLM and the Fish and Wildlife Service "need to ensure that their financial guarantees are adequate in case a company is unwilling or unable to pay for returning the land to whatever standards have been established? To do otherwise would leave the taxpayer with an unacceptable risk."**

Yes, as it relates to federal lands. These statements are contained in the conclusions of the report. The Department of the Interior concurred with the report's findings, conclusions, and recommendations.

6. **Did the Department of the Interior comment on the report, and did those comments express concurrence with the need for the BLM to review the adequacy of DR&R financial assurances applied to federal leases in the National Petroleum Reserve—Alaska, and with the need for BLM to get more specific with respect to DR&R requirements?**

Yes. In its May 22, 2002, written comments on a draft of our report, the Department of the Interior concurred with the report's findings and recommendations. Specifically, Interior agreed with our recommendation that the Bureau of Land Management issue specific dismantlement, removal, and restoration requirements that will allow the Bureau to meet its overall goal of returning the land to a condition that will sustain its previous uses including fish and wildlife habitat, as well as subsistence uses. Interior stated that the Bureau would accomplish this by attaching special stipulations and conditions of approval on a lease-by-lease basis. In addition, the Department concurred with our recommendation that the Bureau review its existing financial assurances for oil and gas activities in the National Petroleum Reserve–Alaska to determine if they are adequate to ensure that funds will be available to achieve its overall restoration goal. Interior stated that the Bureau's review would focus on protecting the environment and taxpayers should lessees default. The full text of the Department's comments is included in appendix II of the final report.

7. Was the State of Alaska informed of your report and allowed to comment upon it, and do those views appear in the report?

Yes. Throughout the course of this audit, GAO had numerous, substantive contacts with officials from the state of Alaska. Beginning with the initiation of our work in March 2001, GAO contacted state officials to explain the objectives and scope of our work and the methodology we planned to use to implement the assignment. Further, on April 13, 2001, GAO responded to a letter from Governor Knowles requesting additional details on the purpose, scope, methodology, and timing of our review. As requested by the state, we coordinated all our work with Alaska's Office of the Attorney General, including numerous contacts with various state agencies, written requests for information, and follow-ups. In March 2002, we met with state officials to discuss a statement of facts that presented the preliminary findings of our audit. Comments provided by the state were included in a draft of the report as appropriate. Further, on April 25, 2002, the state of Alaska was asked to provide written comments on our draft report. The state of Alaska's views were summarized in the report's executive summary and incorporated into the body of the report. Furthermore, the full text of the state of Alaska's May 24, 2002, comments is included in appendix III of our final report.

8. Does the report include a discussion of the adequacy of the DR&R requirements in H.R. 4, a bill that would allow oil and gas development in the Arctic National Wildlife Refuge, in which GAO notes that the standards in H.R. 4 "could compromise the guidance that the land be reclaimed to a condition capable of supporting its previous use, which is predominantly wildlife habitat?"

Our report discusses all the bills that were introduced in the 107th Congress that would open the Arctic National Wildlife Refuge's coastal plain to oil and gas development. Some of these bills, like H.R. 4, included language that specified the condition to which the lands used for oil and gas activities should be returned after oil and gas production ceases. In this context, our report states that H.R. 4 requires reclamation of the land to a condition capable of supporting the uses that the lands were capable of supporting prior to oil exploration, development, or production activities, *or*, upon application by the lessee, "to a higher or better use" as approved by the Secretary of the Interior. Because the restoration goal could be subjected to interpretation by the Secretary of the Interior if the lessee requests, our report notes that the inclusion of the phrase "or to a higher or best use" could compromise the guidance the bill provides that the Arctic National Wildlife Refuge should be reclaimed to a condition capable of supporting its previous use, which is predominantly wildlife habitat.

We hope this response fully addresses your questions. If you have any additional concerns, I would be happy to discuss them with you. You can reach me on 512-5500.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

cc: The Honorable Ted Stevens, United States Senate
The Honorable Frank H. Murkowski, United States Senate
The Honorable Richard A. Gephardt, House of Representatives
The Honorable Nick J. Rahall, House of Representatives
The Honorable Don Young, House of Representatives

Mrs. CUBIN. The question: Does the GAO believe that the situation in Alaska is a world-class accounting scandal in the same league as WorldCom or Enron?

No, our report provides no basis for alleging any accounting scandal. We did not audit or evaluate the accounting practices of oil companies operating on the North Slope. Additionally, the lands that were referred to by my friend from Massachusetts were State lands.

I am sure that no one thinks that the Federal Government should go in and take over the State lands or take on the financial responsibility that the States have in this situation.

Mr. MARKEY. May I ask the gentlelady, I actually have a response from the GAO to the letter which Mr. Murkowski sent to GAO. Would it be possible for me to put the response from—

Mrs. CUBIN. That is what I am entering into the record, but we will check to make sure it is the same document.

Mr. Fulton, a later witness will testify that recent changes in the surface mining regulations will preclude the use of Alaska State Bonding Pool on BLM lands after 2004. Does Interior feel that the Alaska Bonding Pool is not an adequate financial assurance or does the BLM plan to work with the Alaska State government to remedy this problem?

Mr. FULTON. We do feel that the Alaska Bonding Pool is adequate, and yes, we do intend to work with the State of Alaska and the Alaskan mining community to address this issue.

Mrs. CUBIN. Here is another question that is interesting to me. If there is a company that goes out of business or whatever before the reclamation is done and there is a surety bond on that lease, why doesn't Interior allow the surety company to go in and complete the reclamation or clean up the site prior to forfeiting the entire surety bond?

What is the reason for that practice?

Mr. FULTON. I am not sure what the reason is. It would be an item that the task force would look at. The goal of the Secretary is to make sure that the public lands are restored to a satisfactory state.

That is going to be the end goal that the task force looks at in all these matters relating to the adequacy of the bonds.

Mrs. CUBIN. That is one of the things I was referring to earlier when I said we all agree that we want the land reclaimed and the State lands cared for, but we disagree on how to get there. That is just one of the issues that I couldn't understand.

I don't have any further questions then. I do thank you very much for being here. We will keep the record open for 10 days and I am sure the members will have written questions and we will appreciate your reply to them. Thank you very much.

Mr. FULTON. Thank you, Madam Chair.

Mrs. CUBIN. I would like to call the next panel forward, realizing we have a vote that is coming relatively soon.

At this time I would like to call the second panel forward, Ms. Lynn Schubert who is the President of Surety Association of America; Mr. Steve Borell, Executive Director, Alaska Miners Association; and Mr. Gerald Schlief, Senior Vice President of ATP Oil & Gas Corporation, testifying on behalf of the National Ocean Industries Association.

STATEMENT OF LYNN M. SCHUBERT, PRESIDENT, SURETY ASSOCIATION OF AMERICA

Mrs. CUBIN. First, I would like to recognize Ms. Schubert to testify. Please note the lights on the table. You are recognized for 5 minutes, but your entire written statement will be included in the record.

Ms. SCHUBERT. Thank you very much and thank you for inviting us here to testify today on this very important topic.

The Surety Association is a trade association whose members write the vast majority of surety bonds in the United States. We are aware of the difficulties that permittees are having in obtaining surety bonds for oil, gas and mining projects and we have been working closely with the Department of Interior Bonding Task Force to identify the issues and to attempt to craft solutions.

We also have met with the Interstate Mining Compact Commission on the same issues. Surety bonds have been a vital part of American business for over 100 years, facilitating commerce and protecting taxpayer dollars. Our members wish to continue to provide this valuable service for the mining gas and oil industry.

Bonds, however, are not a panacea for all potential problems. To understand the current market situation, it is necessary to understand some very fundamental principles about suretyship. The essence of suretyship is that one party guarantees the performance of another to a third.

Essentially, surety bonds guarantee that a principal will perform its obligations whether imposed by contract or by law. In this case the permittees will fulfill the terms of the permit including all applicable legal requirements.

Unlike traditional insurance where there are two parties, this is a three party arrangement: The principal who is going to perform, the surety who guarantees that performance, and the obligee who is to receive the performance.

The principal always remains primarily liable and the surety is secondarily liable. So, to guarantee someone's performance of an obligation, what must you do?

Well, first you must understand the obligation itself. Second, you must assess the risk of payment on the guarantee. In other words, will the principal actually be able to perform?

Third, you must assess the likelihood that if you do pay as a guarantor, that you will be repaid by the person who is primarily liable, the principal.

So, essentially, it is a risk analysis. Keeping in mind this analysis, a look at the risk characteristics of these bonds and the changing interpretation and scope of the bonds quickly reveals one reason why surety bonds have become less available.

Understanding the obligation, let me start with just one example, and that is when I started in the business over 22 years ago, reclamation bonds were very available. They were very common bonds. The permittee was required to reclaim the site. Reclaim meant put the site back into the state that it was when you started the mining.

Well, sureties understand that obligation. We understand about moving the dirt and grading the dirt and seeding and putting in trees and we wrote those bonds. Unfortunately, that is no longer the case. The duration is much longer. It is sometimes 30 and 40 years. We are also looking at bonds not being released when the reclamation is finished.

What used to happen is you had two phases. You graded, you put in the revegetation and then you monitored it. At the end of the vegetation stage, the bond would be significantly reduced. That is no longer happening because of the concern of acid mine drainage or water issues, those mines are being kept in the full amount for an indefinite period.

So, understanding the obligation and analyzing your risk is virtually impossible at that stage. You can't be sure as to the obligation and you certainly can't be sure whether the principal will still be there 40 years down the road. It is very difficult.

Perhaps even worse, lease bonds required by the Minerals Management Service not only are of long duration, but after they are canceled, they can be reinstated by the obligee. It is impossible to analyze what your risk is going to be on a bond that can be reinstated.

The expanded scope of the obligation contributes to the uncertainty. The acid mine drainage issue is a perpetual issue. It requires a funding mechanism. A surety bond is an instrument that provides a guarantee of a certain performance, the reclamation or whatever it might be, a lease payment.

It does not provide for perpetual funding mechanism. While all these increases in liability and uncertainty were being created, the surety industry also was experiencing significant losses.

Traditional loss ratios for surety are somewhere in the 20 percent range, 29 percent range. In 2000, loss ratios were approximately 45 percent. In 2001 they were approximately 85 percent. So, as the sureties are looking at reducing their risks, their obligations are becoming riskier.

That is the fundamental reason that you are seeing the significant change in availability of surety bonding. We would like to work with Congress, the regulators, the environmental groups, as well as the permittees to solve these concerns. There are some simple solutions, reduce the duration, make it clear what the obligation is, make the bond cancelable, allow options other than the full forfeiture as you stated earlier, and look for another solution for perpetual issues such as acid mine drainage.

I thank you very much for allowing us to be here today. Thank you.

[The prepared statement of Ms. Schubert follows:]

Statement of Lynn M. Schubert, President, The Surety Association of America

Introduction

The Surety Association of America is a voluntary, non-profit association of companies engaged in the business of suretyship. It presently has approximately 600 member companies, which collectively underwrite the overwhelming majority of surety and fidelity bonds written in the United States, and seven foreign affiliates. The Surety Association of America is licensed as a rating or advisory organization in all states, as well as in the District of Columbia and Puerto Rico, and it has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience.

Surety bonds provide a fundamental service to consumers, taxpayers and the U.S. treasury and have been a vital part of business in America for more than 100 years. The role of surety bonds is to reduce or eliminate uncertainty in a variety of business transactions. For example, the majority of surety bonds are written for construction of our nation's infrastructure, which accounts for 10% of the Gross Domestic Product. In 2000, nearly $175 billion in public works projects were under construction in the United States with surety bonds providing qualified contractors and protection against contractor failure. Surety is vital to public construction, saving taxpayer dollars and spurring economic activity. Surety also has been written for mining, gas and oil projects for many years. Again, the fact that bonds have stood behind miners and drillers has allowed the government to be sure that these projects would be undertaken responsibly and with a third party available if the permittee did not perform. The capability of the surety industry continues to be there to meet the challenges and needs of American business. However, surety bonds cannot be a panacea for all potential problems. The surety industry continues to support the need for responsible mining and drilling, reclamation and general protection of the environment, and we look forward to working with Congress, regulators, environmental groups and contractors to find a way to best do this.

SAA is aware of the difficulty that permittees are having in acquiring bonds and has been working with regulators and other stakeholders to seek ways to address this issue. We believe that the limited availability of bonds required in connection with mining, oil and gas operations results from a change in the requirements as well as a change in the current marketplace. Bonding remains a viable option to address the concerns surrounding many of the risks associated with these projects, but the responsibility of the surety must be clearly defined and must be able to be underwritten.

What Are Surety Bonds

In analyzing the availability of any type of surety bond it is critical to understand the concept behind surety bonds, how they differ from traditional lines of insurance, and why they are underwritten the way they are. The fundamental concept behind a surety bond is to guarantee that someone will perform a duty. Whether it is a duty imposed by contract, such as to build a building, pay a lease, etc., or a duty imposed by law, such as to pay customs duties or to reclaim a mining site, the bond provides an independent third party to ensure that the principal, the person who agrees to the duty, performs, or that there is money available to complete that obligation. The surety is only secondarily liable. The principal remains primarily liable. Unlike traditional insurance, a bond creates a tripartite relationship: the principal, the surety, and the obligee, the one receiving performance. This relationship is best explained by a triangle.

Each of the parties has rights and responsibilities with regard to the other. While the surety has the obligation to the obligee to either perform the obligation of the principal if the principal defaults, or pay a sum of money, up to the amount of the bond, for performance, the principal remains obligated for that performance. By performing on the principal's behalf, the surety steps into the shoes of the obligee and the principal is obligated to reimburse the surety for any money paid. Theoretically, therefore, a surety should never have a loss. Similar to a bank issuing a line of credit, the surety stands behind the principal, allowing a third party to rely on that principal, knowing a third party is guaranteeing the obligation. Unlike a bank, however, sureties do not always take collateral or have the right of set off of the principal's bank account to recover amounts paid on the principal's behalf. Therefore, the surety must prequalify the principal as to performance and financial strength.

It is critical to understand that the beneficiary of the bond is not the principal; it is the obligee. Unlike a homeowners or auto policy where there are only two parties to the contract and the beneficiary of the policy is the policyholder, in the case of a surety bond, the beneficiary of the bond is the obligee. In the case of the bonds under discussion today, that obligee is the government. The principal remains liable for performance. Therefore, in analyzing whether or not to write a bond, a surety will review two crucial items: the likelihood that the principal will perform its obligations, and the likelihood if the principal defaults and the surety performs, that the principal will be able to repay the surety for its losses. If the surety decides to write the bond, whether or not the surety is correct in its analysis, the obligee obtains the benefit of the bond. Understanding these relationships makes it easier to understand that a surety must be able to know the specific promise it is guaranteeing and assess the risk of loss. An increase in the duties imposed under reclamation and other bonds, as well as serious increases in losses for sureties over the last two years, have contributed to the current market situation.

Federal Mining, Oil and Gas Project Bonds

As mentioned above, SAA is quite aware of the difficulty that permittees are having in acquiring bonds in today's surety market, and we are in active dialogue with regulators and mining industry to seek a resolution to the issue. For example, SAA is working closely with the Department of the Interior's Bonding Task Force to provide information and recommendations regarding bonding availability. In addition, we recently participated in a bonding meeting sponsored by the Interstate Mining Compact Commission, an organization of twenty state regulatory authorities. We believe that the limited availability of bonds required in connection with mining, oil and gas operations is a result the risk characteristics of such bonds as viewed by an industry that has returned to tighter underwriting standards. We hope to provide information to this Subcommittee that will assist it in developing solutions.

Risk Characteristics of These Bonds

First let us address the risk characteristics of these bonds and why they present a concern to sureties. We reference specific types of bonds for illustrative purposes.

Long-term Duration

A primary risk characteristic that concerns sureties is the long-term duration of these obligations. For example, with respect to mining operations, the Surface Mining Control and Reclamation Act of 1977 ("SMCRA") requires the permittee to provide a bond to the regulatory authority which is conditioned upon the faithful performance of the requirements of the SMCRA, the applicable regulatory program and the approved permit, and the completion of the reclamation plan (30 U.S.C § 1259(a)). The form of bond and the required bond amount depends on the controlling statute and regulation (either federal or state). However, in any case, reclamation bonds for surface mining operations are long-term obligations. A mining operation under a permit can last thirty or forty years. Considering that the duration of a reclamation bond obligation must be for the duration of the mining and reclamation operation (30 C.F.R. § 800.13), and that the bond is non-cancelable (30 C.F.R. 800.20), a surety's liability could conceivably extend for thirty to forty years as well [1]. This creates a high degree of uncertainty and risk for the surety. To determine if a permittee qualifies for a bond, a surety makes a judgment about the operational and financial viability of the permittee. The surety essentially is making a prediction about the permittee's future performance thirty or forty years in the future. As the duration of the obligation extends further into the future, the surety's judgment becomes less certain and its risk increases. Of course, a thirty or forty

[1] The regulation allows a bond to be replaced by other bonds that provide equivalent coverage. 30 C.F.R. § 800.30.

year duration assumes that the operation does not have water issues such as acid mine drainage. In these cases, the regulatory authorities are holding the bond to secure treatment that may be perpetual. This raises the surety's risk to unworkable levels.

Another type of bond that illustrates the long-term and uncertain duration of bonds, this time for oil and gas operations, is the lease bond required by the Minerals Management Service ("MMS"). MMS requires lessees of Outer Continental Shelf mineral leases to provide a bond to secure compliance of all the terms and conditions of the lease (30 C.F.R. § 256.52). The leases have an initial term of five or ten years and continue for as long as oil and gas is produced in paying quantities (30 C.F.R. § 256.37). While the lease bond is cancelable, cancellation does not release the surety from liability that accrued while the bond was in effect, unless the replacement surety assumes prior liabilities (30 C.F.R. § 256.58). Further, the bond may be reinstated after cancellation if any payment of any obligations of the bond principal (the lessee or operator) is rescinded or must be restored (30 C.F.R. § 256.58(c)). Thus, the duration of the surety's liability is uncertain, even after cancellation.

Expanding Scope of the Obligation

Over the years the obligation covered by surety bonds for mining, oil and gas operations has expanded considerably and introduced risks that are better covered by an instrument other than a surety bond. The clearest example of this phenomenon is the relatively new requirement by regulatory authorities that liability for acid mine drainage be covered by the SMCRA reclamation bond. Under current regulation, the surety bond is fully released after completion of the three phases: backfilling and regrading, revegetation and monitoring (30 C.F.R § 800.40). With respect to actual reclamation activities - moving the dirt - the surety has a clear understanding of the scope and duration of the mining company's obligation and consequently the scope of its liability. However, the presence of acid mine drainage and the requirement to treat the water clouds prolongs the surety's obligation considerably. Historically, regulatory authorities reduced the bond penalty at the completion of phases one and two. Now, however, regulatory authorities are not reducing the bond penalty when phases one and two are completed if the site has water issues that must be treated.

The defaults that a surety can underwrite and address effectively are defaults of the permittee's performance: events that can be prevented through sound practices and compliance with the reclamation plan. A surety cannot underwrite effectively unanticipated acid mine drainage problems that require treatment in perpetuity. It appears that the problem of acid mine drainage requires a funding vehicle, and a surety bond is not a funding vehicle, but rather an assurance of performance which can be controlled. The post mining water issues should be resolved outside of the surety bond, and the surety bond obligation should be the phases of reclamation.

Limited Choices in Remedying a Default

A second risk factor is the limited approaches available to a surety in addressing a bond default. A surety often is faced on these types of bonds with forfeiture of the entire bond penalty as its only means to discharge its obligations. In the case of reclamation bonds required by SMCRA, state regulatory authorities may require the surety to forfeit the full penal sum of the bond rather than giving the surety the option to reclaim the site at possibly a lower cost. As another example, under the Federal Coal Management Program, the Bureau of Land Management requires bonds to secure lease obligations (43 C.F.R. § 3474.1). If a lease is canceled or terminated, all rentals and royalties already paid are forfeited (43 C.F.R. § 3452.3(b)). Therefore, the surety may be liable for a substantial sum rather than having the opportunity to step in and cure the default by undertaking the monthly lease payment. The likelihood of a full bond payout without opportunity to mitigate the loss to the obligee by undertaking performance increases the surety's risk and limits the availability of the bond only to those entities that have significant financial resources.

State of the Surety Market

Sureties recently have refocused on the risk characteristics discussed above as a result of a return to tighter underwriting standards. This adjustment is the culmination of a decade long underwriting cycle that recently generated significant losses in 2001. According to the report entitled "Top 100 Writers of Surety Bonds," released by SAA on May 21, 2002, the industry reported the following results for the year ended December 31, 2001:

Direct Written Premiums: $3,473,100,578

Direct Earned Premiums: $3,330,170,608
Direct Losses Incurred: $2,748,411,932
Direct Loss Ratio: 82.5%

The results reflect significantly increased losses compared to prior years. Although we are not privy to the company-specific information that would be necessary to provide an explanation that includes each and every factor, we are able to share with you some of the dynamics in general terms that led to the 2001 results. The 2001 results are a continuation of a trend that first was manifested in 2000 and are a result of market activity over the past decade. There is no one event that instantly triggered the 2001 results.

For over a decade, the surety industry had experienced considerable profitability. The positive results attracted new players to the surety market and caused existing players to battle for greater market share. Two mechanisms to attract greater market share are to reduce pricing and to relax underwriting standards. The combination of relaxed underwriting and softened pricing can create a tenuous condition, especially considering that surety theoretically is written to a 0% loss ratio.

A significant factor in surety results is the financial strength of bond principals as affected by the general health of the economy. A surety bond is written with the expectation that the bond principal will perform its obligations or hold the obligee harmless if it defaults. Therefore, financial health is crucial. According to the percentage change in Gross Domestic Product, the economy began to experience some softening in the latter part of 2000.

The softened underwriting and pricing combined with declining financial strength (as indicated by GDP) led to a downturn in results in 2000. The 2000 Top 100 Writers Report reflected a loss ratio of 45.4%, compared to a 29% loss ratio in 1999.[2] Further, according to the 2000 Insurance Expense Exhibit, the industry had an underwriting loss (including incurred losses and operational expenses) of $216.3 million. The 2001 results are a continuation of the 2000 results and magnified by losses attributable to some high profile bankruptcies.

To reverse this trend, we suspect that sureties have reversed the factors that played a role in the downturn, softened underwriting and pricing. We likely will see a firming of pricing and tightened underwriting requirements in the coming years. For example, surety companies have become especially hesitant to underwrite any type of obligation that extends five, ten or fifteen years into the future. Sureties seek to control risk in part by writing obligations that have a reasonable duration.

Reinsurance companies suffered serious losses in this surety market downturn as well. In response, reinsurance companies are requiring primary sureties to retain more risk and have tightened the terms and conditions in reinsurance treaties. For example, we are aware anecdotally that certain reinsurance treaties exclude coverage for long-term obligations such as self-insured worker's compensation bonds or reclamation bonds unless specifically consented to by the reinsurer. This in turn impacts the primary sureties" underwriting decisions.

The correction in the surety market also includes a changed perspective on underwriting risk. In the past, a determination of the risk of a particular type of bond has been based on historical loss experience. If a particular type of bond generated reasonably low losses in the past it will have similar results in the future. The results of 2000 and 2001 have altered that approach. Now sureties determine risk by determining the probable maximum loss on a particular type of bond. Sureties assess their exposure by considering bond amount, duration and the likelihood of full bond forfeiture. In the case bonds required in connection with mining, oil and gas operations, the potential exposure is high, and sureties make their underwriting decisions accordingly.

The September 11, 2001, terrorist attacks did not impact surety companies directly. However, the impact was felt by the property and casualty insurance companies that are the sureties" parent companies and affiliates. The terrorist attacks caused an erosion in capital as property and casualty losses were paid out. Although much of this capital has returned to the market, insurance companies have become especially careful how capital is used. This decision regarding capital usage affects underwriting decisions as well.

[2] The 1999 loss ratio is based on the SAA Top 50 Writers Report. This report was used in order to make a meaningful comparison. The results of 2000 and 2001 Top 100 Reports are gross and before reinsurance. The 1999 Top 100 Report's results are net of reinsurance. Therefore, the 1999 Top 50 Writers Report which reflects gross results was used for the sake of consistency.

Developing Workable Solutions

The surety industry has played a vital role in securing obligations to the federal government so that public interests are protected. As the surety industry returns to financial health it will continue to provide this protection. With respect to bonds for mining, oil and gas operations, we believe that it is important to examine the current bonding requirements and policies to address concerns of the permittees and their sureties, particularly the duration of reclamation and lease obligations. Such a review likely would create a market effect and encourage surety participants to meet ongoing bonding needs of mining operations. For example, we believe that the bond obligation should be well defined and cover a specific scope of work. With respect to reclamation, the bond should be limited to the three phases and should not cover the obligation for water treatment that is uncertain and long-term. In addition, we believe that regulatory authorities should consider inserting a cancellation provision in bond forms that currently lack one. Once cancelled, the obligee should not have the ability to reinstate the bond. In addition, authority should consider that the bond term should be tied to the permit term. At the end of the permit term, the surety should have the option of renewing or not renewing the bond. We also encourage regulators to provide additional options to sureties in addressing claims short of a full bond forfeiture. As to the issue of acid mine drainage, we urge Congress and regulators to look at all options such as finite risk insurance products, pools, trust funds and other similar mechanisms.

We look forward to continued discussion with the Subcommittee, the Department of Interior, state regulatory authorities and other stakeholders to develop concrete solutions.

Mrs. CUBIN. Thank you, Ms. Schubert.

I would now like to recognize Mr. Borell to testify.

STATEMENT OF STEVE BORELL, EXECUTIVE DIRECTOR, ALASKA MINERS ASSOCIATION

Mr. BORELL. Thank you, Madam Chairman. We very much appreciate this opportunity to testify and to testify on this very crucial topic.

The Alaska Miners Association is a non-profit membership organization established in 1939 with approximately 1,000 members. Our members range all the way from prospectors, individual geologists, miners, family mining operations as well as the largest mining companies.

Our written testimony explains, talks about five different examples since early 2001 where we sought to find availability for surety bonding. We found none. Simply stated, we have been unable to locate any surety bonds or any other alternative form of financial guarantee that is commercially available for mining operations.

This includes mining operations on BLM-managed lands under the current 3809 regulations. This situation exists for large hard-rock mines, small hard-rock mines and for small family placer mines that are not susceptible to acid rock drainage and that do not use chemicals for processing the ores.

The current 3809 regulations list State bond pools as an alternative, however, as written, such bond pools must provide for 100 percent of the cost to reclaim 100 percent of the mines 100 percent of the time, indeed not a bond pool as we have been meant to understand.

We have the five different examples there including a very significant meeting that was held in Toronto with the Marsh Group and I submit those with the written testimony. But it is now very clear that the bonding marketplace will not be offering commercial surety bonds or other financial guarantee alternatives for mine reclamation in the foreseeable future.

However, some minor changes to the BLM 3009 regulations would alleviate the crisis for mines that do not use chemicals. These mines are typically placer mines which are essentially the same as a gravel operation where the water is used to wash the gravel and distribute it by size and specific gravity.

The National Research Council's report in 1999 encouraged the use of these kinds of bonding pools to lessen the financial risk, especially on small miners. It also encouraged the use of standard bond pool amounts in lieu of detailed calculations.

There were only two State bond pools in place at the time, the Alaska and Nevada pools. The Alaska State Bond Pool has worked for more than 10 years without a single default and will only grow stronger over time as more fees are paid into the pool.However, it does not and cannot be expected to provide the full cost of financial guarantee assuming that from mine went bankrupt or went out of business at the same time which the BLM regulations require.

In our May 13, 2002 comment letter to the BLM, we suggested several changes to the wording, minor changes, if I will, to the wording. It is our understanding that these are still under review. These changes would allow mines on BLM-managed lands to continue using the Alaska State Bond Pool and conform to the recommendations of the NRC report.

Thank you very much, ma'am.

[The prepared statement of Mr. Borell follows:]

Statement of Steven C. Borell, P.E., Executive Director, Alaska Miners Association

Thank you for the opportunity to provide testimony on the availability of bonds or other financial guarantees for the mining industry. This is a topic with which we have been involved for many years.

The Alaska Miners Association is a non-profit membership organization established in 1939 and has approximately 1000 members. The Association represents individual prospectors, geologists and engineers, small family mines, junior mining and exploration companies, and major mining companies. Our members explore for and mine gold, silver, copper, lead, zinc, nickel, platinum group metals, diamonds, and various industrial minerals.

COMMERCIAL FINANCIAL GUARANTEES

Simply stated, we have been unable to locate any surety bonds or any other alternative form of financial guarantee that is commercially available for mining operations. This includes mining operations on BLM-managed lands under the current 43 CFR Subpart 3809 regulations. This situation exists for large hardrock mines, small hardrock mines, and for small family placer mines that are not susceptible to acid rock drainage and do not use chemicals for processing ores. The 3809 regulations list state bond pools as an alternative but as written, such pools must contain 100% of the cost of reclamation, for 100% of the mines, 100% of the time.

The Alaska Miners Association (AMA) and individual members of the AMA have tried to locate financial guarantees at various times during the past several years but all attempts have failed to identify any commercially available financial guarantee. Some of the attempts are as follows:

Example 1: We tried to identify financial guarantee alternatives while preparing our May 7, 2001 comment letter on the Department of the Interior's notice of proposed rulemaking published at 66 Fed. Reg. 16162–71 (March 23, 2001) ("the Suspension Proposal"). At that time the Department of Interior proposed suspension of the new 43 CFR Subpart 3809 and related regulations which had been published by the Department on November 21, 2000, at 65 Fed. Reg. 70112–32 ("the New 3809's), and reinstatement of the pre-existing 43 CFR Subpart 3809 ("the Pre-existing 3809's"). We asked Mr. Gordon Depue, a surety bond broker in Fairbanks, Alaska, to search out and identify commercially available surety bonds or other financial products or mechanisms that would satisfy the proposed rule. After an extensive investigation Mr. Depue concluded that surety bonds or other forms of financial guarantee were not available in the market for mining operations under the 3809 regulations. To quote his May 2, 2001 comment letter to BLM on the Suspension Proposal, "I have searched nationally for surety companies willing to write bonds and I am unable to find any.

In his letter Mr. Depue touched on a basic problem with the BLM 3809 regulations. The 3809 regulations mandate the use of surety bonds in an application for which they are not designed and in which they are not appropriate. Mr. Depue identified three major problems in the 3809 regulations that preclude most, if not all, companies from issuing surety bonds for mine reclamation under the 3809 regulations: 1) Uncertainty of amount - the regulation allows the BLM to change the scope of the work required and therefore the amount of the bond, whereas bonds are designed for specific, definable projects; 2) Uncertainty of duration - surety bonds are typically written for one or two years. Reclamation bonding is considered to be high risk, extending over a long period of time, whereas bonding companies will only accept exposure on a single risk and for a specific period of time; and 3) Uncertainty regarding bond release criteria - the regulation allows the BLM to hold the financial assurance for an indefinite period of time after the reclamation has been approved. There is no clear mechanism for release of the financial assurance.

Example 2: During the winter of 2001–2002 some of our members were being quoted huge increases in the rates for cargo aircraft flights which were due primarily to increased insurance costs. For one small placer miner, a single C–130 Hercules load to west-central Alaska had previously cost $7,500 to $13,000 per load. Quotes for Spring 2002 were $23,000 per load, the increase due specifically to increased insurance costs. To determine if such insurance increases were happening elsewhere, we sent letters to all AMA corporate members inquiring whether they were seeing increased insurance costs. The responses indicated that indeed these rates had risen significantly in 2002. General liability rates had increased 15% to 20%, health insurance rates had increased over 20% and air cargo rates had increased 10% to 78% due to insurance costs.

This example obviously deals with insurance, not surety bonds. Surety bonds are a distinct product line that must not be confused with insurance. The nexus between the two, however, is that the health of one part of the business affects the other parts of the business.

Example 3: A third attempt to locate surety bonding or other financial guarantee alternatives for our members occurred in April 2002. We sent letters to 14 companies that have in the past offered surety bonding and/or various other forms of bonding and insurance coverage for the mining industry. We received responses from only two of these companies and only one was a written response. That response was from St. Paul American Surety and to quote in part, "Unfortunately, because of the risks associated with these obligations, St. Paul American Surety is unable to provide a market for this coverage.

Example 4: Even before the September 11 terrorist attacks, some mining companies were not able to obtain bonding for mine reclamation, at any price. We are aware of one major mining company that solicited surety bonding from at least 20 bonding and insurance companies in early 2001, seven months before September 11th. None of the companies were willing to offer bonding or any other financial guarantee for mine reclamation. That mining company has tried all manner of "creative" bonding approaches but, to our knowledge, no approach has yet been found workable. This level of super-human effort is not working for a large company having considerable expertise and staying power and such effort will obviously not be feasible for small-scale Alaska family mines.

In addition to the impacts of September 11th, major bankruptcies such as Enron, K–MART, Global Crossings, etc., have resulted in a total retrenchment within the surety bond industry. As we determined through Mr. Depue and through our direct solicitation, companies that have historically provided surety bonding have now withdrawn from the market.

Example 5: On June 27, 2002, the international bonding and insurance provider, MARSH (An MMC Company), met with mining industry officials in Toronto, Ontario. The purpose of the meeting was to review the status of the surety market, discuss the reclamation bond problems and risk, and look for solutions to the current crisis:

> Regarding the surety market - MARSH noted changes in the economy, banks tightening credit policies, increased bankruptcies (not in mining), deteriorating results for the reinsurance market, Enron (potential for $2.5B in losses), and KMART (potential for $470M in losses). They defined the

major surety issues as decline in capacity, reinsurers exiting the business, more losses likely to come, and the fact that the crisis is worsening. They also noted that: bond cancellations are occurring; rates have increased as much as 500%; collateral is being required; and that there are generally no markets for workers compensation, reclamation, landfill closure, or any risk with exposure over 5 years.

Regarding the surety bond problems - MARSH stated that the surety industry: wants out of these bonds; companies that previously provided reinsurance have dropped that business; rates have increased; and there are generally no markets for reclamation bonds.

Regarding reclamation bond risk - MARSH described the impediments as: the "long tail obligation" (time a bond must be in place) which keeps the surety company on risk for the life of the mine; bonds not being released by regulatory agencies—even when reclamation has been completed; environmental uncertainties; and capacity for funding reclamation exposure.

It is clear from bonding industry representatives Depue and MARSH that "surety bonds", in their current form with the limitations imposed in various parts of the 3809's, are not an appropriate product for mine reclamation and closure.

As for the other financial guarantee alternatives—Subsection 3809.555 of the current BLM regulations lists the specific types of individual financial guarantees that are acceptable to BLM. The other financial guarantee alternatives are effectively cash or cash equivalents. However, it is grossly impractical for any business entity to tie up vast amounts of capital in a non-productive vehicle for a long period of time. Any given plan of operation will likely cover work occurring over several years and as a result the reclamation obligation will be on-going. Virtually no mining company in the country is able to shoulder such a burden. Due in part to this terribly onerous situation, several mining companies have already begun shifting their focus to non–BLM lands domestically or properties outside of the U.S.

Solutions for the Crisis in Bonding/Financial Guarantees

It is now quite clear that the bonding marketplace will not be offering commercial surety bonds or other financial guarantee alternatives for mine reclamation in the foreseeable future. However, there are things that can be done to address some of the problems where mines are operating on lands managed by the Bureau of Land Management. Minor changes to the BLM 3809 regulations would alleviate the crisis for mines that do not use chemicals for the processing of ores, that is, for mines that are processing placer/alluvial gravels. Also, expanding the list of acceptable forms of financial guarantees for hardrock mines would improve the situation for those operations.

Bonding Solution for Mines that do not Use Chemicals in Processing Ores

We believe that the use of state bond pools is the only solution for many mines that do not use chemicals in processing ores. These mines are typically placer/alluvial mines which are essentially the same as a sand or gravel operation where the product is processed in a movable plant by washing the gravel to separate the various products based on size and/or specific gravity. However, as written, the 3809 regulations require that bond pools provide for 100% of the cost of reclaiming 100% of the mines, 100% of the time.

The National Research Council (NRC) of the National Academy of Sciences specifically addressed the use of state bond pools in its September 1999 report entitled "Hardrock Mining on Federal Lands" (NRC Report). (Note that in this report, the term "hardrock" includes "placer/alluvial" mining.) The NRC Report not only contemplated the use of bond pools, in Recommendation 1 (page 95) it "encourages the use of bond pools to lessen the financial burden on small miners." It also encouraged the use of standard bond amounts in lieu of detailed calculations. There were only two state bond pools in place at the time the NRC Report was prepared, the Alaska pool and the Nevada pool.

Use of Bond Pools in General - Pools, by their very intent and nature, are designed so the full cost of reclamation will not have to be posted by each miner. Pools recognize that only a few mines are likely to default and by using a pool, the risk of default can be spread over a large number of operations with the cost to each miner set at a reasonable level. The miner pays a reasonable fee in order to participate in the pool and the fees from many miners maintain the pool at a level that will provide funding for reclamation of the very limited number of operations that may actually go into default. The bond pool is available for the full cost of reclamation for a mine, even though the individual miner in default had not paid that much into the bond pool.

This is a basic premise of any bond pool but it not recognized by the BLM 3809 regulations. The 3809 regulations require that the bond cover the “full cost of reclamation” for each operation so the BLM could reclaim all operations, assuming all operations would go into default at the same time. Such a requirement defeats the very premise of a bond pool.

The Alaska State Bond Pool - The Alaska State Bond Pool was established in 1990 and it was specifically designed to allow use by mines operating on lands managed by the BLM under the Pre-existing 3809 regulations. Appendix A to this testimony provides a history of the Alaska State Bond Pool. The Alaska state bond pool is based on the basic premise of spreading the small risk of default over a large number of operations, as described above. If an operation were to go into default, the bond pool would be available to reclaim 100% of that operation, even though the individual miner in default had not paid that much into the pool. The bond pool does not contain, and was not designed to contain, funding that would pay the cost of all reclamation obligations it is covering at any one time. The Alaska state bond pool has worked for more than 10 years without a single default and will only grow stronger over time as more fees are paid into the pool. However, it does not and cannot be expected to provide “full cost” financial guarantee for all of the operations it is covering, as now required in the BLM 3809 regulations.

Some further comments on the Alaska state bond pool are appropriate. It is important to note that there are several significant requirements in the Alaska statute and regulations that restrict the types of operations, and the types of operators, that can utilize the Alaska bond pool. The bond pool cannot be used for facilities or areas where cyanide or other chemicals are utilized in the processing ores. It cannot be used for settling ponds or other facilities designed for waste rock or tailings that have been treated with chemicals. In short, the Alaska bond pool is limited to placer mining or other operations that do not use chemicals to process ore. These limitations greatly decrease the universe of mines that can use the pool and greatly reduce the opportunity for catastrophic long term treatment costs. Also, operators with a record of non-compliance cannot use the bond pool. In addition, the State and BLM can deny an applicant the right to participate in the bond pool any time they feel it is appropriate.

Specific Solution Recommendation - As stated in our May 13, 2002 comment letter to the BLM on the Proposed Rule of Surface Management Regulations, 67 fed. Reg. 17962 (April 12, 2002), we recommend the following changes be made in subsections 3809.570 and 3809.571 with new material in *italics* and material to be removed [bracketed]:

State–Approved Financial Guarantees

Sec. 3809.570 Under what circumstances may I provide a State-approved financial guarantee?

When you provide evidence of *coverage by* an existing financial guarantee *program* under State law or regulations that covers your operations, you are not required to provide a separate financial guarantee under this subpart [if—

(a) The existing financial guarantee is redeemable by the Secretary, acting by and through BLM;

(b) It is held or approved by a State agency for the same operations covered by your notice(s) or plan(s) of operations; and

(c) It provides at least the same amount of financial guarantee as required by this subpart].

Sec. 3809.571 What forms of State-approved financial guarantee are acceptable to BLM?

You may provide a State-approved financial guarantee in any of the following forms, subject to the conditions in Secs. 3809.570 and 3809.574:

(a) The kinds of individual financial guarantees specified under Sec. 3809.555;

(b) Participation in a State bond pool, if——

(1) The State agrees that, upon BLM’s request, the State will use part of the pool to meet reclamation obligations on public lands, *provided however that the state bond pool shall be the remedy of last resort and shall be required to disburse such funds only after the state has had a reasonable opportunity to pursue a defaulting party through civil litigation;* and

(2) The BLM State Director determines that the State bond pool provides *a* [the equivalent] level of protection *adequate to meet the requirements of* [as that required by] this subpart; or

(c) A corporate guarantee that existed on January 20, 2001, subject to the restrictions on corporate guarantees in Sec. 3809.574.

(d) For purposes of this section, the state bond pools existing in Alaska and Nevada on November 21, 2000 provide a level of protection adequate to meet the requirements of this subpart.

(e) No administrative or oversight charges shall be included in the reclamation costs charged against any state bond pool.

These changes would allow mines on BLM managed lands to continue using the Alaska state bond pool. These changes are also in accordance with the NRC Report.

Solutions for Expanded Forms of Individual Financial Guarantees for Hardrock Mines that Use Chemicals

Due to the fact that, as discussed previously, surety bonds are not appropriate for mine reclamation, it is imperative that BLM allow additional types of financial guarantees. These should include liens on property, corporate guarantees with specific requirements, and other mechanisms. Given the tremendous crisis that now faces the bonding and financial guarantee markets, several additional alternatives, and combinations of these alternatives, will likely be required to provide effective financial guarantees without killing the mining industry.

The use of liens or other pledges of property would help alleviate the financial guarantee crisis. Property can be used as collateral with specific review periods to ensure continued adequacy. Some form of collateralization is often used to support surety bonds.

Past problems with corporate guarantees have been due to incomplete or inappropriate qualification criteria that allowed financially weak companies to qualify. Other federal agencies such as the EPA, Nuclear Regulatory Commission (NRC) and Office of Surface Mining now recognize corporate guarantees as an acceptable financial guarantee. The NRC has a regulatory guidance document, Reg. Guide 3.66 (DG–3002), that defines qualifications for Escrow Agreements, Certificates of Deposit, Trust Funds & Standby Trust Agreements, Government Security Transactions, Payment Surety Bonds, Irrevocable Standby Letters of Credit, and Corporate Guarantees. In the past BLM has accepted NRC-approved corporate guarantees for uranium projects on BLM-managed lands in Wyoming, Utah, and New Mexico. BLM should consider a corporate guarantee program for the hardrock mining sector based upon sound qualification criteria, just as EPA, NRC and OSM programs have done in order to provide other mechanisms to satisfy financial assurance requirements.

Other mechanisms including liens against the metal being produced should be established. This may not be feasible for all mines but it should be a benefit to some.

Conclusion

This country in general, and mining specifically, is now facing a huge crisis regarding bonding and financial guarantees. Mining companies are finding that due to the restrictions now being imposed, surety bonds will not work for mine reclamation. As a result, such bonds no longer exist in the marketplace. There are, however, actions the BLM can take that will help alleviate the problem in some instances. The simple, straight-forward change we have suggested for Subsections 3809.570 and 3809.571 will solve the crisis for several hundred small placer family mines in Alaska and elsewhere. Other changes to expand the allowed forms of financial assurances will be needed for hardrock mines.

Thank you for the opportunity to testify on this important issue.

APPENDIX A

A History of the Alaska State Bond Pool

The Alaska State Bond Pool was developed in large part in response to a letter from former BLM Assistant Director for Minerals Hillary Oden. In about March of 1990, Mr. Oden sent a memo to all BLM State Directors instructing them to require bonding for all plans of operation for mining on BLM managed lands. The letter directed BLM offices to implement this requirement before the next mining season. Although placer miners can not begin mining until May or June, they begin moving supplies and equipment into their sites in March and April. AMA immediately contacted the BLM in Washington, DC and explained why this was not workable for miners (large and small alike) in Alaska. The BLM Director at that time, Cy Jamison, understood the problems and extreme hardship, if not impossibility, of imposing this bonding requirement, and he withdrew the requirement that all plans of operations be bonded.

At that time the AMA was working with the Alaska State Legislature to develop a reclamation law that would apply to mining on all lands in Alaska - State-owned, municipal, private, and federal. Given BLM's bonding initiative, it became a major priority to ensure that miners operating on federal lands, whether managed by BLM or the Forest Service, had access to the bonding pool that was being developed in State law. AMA told Director Jamison of our intent and he encouraged AMA to proceed in that direction.

The Alaska reclamation statute established standards consistent with those in section 302(b) of FLPMA, 43 U.S.C. § 1732(b). A.S. § 27.19.020 requires, "A mining operation shall be conducted in a manner that prevents unnecessary and undue degradation of land and water resources, and the mining operations shall be reclaimed as contemporaneously as practicable with the mining operation to leave the site in a stable condition." Again consistent with the proper definition of the statutory term in FLPMA, the Alaska Legislature defined "unnecessary and undue degradation" as "surface disturbance greater than would normally result when an activity is being accomplished by a prudent operator in usual, customary and proficient operations of similar character and considering site specific conditions" and including "failure to initiate the complete reasonable reclamation under the reclamation standard of A.S. 27.19.020 "." A.S. § 27.19.100(8).

While the Alaska State Legislature considered Alaska's mine reclamation statute (A.S. Title 27, Chapter 19), it became clear to everyone working on it that no commercial bonding of any kind was available for most Alaska miners. As a result, the Alaska State Legislature decided to utilize a bonding pool. A.S. § 27.19.040(b). Key elements included in the statutory design of the state bonding pool were: (1) the recognition that most operators were good responsible miners and that only a very few were likely to default; (2) by using a pool, the risk of default could be spread over the entire industry and the cost of bonding to each individual operator could be set at a reasonable level, far below the cost of any commercial, private bond coverage; (3) if a default were to occur, the bonding pool must be available for the full cost of reclamation, even though the individual miner in default had not paid that much into the bonding pool; and (4) the agencies needed statutory tools to ensure that, if a miner defaulted, that miner would still be responsible for the full cost of the reclamation and, until he repaid the full cost of that reclamation, he would be barred from using the bonding pool.

The bond pool contains provisions that are built-in incentives to encourage the miner to do things right, such as minimizing the area of disturbance, keeping reclamation as contemporaneous as possible, and the like. It also contains "hammers —only after a prior defaulter has paid the fund back would he be covered again, and then the cost to him would be five times the current cost to a non-defaulting participant.

The cost to the miner was maintained at a reasonable level in two primary ways. First, the cost per acre was set at a specific level for all operations. This meant that the miner did not have to develop, and the agency did not have to evaluate, a detailed cost estimate for the specific project, a detailed cost estimate some third party could use to challenge and harass the miner and/or the agency. A detailed cost estimate was not necessary because the bond pool would pay the actual cost of reclamation, the reclamation specified in the approved plan of operations and the miner was always liable for this full cost. Second, the cost to the miner was established in two parts. Part one was an annual fee per acre that went to building the bonding pool. The other part was a set amount per acre that was placed in the bonding pool as an escrow account in the name of the miner. Interest from this account also went into the bond pool to build the pool. When reclamation is complete and approved by the agency, this escrowed money is returned to the miner, without interest.

The State Bond Pool has worked very well for more than 10 years. There has not been a single default, including operations on BLM lands bonded through pool participation. Because the State reclamation law applies to all mining in Alaska irrespective of land ownership, the State Bonding Pool has been utilized by miners on BLM lands during this 10 year period. It was not until June 30, 1997, however, that the BLM and the State of Alaska executed their formal Cooperative Agreement (the MOU), to agree on administration of the State Bond Pool as it covered miners operating on BLM land. This MOU formalized the procedures now followed by both the State and BLM, especially in connection with supervision and enforcement of potential defaults.

On June 4, 2001 the MOU between the BLM and the State of Alaska was extended through January 20, 2004. This will allow miners on BLM lands to continue using the Alaska State Bonding Pool as they have for approximately 10 years. We appreciate the explanation in the preamble to the final rule of October 30, 2001 at 54842. However, these assurances (see the following) are in the preamble to the regulation, not in the regulation itself and contain significant conditions that are open to interpretation (emphasis added) -

> At this time we want to reiterate the Department's commitment to allow the use of existing state bond pools, if the BLM State Director determines that they provide an adequate level of protection to meet *the requirements of this subpart.* In particular, we wish to respond to comments suggesting that the State of Alaska bond pool would no longer be available for operations on BLM lands. That is an erroneous interpretation. Under these regulations, BLM could continue to use the State of Alaska bond pool to satisfy the requirements of subpart 3809. BLM and the State of Alaska are currently negotiating a revised Memorandum of Understanding to continue use of the bond pool. The previous Memorandum of Understanding allowing use of the bond pool has been extended until January 6, 2002 and may be extended twice again for a total of two years at the request of the State Governor. Thus negotiations can take place through the year 2003 before there would be a question as to whether BLM will accept a financial guarantee that uses the bond pool. In addition, you should note that BLM can accept other instruments, such as insurance.

The extension of the MOU is now in place but before January 20, 2004 the BLM State Director must be satisfied the bond pool level of protection will "meet the requirements of this subpart.

The intent of the extension was to provide time for the state and BLM to develop a new MOU that would meet "the requirements of this subpart." However, in a joint meeting of AMA, the State of Alaska, and the BLM, all agreed that, given a reasonable interpretation of the language of the 3809 regulations, the Alaska bond pool will not qualify for use by operators on BLM lands.

Mrs. CUBIN. The Chair now recognizes Gerald Schlief.

STATEMENT OF GERALD SCHLIEF, SENIOR VICE PRESIDENT, ATP OIL & GAS CORPORATION, TESTIFYING ON BEHALF OF THE NATIONAL OCEAN INDUSTRIES ASSOCIATION

Mr. SCHLIEF. Thank you. Good morning, Madam Chairwoman. I appreciate the opportunity to testify here today on the availability of bonds to meet MMS requirements.

I have a short statement, but I ask that the full written statement be entered into the record.

Mrs. CUBIN. Without objection.

Mr. SCHLIEF. Thank you. I am the Senior Vice President of ATP Oil and Gas Corporation, a Texas Corporation engaged in the acquisition, development and production of natural gas and all properties primarily of the Outer Continental Shelf of the Gulf of Mexico.

ATP was formed in 1991 and in 2001 we became a public company under the NASDAQ. We own about 50 offshore blocks in the Gulf of Mexico.

I am here today representing the National Ocean Industries Association, the Domestic Petroleum Council, the Independent Petroleum Association of America, the Natural Gas Supply Association and the U.S. Oil and Gas Association.

We work to develop, produce and supply the nation's valuable offshore natural gas and all resources in an environmentally responsible manner. We strive to be good stewards by protecting and enhancing the coastal and marine environments where we conduct our business.

Therefore we understand and are supportive of the MMS and agree to the Federal regulators need to require bonds in order to ensure against default of obligations by smaller and possibly underfunded entities.

However, recent events have dramatically altered the bond market for everyone, including the offshore oil and gas industry. Large bankruptcies such as K-Mart caused sizable losses for the surety industry.

Several companies such as Reliant, Amwest and Frontier have gone out of business. Several other companies such as St. Paul and CNA have severely restricted the writing of commercial sureties.

On a personal note, ATP had used Frontier and Amwest and had to obviously get different companies to provide bonding. For the offshore oil and gas industry, the effect has been to require that industry pay many times more for the same bonds they used to receive and sometimes to pay cash when a bond is not available.

Industry supports bonding and is committed to conducting our operations including termination of those operations in the most environmentally responsible manner. Bonding is an efficient tool, an effective tool for both industry and the regulators to allow to meet our commitments.

Unfortunately, even though there have been no incidents in our industry to raise liability costs or risks, the increasingly tight bonding market has made the bonding process an impediment rather than a tool. Some sureties now require companies to deposit cash for a portion, sometimes 50 percent of the bond amount, in order to obtain a bond. There is no additional coverage or protection for the environment provided with these changes.

When the surety industry is unable to meet the bonding requirements, cash is the alternative. Cash for 100 percent of the required bonding amount may have to be posted for the plugging and abandonment obligation. This takes cash directly out of the pool of money available for exploration and development and is a much less efficient manner to employ in order to meet our obligations.

In some cases the net effect is also prohibited operations because of the inability to obtain sureties.

Just last week this market affected our company's operations. We were looking at a package of four producing properties from a large independent company. As we looked at those properties we were very interested, however there was about $35 million of bonding obligations associated with those properties.

Based on discussions with our insurer, if we could find the bonds, we would have to put up at least 50 percent cash deposit in order to acquire these properties. That made the transaction economically unappealing and we decided to pass. We are also looking at other obligation that require such levels of cash bonds. We have to take the cost of this type of cash deposit into account.

As you can see, the tight bonding market is a major problem for my industry. This concludes my prepared remarks. I will be happy to answer any questions.

[The prepared statement of Mr. Schlief follows:]

Statement of Gerald W. Schlief, Senior Vice President, ATP Oil & Gas Corporation on behalf of the National Ocean Industries Association, Independent Petroleum Association of America, Natural Gas Supply Association, and U.S. Oil & Gas Association

Madam Chairwoman and Members of the Subcommittee, I appreciate the opportunity to testify here today on the subject of the availability of bonds to meet the requirements of the Minerals Management Service for offshore oil and gas operations. ATP is a member of the National Ocean Industries Association (NOIA), the only national trade association representing all segments of the offshore energy industry. This testimony is submitted on behalf of NOIA, the Independent Petroleum Association of America, the Natural Gas Supply Association, and the U.S. Oil & Gas Association.

I am the Senior Vice President for ATP Oil and Gas Corporation. ATP Oil & Gas Corporation was formed in 1991 as a Texas corporation and became a public company in February of 2001. ATP trades publicly as ATPG on the NASDAQ National Market. The company is engaged in the acquisition, development and production of natural gas and oil properties primarily on the Outer Continental Shelf (OCS) of the Gulf of Mexico. During 2001, ATP additionally entered into agreements to expand its business in the shallow-deep waters of the Gulf of Mexico and in the Southern Gas Basin of the U.K. North Sea. The company focuses on natural gas and oil properties with proven reserves that are economically attractive to ATP but are not strategic to major or exploration-oriented independent oil and gas companies.

We work to secure reliable access to the nation's valuable offshore hydrocarbon resources in order that they may be developed, produced and supplied in an environmentally responsible manner. As such, we understand and are supportive of the Minerals Management Service's (MMS) intent to insure against default of obligations by smaller and possibly underfunded entities owning leases, rights-of-way, or exploration permits. However, external events beyond the control of industry have severely limited the availability of bonds and led to a relatively tight market that it is now hampering exploration and development efforts on the OCS to the extent that hydrocarbons are not being recovered due to an inability of industry to obtain the bonds necessary to satisfy the regulators.

Minerals Management Service Bonding Requirements

In recent years, there have been changes in the regulatory requirements for the oil and gas business, as well as an increase in bonding requirements to cover end-of-life obligations on the plugging, abandonment and site remediation of oil and gas wells and their related support equipment.

At the end of lease operations, oil and gas lessees must plug and abandon wells, remove platforms and other facilities, and clear the lease site sea floor. The MMS requires that companies operating on the OCS obtain surety bonds to ensure that the companies meet these obligations. In 1997, the MMS issued a final rule amending the agency's surety bond requirements for operations on the OCS. Under the MMS rule, lessees and owners are jointly and severally liable for compliance with the terms and conditions of the leases. Furthermore, when leases are transferred from one company to another, the assignor of the lease, as well as the new lessee, remains responsible for all wells and facilities that were in existence at the time the assignor assigned its interest until the wells are plugged and abandoned, the facilities are decommissioned, and the site is reclaimed. There is also a higher level of bonding required for the holder of geological and geophysical permits to drill deep stratigraphic test wells. The MMS is authorized to demand a supplemental bond from the holder of these permits or pipeline rights-of-way.

There are three tiers of bonds prescribed by the MMS. First, when there are no operations, the agency requires a $50,000 bond per lease, or a $300,000 areawide bond. These bonds are for leases with no MMS-approved operational activity plan or leases under an MMS-approved operational activity plan with no submittal to MMS of assignment or operational activity plans. A lessee does not need to provide this bond if an applicable lease or areawide bond is in place in accordance with one of the following, higher requirements.

The second tier of bond is for exploration. The agency requires a $200,000 bond per lease or a $1,000,000 areawide bond for leases of a proposed exploration plan or a significant revision to an approved exploration plan, or a proposed assignment of a lease with an approved exploration plan. A lessee does not need to provide this bond if an applicable lease or areawide bond is in place in accordance with one of the following, higher requirements.

The third tier of bond is for development. Here, the agency requires a $500,000 lease bond or $3,000,000 areawide bond for leases of a proposed Development and Production Plan or Development Operations Coordination Document, or a significant revision to an approved Development and Production Plan or Development Operations Coordination Document or a proposed assignment of a lease with an approved Development and Production Plan or Development Operations Coordination Document.

In practice, these bond requirements are often floors the agency uses in setting bond rates. This is due to the fact that under the MMS regulations, the Regional Director is authorized to raise these levels on a case-by-case basis, requiring companies to provide additional security in the form of supplemental bonds or an increase in the amount of coverage of an existing general lease surety bond. This determination is based on his evaluation of the company's ability to carry out present and future financial obligations. Companies may submit evidence to rebut the determination of the agency, and in principle the agency may then reduce the amount of the bond required, based on that information. In our experience, the amount is seldom reduced after the determination is made. In effect, this means that often the bond requirements are higher than prescribed above, leading to regulatory uncertainty for companies, and little recourse if they do not agree with the analysis of the agency.

Bonds for Plugging and Abandoned Older Wells

Earlier this year, the MMS announced that the agency was reviewing its methodology for supplemental bonding requirements for all unplugged well bores which are twenty years of age or older. Currently, the agency uses the sum of $100,000 per well bore to calculate liability. The MMS suggested that they thought the number might need to be increased to as much as $450,000 per well bore, with a rebuttal of the amount on a case by case basis. For companies subject to bonding, a change such as this would require posting of additional supplemental bonds, and for those companies that are now exempt, the new figure would be added to the companies" liabilities. This, in turn, could cause some companies that are currently exempt to lose their exemption.

Such changes would have been unnecessary and overreaching. The data on the costs to plug and abandon wells did not support such drastic measures. Fortunately, MMS did not simply implement the changes. The agency admitted that it did not have data to determine the average cost to plug a well, and sought information before making its decision. Industry representatives, including NOIA members, the Louisiana Independent Oil and Gas Association, Louisiana Mid–Continent Oil & Gas, and Energy Partners Ltd., provided the MMS with extensive data on close to 600 wells that had been plugged and abandoned over the past six years. The data showed that the average cost of plugging a well is actually less than $100,000. The MMS reviewed the data provided, and made a reasoned decision that there was no cause to raise the bonding floor. This decision was based on facts and statistical data, rather than on speculation and unfounded concerns.

The Bond Market

Some of the events in recent years have dramatically altered the bond market for everyone, including the offshore oil and gas industry. There have been large bankruptcies of companies like K–Mart, Enron and Superior National. In addition, there have been natural disasters such as tropical storm Allison, and the disaster of September 11.

These events have severely impacted the bonding industry, as well as the insurance industry. Insurance and surety companies are for-profit entities. Their response to these types of losses has been to raise premiums, cut risks or exit lines of business. All of these responses are present in the market today. In the oil and gas arena, premiums for insurance have multiplied by as much as five or six times over what it was last year, with no change in conditions. Furthermore, some coverages are not available at any price. OPA 90 coverage, where there have been no losses, has increased several times over what it was, with only a few syndicates in London providing the coverage.

Like insurance, the surety industry has been severely affected by large bankruptcies. Sureties have been in a long period of depressed pricing. When conditions converged to bring large losses into contact with falling investment income, the shock to the surety industry was profound. Several companies, such as Reliance, Amwest and Frontier, have gone out of business. Several other companies, such as St. Paul and CNA, have severely restricted the writing of commercial sureties.

In many cases, these impacts were driven by reinsurers, who were hit with the same loss from many different sureties. Reinsurers write for many sureties. Several direct surety companies were writing different bonds for the same account, such as K–Mart, so that when losses occurred, there were huge aggregations at the reinsurer's level. Since reinsurers have for years been writing commercial surety (of which oil and gas is a subset) at low premiums, this type of loss resulted in enormous changes in reinsurance. Rates went up dramatically; exclusions were greatly increased, and much larger retentions by the direct insurer were required. The trickle down on direct surety has increased the prices for oil and gas surety and severely limited the capacity.

The effect of all of this on the oil and gas industry has been to require that industry pay many times more for the same bonds they used to receive, and sometimes to pay cash when a bond is not available. Industry supports bonding, and is committed to conducting our operations, including the termination of those operations, in the most environmentally responsible manner possible. Bonding is an effective tool for both industry and the regulators to allow us to meet our commitments. Unfortunately, even though there have been no incidents in our industry to raise liability costs or risks, the increasingly tight bonding market has made the bonding process an impediment to our safe operations, rather than a tool.

Some sureties are now requiring that companies deposit cash for a portion, sometimes 50% of the bond amount, in order to obtain the bond. There is no additional coverage or protection for the environment provided with these changes. And, when the surety industry is unable to meet the bonding requirements, cash is the alternative. Cash for 100% of the required bonding amount may have to be posted for the plugging and abandonment obligations. This takes cash directly out of the pool of money available for exploration and development, and is a much less efficient manner to employ in order to meet our obligations. In some cases, the net effect has also prohibited operations because of the inability to obtain sureties.

Summary

The tight bonding market impacts virtually every company that conducts business on the OCS. Companies that are required to bond their activities are finding it more and more difficult to do so. Companies that self bond find it difficult to transfer operations to entities that are not exempt. It is a fairly common practice for large (normally exempt) companies to sell producing properties in the sunset phase of their productive life to smaller (normally not exempt) companies; however, the lack of adequate bonding capacity is making this increasingly more difficult and costly, and in some cases impossible.

Too much capital pulled out of the exploration and development budgets because the surety industry is unable to meet the bonding demands leads to less development, which impacts our country's energy security, as well as tax and royalty collections to the federal and state governments. The tight bond market, combined with the high bonding amounts often imposed, is creating a situation where offshore operations are unreasonably costly, and sometimes prohibitive.

This concludes my prepared remarks. I will be happy to answer any questions.

Mrs. CUBIN. Thank you very much.

Thank you very much. I will begin the questioning with a question for Ms. Schubert.

In your testimony you said that in the case of bonds for mining oil and gas operations that the potential exposure to the underwriter is high because of long-term exposure, expanding scope and limited default remedies.

First of all, I want you to say whether that is a correct summary of your statement and if it is, could you tell me in your view how much of that potential increased exposure is due to poor reclamation performance by mining and oil and gas companies?

Ms. SCHUBERT. That is a correct summary and it appears really to be due more to a change in the interpretation of the regulations than poor reclamation by the permittees in the past.

Mrs. CUBIN. From your point of view of the surety industry, what changes in surety bond requirements can be made to reduce the risk to the underwriter while we still maintain the utility of the surety bond as a guarantee of performance?

Ms. SCHUBERT. It is important to recognize that what we are really talking about is defining the risk as opposed to reducing the risk. It is critical that we can project what our risk is into the future. The only way to do that is to have a limited duration to know exactly what the obligation, relatively exactly, what the obligation is, and then we can analyze also the ability of the permittee to perform that obligation.

Mrs. CUBIN. Thank you very much.

Next question for Mr. Schlief: Mr. Fulton discussed in his testimony the minimum bonding requirements for the oil and gas industry. Realistically, what are the bonding levels that are required, if you had to put cash up.

Mr. SCHLIEF. Currently, on the examples that I gave, if we have to increase our bonding levels and ATP currently has about $25 million in bonds that we currently have with no cash deposits. With respect to additional bonds, we have been informed that we would generally have to put about 50 percent cash deposit with respect to those bonds.

Mrs. CUBIN. Well, I think the answer is pretty obvious. I would like to ask you this question to have it on the record. What do you think the impacts of the tight bonding market on oil and gas production from marginal wells is?

Mr. SCHLIEF. It is my expectation that what will happen is that the properties that I gave the examples to were properties that were owned by larger companies. These properties are relatively less significant to them and they are going to tend to plug and abandon these properties at an earlier stage.

ATP and other small companies would be interested in acquiring these properties. Our expectation would be to produce these properties for a longer period of time, therefore producing more oil and gas and paying more royalties and trying to extract more value. They are relatively more important so it is basically an issue of scale.

Mrs. CUBIN. Your testimony discusses insurance as well as bonding. How have these changed for ATP in the last year?

Mr. SCHLIEF. Insurance costs have gone up dramatically. We are seeing at least a doubling in costs for less coverage and higher deductibles. The cost of insurance is becoming very significant.

Mrs. CUBIN. I understand that there are more than 4,000 operating platforms and 7600 active leases on the Outer Continental Shelf. A few weeks ago I took a trip out, 100 miles out, went on a deep well, a deep-water platform and then came 30 miles in and went on a production and drilling platform. It was very interesting.

I was not surprised during that time to find out that a quarter of the total production of the United States comes from the Gulf of Mexico. At the end of those operations the lessees have to plug and abandon the wells, remove the platforms and any other facilities that are there.

Are you aware of any incidents in which this has not occurred or in which the government has had to pay to restore a site or just difficulties that the government has had about those wells that are finished being closed down?

Mr. SCHLIEF. To my knowledge, the government has not had to pay anything with respect to plugging and abandoning any wells or any removals that have had to be performed in the off shore OCS.

Mrs. CUBIN. You did describe very well in your testimony, Mr. Borell, what effect the new BLM bonding requirements have on the Alaska placer miners so I won't go into that. I will have some questions that I will submit to you in writing about that.

But one thing I do want to ask you, realizing that my time is already up, to ask the indulgence of Mr. Inslee, a later witness will testify that Illinois Creek in Alaska is an example of a mine that highlights the consequences to the taxpayer and to the environment from inadequate financial assurances combined with the recent spate of bankruptcies and inadequate reclamation plans.

Could you describe the situation for me at Illinois Creek?

Mr. BORELL. Well, Madam Chairman, Illinois Creek is a heap leach operation about halfway between Anchorage and Nome. It is purely a fly in, fly out. There are no roads whatsoever in the area. Illinois Creek operated under two different companies for several years, USMX was one of them and Dakota Mining was another.

Because of factors at one of Dakota's other operations, which was in South Dakota, the company went bankrupt. The State of Alaska took the operation over. It is all on State land. It is not on Federal land. They took the operation over and have since found a contractor that is in there mining it to completion. It is not going to cost the State of Alaska anything to clean up the operation whatsoever.

As the price of gold continues to go up, hopefully not the State but the contractor will make some money on it and the taxpayer will not pay anything.

Mrs. CUBIN. Could you just very briefly discuss for me the reclamation process for placer mines in terms of the amount of disturbed acreage, concurrent reclamation, toxic chemicals and closure problems such as acid rock drainage.

Mr. BORELL. Well, regarding chemicals and acid rock drainage, there is no connection because the placer mines, as I briefly described, are basically a process where you take the gravels and you put them through a wash plant just like you would for cleaning sand for a concrete facility if you are making concrete. And you wash that gravel and in the process of putting it in the water the heavier gold particles fall out to the bottom and you separate those out and hopefully you can make a living in doing that.

That is the basic process for placer mining. The amount of acreage depends on the operation. I visited about seven operations over the 4th of July weekend. Historically, the miners shut down for the 4th of July. It is the only day of the year they will shut down when they are operating. One of those operators had, I would say, seven or eight acres disturbed. All of the others were probably less than five acres disturbed. Every one of them is a long-term miner. They have been miners for years and years. They have mined in various places and reclaimed them. They have come back to other places.

As a matter of fact, the fellow who had mined, he probably had eight acres disturbed, he complained to me at the picnic that the BLM had not used the opportunity to remove some trash from an abandoned operation long before the regulations required it. This older mine had operated. It had shut down.

He told them. He said, "We have tractor-trailer semis bringing our dozers and equipment in. I would like to put some trash on those as they go out and they will take it to the dump. For some reason, the local BLM office didn't see it in their ability to utilize the free resource that he had offered."

I don't know if I answered your questions.

Mrs. CUBIN. Thank you very much.

The Chair now recognizes Mr. Inslee for 5 minutes of questions.

Mr. INSLEE. Thank you, Madam Chair. You know, if you are around here you try not to be shocked at anything. But I have to tell you, the timing of this hearing and this effort to move the responsibility for cleanups of mines onto the shoulders of potentially the taxpayers is just stunning to me, while the stock market has been just melting down due to these multiple cases of corporate responsibility of Enron and WorldCom.

Now, we are here talking about a request to shift responsibility off corporations that may act irresponsibly onto the shoulders of the taxpayers.

I have to tell you, my constituents have loss enough money in the last several weeks in the stock market not to have further exposure for lost put on their shoulders for corporate responsibility. So, to me it is stunning that this morning we are having a hearing that could potentially result in putting the burden of corporate irresponsibility on my constituents.

I can tell you for 600,000 people out in the northwest part of the country, out north of Seattle, they don't want that responsibility. They have seen enough corporate responsibility. They want that responsibility to stay on the corporation's shoulders and the individuals who are responsible for this injury to the public watersheds.

So, I just want to tell you, the timing of this, in my view, could not have been worse from your perspective given the losses that have been suffered by people when people haven't hued to their legal responsibilities.

Secondly, it is stunning to me that we are here this morning when the administration and the Secretary rolled back existing requirements to protect our clean water and our watersheds. When she did so, she said, "But don't worry, we are keeping the bonding requirements."

You know, if these roll backs of Clean Water law results in damage to watersheds, we are at least going to keep the bonding requirements so the taxpayers don't end up footing the bill. And now here we are, after reducing those requirements, increasing the risk to the environment and taxpayers.

Now, there is talk, I am told, and I don't know, I am going to ask you about this, about now reducing those bonding requirements and putting that burden on the taxpayers. So, I just want to tell you I think it is a very unfortunate, from your perspective, time to have this hearing in this regard.

I wanted to tell you how my constituents feel about it. With that in mind, perhaps I can start with Mr. Schlief. I would like to ask you about your participation in getting the administration to weaken these existing requirements that the Secretary of the Interior did a while back in relationship to your current request to also, as I understand it, to reduce the bonding requirements.

Did the Secretary know you were going to come back for that second bite of the apple? Did she tell you at that time you weren't going to get to do it? Did she tell you to relax and we will do this later? What happened there?

Mr. SCHLIEF. Well, sir, I really don't have an answer for that question. We didn't really come to ask for any relaxing of bonding. The main emphasis of what we were talking about was the lack of capacity within the industry.

Mr. INSLEE. Well, let me ask you why you are here. I mean I appreciate your coming. We always do. I assume that you are here because there is something brewing to reduce and relax bonding requirements.

I am told that there is some task force talking about this issue. I mean, are you suggesting that we not? Tell me what you think, what you would like to see happen.

Mr. SCHLIEF. Well, sir, what I was making reference to is the fact that we have difficulty in obtaining bonds and sureties with respect to offshore bonding obligations. That was really the focus of my talk. There could be others on this particular panel that might be better suited to answer your question, sir.

Mr. INSLEE. Thank you. Is there anyone at the table there who is suggesting that we relax the bonding requirements?

Ms. SCHUBERT. What we are here to talk about and what we were asked to come and talk about is what is causing the difficulty in the capacity of the surety market. We are not talking about reducing bonding requirements. Surety bonds continue to be in effect for mines and leases and we will continue to make payments on those obligations.

What we are talking about is trying to clarify the obligations so that we can continue to provide that taxpayer protection in the future.

Mr. BORELL. Madam Chairman, Mr. Inslee, from the mining industry in Alaska standpoint, the bond pool has functioned for more than 10 years without a single default. Our interest is just to be able to see that bond pool continue to be used. And the way 3809 regulations are written right now, we don't believe it will be usable after January 20 of 2004.

Mr. INSLEE. Mr. Borell, do you have suggestions for us on what to do to solve this problem?

Mr. BORELL. Yes, sir, in our testimony that was submitted, there is a recommendation in there which is the same recommendation that we provided the BLM in a May 13 comment letter on the 3809 regulations. Basically some minor adjustments of the wordage in there would allow continued use of the State bond pool.

Again, this bond pool has been in place for more than 10 years and there has not been a single default either on State lands, on private lands or on BLM lands.

Mr. INSLEE. I am out of time. Thank you.

Mrs. CUBIN. I would like to say for the record that the only thing I see stunning about the timing of this hearing and the testimony that has been presented to this hearing is the lack of preparation by the gentleman from Washington.

Obviously, he was not informed. I don't know whether it is poor staffing or just political diatribe that we have heard today from him. But I want you to know that I personally thank you very much for being here.

I am glad that we have a coalition of people trying to work together to see that the environment is protected, that the surety business remains intact and that there is adequate bonding and financial capability for clean up and reclamation and still allow us to produce resources.

So, thank you very much for your testimony.

Mrs. CUBIN. I would like to call the third panel forward.

I would like to introduce our third panel of witnesses, Mr. Chuck Jeannes, Senior Vice President and General Counsel of Glamis Gold, Limited; Mr. Ken Done, Director of Treasury Services, Rio Tinto Services, Inc., testifying on behalf of the National Mining Association; and Mr. Jim Kuipers, Kuipers Engineering, testifying on behalf of the Mineral Policy Center.

STATEMENT OF CHUCK JEANNES, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, GLAMIS GOLD LIMITED

Mr. JEANNES Members of the Committee, Glamis Gold, Limited is a gold-mining company headquartered in Reno, Nevada. We explore for, develop and produce gold in Nevada at our Marigold Mine which is currently undergoing an expansion and at the Rand mine in southeastern California.

Although a small company relative to others, we have a long history of responsible and profitable operations in the U.S. We have been continuously producing gold and providing economic benefits to our shareholders, our employees and the communities in which we operate for over 20 years.

Unfortunately, these benefits have been threatened recently by our inability to obtain surety bonds to meet Federal regulatory requirements for mine reclamation. Glamis operates in the U.S. primarily on Federal lands and our bonding requirements are found in the 3809 regulations that we have been discussing here earlier.

I want to make clear the Glamis fully recognizes its responsibility to properly close and reclaim its mining sites at the end of operations and to provide appropriate financial assurance to make certain for the benefit of the taxpayers that that gets done.

You have heard from other witnesses as to the reasons for the surety crisis. What I would like to do is give you some details about how it is actually affecting companies like ours on the ground. I mentioned our Marigold expansion in Nevada. The permitting for that is in process. We are anticipating approximately $10 million of incremental bonding increase for that expansion.

We have conducted a thorough search through our broker, Marsh, actually on a worldwide basis and have found no surety companies willing to even give us a quote for those bonds.

Now, let me give you a little detail about our company. We have an absolutely clean balance sheet, no debt, short-term or long-term. We have $45 million in the bank. We are profitable. We have been for some time even at low gold prices. We have an absolutely clean environmental and reclamation record.

In fact, we just completed closure of a mine that we operated in Southern California for 20 years, the Picacho mine. This spring, after completing the reclamation and closure, we received our bonds back from the BLM and the State of California.

Now even with this record, we are unable to get any surety bonding in the current market.

Now, fortunately, we have the cash to put up to build the Marigold Expansion. Fortunately, its economics are robust enough to support that additional cash infusion. But I would submit that that will not be the case for many other companies or projects.

The additional cash required to put up at the outset of a project will increase the capital requirements, thereby decreasing the economic benefit and just taking some projects below the line as to whether you get a strong enough return to build that line.

Secondly, I would expect that premature closure of existing operations is a possibility if bonds cannot be replaced in an economic way.

Finally, I think this situation will be almost an absolute impediment to the entry of new businesses, small business startups in our industry. It is difficult enough to raise risk capital for mining; to have to raise the capital in addition to that for bonding will be extremely hard.

You have heard various solutions from others. I would like to second what has been said in terms of public-private collaboration. We would love to see the regulations and the manner in which the bonding is administered by the regulatory agencies attempted to fit more with the needs and the market realities of the surety industry in terms of the long tails, the lack of certainty of obligation, things like this.

If we can somehow improve the ability of the surety industry to work in our industry, I think we will all be much better off. Thank you. I would be happy to answer any questions.

[The prepared statement of Mr. Jeannes follows:]

Statement of Charles A. Jeannes, Senior Vice President and General Counsel, Glamis Gold Ltd.

Introduction

Thank you for the opportunity to present written and oral testimony regarding the impact of the surety industry crisis on the U.S. minerals industry. My name is Charles Jeannes, Senior Vice President Administration and General Counsel of Glamis Gold Ltd. A synopsis of my background and qualifications are included in the Disclosure Form submitted to the Subcommittee with my written testimony.

This testimony is presented on behalf of Glamis Gold Ltd., an intermediate gold mining company headquartered in Reno, Nevada. Glamis is involved in the exploration for, development and mining of precious metals—primarily gold—at operations located in the United States and Central America. We operate the Marigold Mine in Nevada which is presently undergoing a significant expansion, the Rand Mine in southeastern California and our newest mine, San Martin in Honduras. Glamis has two advanced stage development projects in Mexico and Guatemala and is also engaged in active closure and reclamation activities at two mines in Nevada that have reached the end of their productive lives.

Although a small company in terms of gold production relative to some of its peers in Nevada—Glamis will produce approximately 260,000 ounces this year—the company has a long history of successful and responsible operations in the United States, having been in continuous operation for more than 20 years. Glamis was one of the pioneers of heap leaching technology so prevalent in the gold industry today, and we are very proud of our environmentally sound operating mines and our innovative and award-winning reclamation practices at the closed operations. In fact, Glamis had the distinction of becoming one of the few companies to take a mine “cradle to grave” when it successfully completed closure and reclamation activities at its Picacho heap leach gold mine in California earlier this year. Following over twenty years of exploration, mining and related operations, Glamis completed all requisite reclamation and was granted the full return of all of its bonds from the State of California and the Bureau of Land Management.

Unfortunately, the continued benefits of Glamis’ success to its shareholders, employees and the communities in which it operates in the United States are threatened by the present crisis in the surety industry. Despite an exhaustive effort undertaken during the first half of this year, we have been unable to obtain surety bonds either for the replacement of existing bonds at the Rand mine in California or the issuance of new bonds in connection with the expansion of the Marigold mine in Nevada. This problem has significantly increased the up-front cost of development and mining for our company, as it doubtless has for others in the U.S. minerals industry.

Discussion

Bonding for closure and reclamation of mining operations is required by both state and federal agencies, and Glamis Gold both recognizes and endorses the policy of requiring appropriate financial assurances to provide for necessary reclamation efforts. With respect to hard rock operations on federal lands, the requirements are contained in the new 43 CFR 3809 regulations, the bonding portion of which was adopted on June 15, 2001 (66 FR 32571; 43 CFR Part 3809, sec.500 - .599).

The problems being experienced today in attempting to secure bonding for mining operations have been the subject of continuing review and discussion, including by the National Mining Association's Surety Bond Working Group and the Department of the Interior Bonding Task Force. Witnesses with more direct involvement in those efforts are better able to describe the details of the causes of the bonding problem, but they can be generally classified as resulting both from the financial problems in the insurance and surety industries worldwide as well as the current regulatory regime for mining on federal lands.

Problems associated with the surety industry itself include extraordinary losses and a resulting lack of capital to fund reinsurance. This situation has been caused by many factors, most directly as a result of the events of September 11 as well as losses incurred in connection with the Enron and K–Mart bankruptcies.

Regulatory issues that have contributed to the inability to obtain surety bonding include the extremely long term of risk exposure throughout a mine's operational and closure phases, burdensome bond release standards that delay or deter a principal's seeking bond release in a timely manner, regulatory policies that result in overstating the cost of the appropriate surety exposure, and changing policies that create new reclamation obligations as a part of an existing financial assurance. Even though the historical loss experience for mine reclamation bonding has been less than overall surety industry averages, each of these problems increases the potential length and amount of exposure to an insurance company, making reclamation bonds an undesirable risk.

The combination of these problems has made it impossible for Glamis to acquire surety bonds to secure its reclamation requirements. Glamis is currently permitting a significant expansion at its Marigold Mine in Nevada, operated and owned two-thirds by Glamis and one-third by Barrick Gold Corporation. This is a $55 million capital project that will nearly triple the mine's annual production, extend the mine life to twelve years and provide significant economic benefit to north-central Nevada. While reclamation bond calculations have not yet been made, Glamis anticipates new bonding requirements to be in the range of $10 million, in addition to the existing $7 million in bonding already in place for the existing Marigold operations. A thorough review of the surety market by Glamis' insurance broker, Marsh, resulted in not a single company willing to even review the file to consider a quote.

As mentioned above, Glamis has been in continuous and for the most part, profitable operations for over twenty years. The Company has current assets of over $60 million, including $45 million in cash in the bank and zero short-term or long-term debt. In other words, the balance sheet is completely clean. In addition, the company's ongoing low-cost operations are generating significant earnings and cash flow and are projected to continue to do so well into the future, even at gold prices below current levels. From an operations and reclamation liability standpoint, Glamis' record is pristine, with no history of environmental problems and no long-term liabilities. In fact, the company has received awards and been commended for its innovative desert mine reclamation efforts at the Picacho mine by the California state legislature.

Despite this record, Glamis is unable to obtain surety bonding in the current regulatory and market environment. Its only options in connection with the Marigold expansion will be to put up cash or equivalents in the amount of 100% of the required bond amount, or to attempt to enter into a banking credit facility that provides for the issuance of letters of credit for bonding. Glamis is fortunate to have the financial capacity to meet its bonding requirements in this fashion. However, many existing companies and nearly all start-up businesses would lack the ability to cash bond in the absence of surety bonding. We are equally fortunate that the Marigold expansion project has relatively robust economics and its rate of return to the company remains acceptable even when the up front cash for bonding is included. But for many projects, the up front cash investment required for bonding in the absence of a surety alternative may well render an otherwise viable project uneconomic.

The negative impacts resulting to the U.S. minerals industry from the surety bonding crisis described above are significant. First, the additional capital required for cash bonding will render certain new projects uneconomic, meaning those projects will not get developed and the local, state and national economies will forego the benefits derived from capital investment, employment and tax revenues. Likewise, the absence of surety bond renewals could cause certain existing projects to be prematurely shut down if the operators are unable to secure alternative financial assurance. Additionally, even for those projects and companies that can absorb the additional cost of bonding, devoting scarce capital to sit in an account as a bond-equivalent will reduce the amount of funds otherwise available for exploration and discovery of new deposits and related economic development. Finally, the need for cash bonding will severely hamper start-up companies and other small businesses. New and small businesses will find it very difficult to finance substantial cash bonds in addition to the regular costs of exploration and development. Hard rock exploration and mining is already a high risk venture for investors—this additional capital requirement will make it even more so.

These new and additional impediments mineral development are contrary to the policy of the United States to promote the development of mineral resources on public lands, and will ultimately threaten the nation's supply of domestic minerals. While the problem and possible solutions are made more complex by the events of September 11 and difficulties in the insurance industry world wide, there are certain regulatory changes that could be taken to help alleviate the problem. Others will testify in more detail on these suggestions, but from Glamis' standpoint the reinstatement of some form of self-bonding (also known as a corporate guaranty) that was eliminated in the new 3809 regulations would be of substantial and immediate assistance.

Self-bonding essentially provides for a guaranty of reclamation obligations by the operator or its parent company, which guaranty is secured by the assets and cash-generating capacity of the entire company. This means of securing at least a portion of a company's bonding obligation was allowed by the Bureau of Land Management prior to the recent 3809 revisions and continues to be an allowed method of financial assurance under SMCRA. The State of Nevada continues to allow self-bonding for reclamation plans within its purview, and is currently examining and revising its financial tests to assure that self-bonding is permitted only for those companies that have the financial wherewithal to meet their ultimate obligations.

For companies that meet strict criteria to test financial well-being, based on audited financial statements, both presently and on a continuing basis subject to active periodic review, self-bonding of at least a portion of the total bonding requirement should be considered as a viable alternative to otherwise unavailable surety bonds.

Conclusion

Glamis Gold Ltd. looks forward to participating in a collaborative effort among the public and private sectors to find appropriate regulatory and market solutions to the surety bonding problems. We appreciate the opportunity to testify before the Subcommittee and will be happy to answer any questions.

Mrs. CUBIN. Thank you.

I would now like to recognize Mr. Done.

STATEMENT OF KEN P. DONE, DIRECTOR OF TREASURY SERVICES, RIO TINTO SERVICES, INC.

Mr. DONE. Thank you, Chairman Cubin, Members of the Subcommittee. I appreciate this opportunity to address the crisis in the surety industry and its impact on the mining industry, our ability to provide minerals.

I also have some ideas for some initiatives that we may want to consider to address this crisis.

I represent the U.S. business units of Rio Tinto and the National Mining Association today. Rio Tinto is a world leader in the finding developing and extracting mineral resources. We are strongly represented in Australia and the United States. And we have assests in many parts of the world.

In the U.S. we have business interests that I will refer to as the Kennecott group of companies, Borax and Luzenac. Borax has operations in California. Luzenac has operations in Montana and Vermont.

The Kennecott group has operations in Montana, Utah, Nevada, Colorado, Alaska and the great State of Wyoming.

I am the Director of Treasury Services for Rio Tinto.

Mrs. CUBIN. I am glad you recognized that great State.

Mr. DONE. I am Director of Treasury Services for Rio Tinto Services, Inc. My group provides treasury and risk management services to Rio Tinto's North America business units.

One of our key functions over the years has been the procurement of surety bonds and other forms of financial assurances as required by our business units as they are required to provide these by law.

I have been in this role since 1994. I have a little bit of history about the good times and the bad times in the surety business. The crisis in the surety industry first came to my attention in the fourth quarter of 2001. Our broker indicated that many of our surety providers were losing their reinsurance.

This indicated that the rates would increase, our requirements for collateral would increase and we may have difficulty finding capacity for new operations. This was further exasperated this spring when we were successful in our bid under the LBA (Lease by Application) Program for the North Jacobs Ranch coal.

This LBA Program requires that you pay one-fifth of the bid down and if successful then you will have to bond for four deferred payments. These deferred payments can be secured by a surety bond, cash or personal lease bond secured by U.S. Treasuries.

This is a key point of my testimony: Despite Rio Tinto's AA-minus credit rating, a clean record of reclamation for Kennecott Energy and Coal where they have never forfeited on a reclamation bond and a 20 percent down payment of almost $75 million, we were unable to secure a surety bond for a reasonable price with reasonable terms.

As a result we were required to purchase U.S. Treasury bonds for $303 million. The utilization of capital in this manner was not in Rio Tinto's strategy or strategic plan. This type of money is only available to very large companies. This reduces competition and jeopardizes the government's efforts to secure a reliable national energy policy.

To address this crisis, the National Mining Association has formed a surety bond work group comprised of a cross-section of producers. The group has confirmed the crisis is not limited to our sector of the mining industry. It has become difficult or impossible to find bonding for new operations or increases in bonding for existing operations.

I am running out of time so I am going to jump ahead. We all understand the history of why bonding is required. Mining companies are not trying to shirk their responsibilities here. They just cannot find bonding. In the '90's it was easy to find bonding. It was never a concern of mine to find bonding. But what has changed?

The economy has changed. September 11th changed. Enron, K-Mart, the surety industry is refocusing on underwriting. They don't like their risk here, OK?

The four items that I will bring to your attention that the surety industry has expressed that they don't like to underwrite in our business is the non-cancel ability of the bonds, the extreme long tail, their lack of reinsurance and a key risk reward factor.

In the year 2000, the surety bond business in the United States of America, their total premiums were $3.3 billion, of which only $29 million of that related to our industry for reclamation.

We are asking them to expose their balance sheet for premiums that are less than eight-tenths of 1 percent of their book of business.

I could go on. I have run out of time. But I do appreciate this opportunity to address the Committee. I do have some suggested solutions in my written testimony. But I will address any questions as they come up.

Thank you again.

[The prepared statement of Mr. Done follows:]

Statement of Ken P. Done on behalf of Rio Tinto Services, Inc., Kennecott Energy Company, Kennecott Minerals Company, Kennecott Utah Copper Corporation, U.S. Borax, Luzenac America and the National Mining Association

Chairwoman Cubin, we appreciate this opportunity to address the crisis in the surety industry, its impact on the mining industry on federal lands nationwide and initiatives to address the crisis.

This statement is presented on behalf of the U.S. business units of Rio Tinto plc, and the National Mining Association. Headquartered in London, Rio Tinto is a world leader in finding, developing, extracting and processing mineral resources. Diversified by both product and geography, Rio Tinto is strongly represented in Australia and North America, with major assets in South America, Asia, Europe and southern Africa. Rio Tinto's U.S. business units include Kennecott Energy Company ("Kennecott Energy"), Kennecott Minerals Company, Kennecott Utah Copper Corporation, U.S. Borax and Luzenac America. Rio Tinto Services, Inc., is located in Salt Lake City, Utah, and provides assistance for the North American business units on a number of business issues including treasury and risk management services and government affairs. Kennecott Energy is headquartered in Gillette, Wyoming, and has low-sulfur coal mining operations in Colorado, Montana and Wyoming. Kennecott Utah Copper Corporation has mining operations near Salt Lake City, Utah. Kennecott Minerals has hardrock operations in Nevada, California and Alaska. U.S. Borax has mining operations in California. Luzenac has mining operations in Vermont and Montana.

The surety industry crisis first came to the attention of Rio Tinto Services, Inc. when it was warned by its broker late in the Fourth Quarter of 2001 that the reinsurance market for surety bonding was eroding. At that time, sureties began to require additional collateral and higher premiums to secure Kennecott Energy's existing surety bonds. Kennecott Energy had even more difficulty obtaining surety bonding for new mining obligations when it acquired the North Jacobs Ranch Tract coal reserves on January 16, 2002, under the Department of Interior's ("DOI's") competitive bid, Lease by Application ("LBA") program. Through this acquisition, which consisted of 515 million tons of recoverable, compliance coal in the Southern Powder River Basin (Wyoming), Kennecott Energy was able to extend the life of the Jacobs Ranch Mine for an additional 18 years.

The LBA program allows lessees to pay for reserves in five ratable payments made over four years, with the first payment due on the date the bid was awarded. Four subsequent installments must be bonded by one of three means: (1) a surety bond obtained from a government-approved (U.S. Treasury listed), bonding company; (2) a cash bond; or (3) a personal lease bond secured by government securities.

Despite Rio Tinto's AA- credit rating, one of the highest credit ratings in the mining industry, Kennecott Energy was unable to find a surety company or a combination of companies willing to issue a bond(s) totaling $300 million for a reasonable price with reasonable terms.

Unable to obtain a surety bond because of the current U.S. bond and insurance industry crisis, Rio Tinto was forced to tie up $303 million to purchase Treasury Bonds to back the remaining financial obligation to the DOI under the North Jacobs Ranch Lease. This financial obligation was not part of Rio Tinto's strategic plan for the use of capital. The utilization of capital in this manner is only available to very large financially secure companies. This reduces competition and jeopardizes the Bush Administration's efforts to secure a reliable national energy policy.

To address the crisis in the surety industry, the National Mining Association ("NMA") has formed the "NMA Surety Bond Working Group" (the "NMA Working Group"), comprised of a cross section of the association's producer membership. The NMA has confirmed that the scope of the problem is not limited to any particular sector of the mining industry. Companies across the board are finding it difficult if not impossible to access surety bonds not only for new operations but also to obtain required increases to existing bonds for coverage for obligations at existing operations.

I. BACKGROUND

A. History.

The federal and state governments have required the posting of surety bonds and other forms of financial guarantees to protect the public interest and assure compliance with payment obligations, reclamation performance and environmental compliance. Within the U.S. Department of the Interior ("DOI"), the Bureau of Land Management ("BLM") has required surety bonds to secure the terms and conditions of federal coal leases, including rental, royalty and bonus bid payment obligations. Section 509 of the federal Surface Mining Control and Reclamation Act ("SMCRA"), specifically requires financial assurance to secure reclamation obligations and the performance of the coal mine permittee. The Office of Surface Mining ("OSM") is also considering a rule regarding bonding and financial assurance for long-term acid mine drainage. The hardrock mining industry has been required to provide financial assurance for reclamation operations pursuant to BLM's surface management regulations set forth at 43 C.F.R. § 3809. States have also required financial assurance for environmental and workers" compensation programs. Until recently, numerous insurance companies (herein "sureties") serviced the surety market and, as a result of competition during the 1990's, sureties reduced rates and were flexible in the types of bonds issued to meet federal and state financial assurance requirements and in the terms (guarantees/collateral) supporting the mining company's commitment to the surety issuing the bonds.

B. What's Changed.

Due to no fault of the mining industry, the surety market has tightened with the decline in the economy beginning in 2000 and losses incurred by sureties in 2001 and 2002 from surety forfeitures involving Enron and KMart and insurance claims from the September 11, 2001 tragedy. The insurance industry sustained substantial losses over this time period and has attempted to reduce its exposure to high risk lines of business. As a result, several primary surety underwriters and reinsurers have elected to leave the business.

The sureties" recent re-evaluation of the risk associated with surety bonds underwritten for the mining industry has resulted in increased costs for maintaining existing surety bonds due to higher premiums and requests that operators provide additional collateral backing. New long-term environmental and reclamation performance bonds have become nearly impossible to obtain. Surety companies and underwriters are focusing on risk and are not inclined to issue new reclamation bonds for the following reasons:

1. Objection to the non-cancelable nature of the obligation, i.e., sureties are unable to re-evaluate the risk that an operator will fail to perform, even if the operator's financial condition or environmental performance record has changed for the worse;
2. Concerns about the indefinite duration of reclamation bonding commitments for the life of the mine, sometimes in excess of thirty years (referred to in the surety industry as "long tails");
3. Reinsurers provide coverage to primary surety companies on an annual basis and therefore the reinsurance is not tied to the life of the mine or the bond obligation. Additionally, as many reinsurers have chosen not to renew coverage for surety bonding, surety companies have little or no reinsurance support;
4. The risk versus the reward for issuance of bonds is not justified in the underwriter's eyes. Although the loss ratios of bonds written for mining operations

are lower than the year 2000 loss ratios for all surety bonds, reclamation bonds for mining and other permits associated with the restoration of land represent only $29 million in premiums of the $3.3 billion in total premiums, earned industry-wide;[1] and

5. The surety industry is even less inclined to issue bonds for hardrock mining operations, particularly those involving heap leach operations.

II. RESULTS

The surety market for mining and reclamation bonds under the terms and conditions prevailing in the 1990's no longer exist. Over the past decade, many industries, including the mining industry, have benefited from the "soft market" for surety bonds. Due to competition, sureties were flexible regarding the terms and pricing of bonds and there was adequate capacity to meet large obligations. The downturn in the economy and tightening of the surety and insurance market has changed this dynamic.

Rather than competing for new business, sureties want out of the bonds that are currently outstanding. However, due to the nature of the surety bond agreement, sureties cannot be released without a replacement bond or other form of financial assurance. Therefore, sureties are requiring increased rates and additional collateral to maintain existing coverage. As a result, the higher cost of maintaining existing coverages means prohibitive increases in costs for the mining industry. In addition, the surety industry now lacks reinsurance and it is not inclined to issue new surety bonds especially for larger obligations. In short, surety capacity for new mining projects is very difficult to obtain at any price.

III. WHAT THIS MEANS TO MINING COMPANIES AND THE INDUSTRY IN GENERAL

A. Increased Costs and Reduction in Activity.

The crisis in the surety industry has resulted in higher costs to the mining industry due to premium rate increases and surety companies demand for additional collateral to secure existing mining obligations. Mining companies are being forced to seek alternatives to surety bonds, including utilization of letters of credit ("loc") capacity or the diversion of operating capital to fund obligations with cash or U.S. Treasury Bonds. Mining companies with bonds issued by sureties who have lost their Treasury rating or have become insolvent, have been ordered by OSM and state regulators to replace bonds or cease mining. The erosion of the surety market also threatens new operations unable to post bonds to continue exploration, expand existing operations or to bid for new coal leases.

B. Specific Needs of Government/Taxpayer.

The surety industry has played a vital role in securing obligations of the federal government so that public interests are protected. Reclamation bonds have assured the completion of reclamation by mine operators in the coal and hardrock industries. Lease bonds have guaranteed performance of the terms and conditions of federal coal leases and have allowed the successful bidder to defer the bonus bid in installment payments for up to four years. Recently, OSM has proposed financial assurance mechanisms to address long-term acid mine drainage. Without a surety market willing to provide financial assurance, the mining industry may be required to bear substantial costs to fund these obligations up front or to cease mining activities.

C. Issues Identified by Surety Bond Industry and Mining Companies.

The NMA and the surety and reinsurance industries have identified several obstacles which should be addressed to encourage sureties to meet the bonding needs of mining operations. First, surety companies are concerned by the indefinite duration of the current reclamation bond commitment. Surety companies also feel that they are unfairly called upon to perform after operator default or bankruptcy when they could be notified much earlier and take over performance when an operator is developing financial or compliance problems. With respect to lease bonds, sureties believe that they should be provided with notice and an opportunity to cure prior to forfeiture of the lease bond. BLM rules at 43 C.F.R. § 3452.3(b) (2001) provide that in the event of lease relinquishment, termination or cancellation for any reason, the entire bonus bid is forfeited, which appears to unduly enrich the federal government. Certain sureties have indicated that they would be unwilling to provide a deferred bonus bid bond without a rule change on this matter.

[1] Letter dated May 28, 2002, from The Surety Association of America to the Honorable Tom Fulton, Deputy Assistant Secretary for Lands and Minerals, U.S. Department of the Interior.

Second, regulators, both federal and state, are reluctant or slow to release bonds although reclamation has been achieved; or attempt to impose additional environmental performance standards which did not exist at the time a particular surety bond was written. In the context of SMCRA, this impediment is exacerbated by several states" reluctance to release surety bonds.

Third, the acceptable forms of financial assurance or bonds vary among DOI's programs as well as among those states which administer state programs in cooperation with DOI. For example, BLM does not allow self-bonding under its § 3809 rules although this has been an acceptable form of assurance in many states with surface management and environmental programs. On the other hand, OSM allows self-bonding, but a number of states with primacy under SMCRA will not allow this form of meeting the SMCRA bonding requirements.

Finally, the recent OSM proposal regarding financial assurance for acid mine drainage imposes indefinite obligations for very long and uncertain periods. The surety industry is unlikely to take on the risks of such a surety bond. Indeed, the surety industry may not touch the acid mine drainage issue with a "ten-foot pole."

IV. SOLUTIONS/ITEMS TO CONSIDER

The erosion of the surety market was not caused by the mining industry. However, the mining industry is willing to partner with the DOI and the surety industry to encourage surety companies to meet bonding requirements imposed by statute and regulation. Although we have not identified at this point all of the initiatives that might alleviate some of the capacity constraints, we can suggest several general areas that merit further consideration:

A. Establish/Maintain Reasonable Bond Amounts.

Policy changes are required to encourage state and federal regulators to set bond amounts at reasonable and attainable levels. Too often bond amounts are calculated in a manner that includes various speculative contingencies which artificially inflate the amounts required for bonds.

B. Impose Time Limitations on Bonds.

New rules are required to set time limitations to fix the duration of bonds. Surety companies are concerned by the indefinite nature of the current reclamation bond commitment.

C. Timely Release.

The DOI should issue a policy statement to state program directors alerting them to the crisis in the surety market and encouraging the timely release of reclamation bonds.

D. Accept Other Forms of Financial Assurance.

1. Self Bonds.

Federal and state regulatory authorities should be encouraged to accept self-bonding for companies that meet the criteria. The criteria to qualify for self bonds should factor in the size and strength of the company. In the global marketplace, regulatory agencies should be willing to accept the guarantees of multi-national companies and foreign parents of mining operators.

2. Letters of Credit and Other Forms of Collateral.

BLM's coal leasing program should be amended to accept a range of financial assurance, including letters of credit and collateral.

3. Combinations of Financial Assurance.

Finally, state and federal regulatory authorities should be flexible enough to accept a combination of forms of financial assurance. Rather than requiring one form of surety for each lease or each phase of mining operations, a combination of vehicles should be considered, including bonds, letters of credit, self bonds and some form of government involvement, i.e., reinsurance, tax relief.

V. CONCLUSION

With the increasing requirements imposed by regulatory programs for financial assurance and the shrinking capacity of the surety industry to serve those needs, the bonding requirements of these regulatory programs have now become a barrier to market entry or continuation in the mining business. This development poses grave consequences for the mining industry's ability to meet the Nation's needs for fuel and non-fuel minerals that are essential to its economic growth and well being. Both the public and the private sectors will need to collaborate to find public policy and market solutions for the present crisis. As we continue to explore for those solutions, we will welcome the opportunity to keep this Subcommittee informed of our progress.

We appreciate this opportunity to address the Subcommittee and will be happy to entertain your questions.

Mrs. CUBIN. Thank you. Mr. Kuipers.

STATEMENT OF JIM KUIPERS, J. KUIPERS ENGINEERING

Mr. KUIPERS. Chairman Cubin, Members of the Committee, I am a consulting mining engineer with the Center for Science in Public Participation. Thank you for inviting me to testify. The public's interest is served by financial guarantees, so that extractive industries like mining companies meet all Federal and State requirements for cleaning up pollution and reclaiming sites.

As a starting point, it is critical that financial assurances provide funds for clean up in the form of a rock solid, irrevocable guarantee.

We must not allow mining companies to use financial instruments such as corporate pledges that are not real guarantees. To allow the use of such instruments would be to potentially transfer the risk of clean up to the taxpayer.

In an era of Enron and Worldcom, it is more important than ever to protect the public stockholders from hidden costs and surprise liabilities. Cleaning up a mine site should be the cost of doing business.

If the mining company cannot guarantee funds for clean-up, then it should not be permitted to mine. As the Worldcom example shows, size is no guarantee against bankruptcy.

I was raised in a mining family in Montana. I have worked as an engineer, operator and manager of mines for over 20 years. Since 1996 I have worked with public interest groups, state and tribal governments to address mining environmental issues at mine sites in the U.S. and Canada.

I am currently involved in reclamation, closure and financial assurance matters in numerous different mine sites in the U.S. and have been qualified as a technical expert in hearings on this subject.

I do quite a bit or work with the mining industry trying to help them out in certain situations. My grandfather is a small miner. I have secured the reclamation and closure costs, or he has secured those costs at his small mines with cash financial assurances since the early 1990's.

He felt that it was the right thing to do and that mine operators needed to ensure that they weren't perceived as being irresponsible. His greatest concern was that the big companies would fail to adequately estimate or ensure their costs, which he thought were much greater than were being reported, putting the entire mining industry, including small miners, at risk.

I think my grandfather was pretty insightful. Mining companies have responded to changes in the availability of surety bonds in a number of different ways. Some companies are keeping their existing bonds and paying the costs associated with those bonds.

Some are putting in place other forms of acceptable guarantees such as irrevocable letters of credit. I would point out that that is the case with both Rio Tinto and Glamis. However, there are some other companies that are seeking to exempt themselves from these requirements by lowering or weakening cleanup standards and by gutting bond requirements to be allowed to put up soft financial guarantees. These amount to nothing more than a promise.

The public interest is not protected by granting exemptions, lowering standards, or softening regulations. This Committee and the Bush Administration, as well as responsible mining companies have an interest in keeping the bar at an acceptable standard.

There is no doubt that the prices for rising legitimate natural guarantees are going up. In my experience, recent regulatory actions at the State and Federal level have led to more realistic estimates of mine reclamation costs. These new cost projections are substantial, but they are real.

Many in the mining industry responded to these increased costs by seeking to avoid responsibility. Rather than pay the new, more accurate costs associated with the environmental risks of mining, some in the industry are essentially petitioning State and Federal Governments to ship the costs of risk to the taxpayer for cleanup.

The present situation with respect to bonding difficulties is only a symptom of the much larger problem that the mining industry faces in regard to corporate accountability and public disclosure.

Total cost of cleanup that the mining industry has failed to recognize could be as high as $10 billion or more for the U.S. hard rock mining industry alone. This raises an important question. If we are aware of these potential risks and no doubt many companies are, is this risk being fully and accurately reported to investors, insurers and regulators?

Unfortunately today, instead of dealing with this situation in a proactive and responsible manner, too many companies are seeking a special exemption or short-term solution. However, we call on the Committee and the Bush Administration to hold the line and enforce the current 3809 regulations as good public and environmental policy that is pro-taxpayer and pro-investor protection.

At a time when the Enron and Worldcom scandals have rocked public confidence and demonstrated a need for much greater corporate accountability, why is the Bush Administration considering allowing the mining industry to evade responsibility for paying to clean up toxic pollution from mines?

Instead of proposing to weaken the regulation, the Administration should embrace its own corporate responsibility rhetoric by enforcing current regulations and seeking new tools to ensure the polluters, not taxpayers, pay for the cost of mine cleanup.

Thank you.

[The prepared statement of Mr. Kuipers follows:]

Statement of Jim Kuipers, Consulting Mining Engineer, Center for Science in Public Participation

Chairwoman Cubin, members of the Subcommittee. My name is Jim Kuipers and I am a consulting mining engineer with the Center for Science in Public Participation. Thank you for inviting me to testify on the important subject of reclamation bonds, which are used as a method to ensure cleanup at mine sites.

Professional Background and Affiliation

I was raised in a mining family and attended Montana School of Mines, obtaining a B.S. degree in Mineral Process Engineering in 1983. I have worked as an engineer and manager at base and precious metals mines in the U.S. and abroad and at the corporate level for one of the world's largest mining companies. I am a registered professional engineer in Colorado and Montana. My main area of expertise is hardrock metals mining and includes mineral processing, project design and permitting, mine reclamation and closure, water treatment, and financial assurance including cost estimating. My professional background is further described in a resume attached to this testimony.

Since 1996 I have worked on behalf of public interest groups, and tribal and state governments to address environmental mining issues at a large number of mine sites throughout the U.S. and Canada. In February 2000 I authored a report entitled: Hardrock Reclamation and Bonding Practices in the Western United States. The approximately 500 page report examines the principles of mine reclamation and closure, financial assurance, and financial assurance cost estimating and includes information on each state's mines and financial assurance and each state's applicable regulations, and contains 20 different specific mine site case studies. It concluded that financial assurance shortfalls could exceed $1 billion, an extreme underestimate, in retrospect. I am at present involved in reclamation, closure and financial assurance matters at over 20 different mine sites in the U.S. and am a qualified technical expert and have testified before on the subject.

Introduction/Overview

My testimony starts from the premise that the public's interest is served by the availability and use of surety bonds, and other financial guarantees, so that extractive industries, like mining companies meet all federal and state requirements for cleaning up pollution and reclaiming sites. As a starting point, it is critical that whatever financial instrument we use to set aside funds for cleanup, it comes in the form of a rock-solid, irrevocable guarantee. To do otherwise, as some mining companies have recommended, is to put the public, communities and other natural resources at risk. Therefore, from the perspective of the public and taxpayer interest, it is important that we explore and mandate all forms of guarantees, not just bonds. But we must not allow mining companies to use financial instruments such as corporate pledges that are not guaranteed. To allow the use of such instruments, as we have seen in too many examples in recent years, would be to potentially transfer the risk of cleanup to the taxpayer. In the era of ENRON and Worldcom, it is more important than ever to protect the public from hidden costs and surprise liabilities. Cleaning up a mine site should be a cost of doing business. If the mining company cannot guarantee funds for cleanup, then it should not be permitted to mine.

There is not doubt that today, there are instances where the costs of bonds are increasing and they are becoming more difficult to secure. Unfortunately, I am intimately familiar with a number of mines, where this is occurring. In my experience, the most direct cause of this is that companies that provide bonds are responding, as one would expect in a market economy, to greater risk. There is greater risk in the sector because over the past few years, in case after case, it has been demonstrated that mining companies and regulators substantially underestimated the cost of mine closure and cleanup. I have seen companies respond in a number of ways. Some are securing larger bonds and paying the costs associated with those bonds. Some are putting in place other forms of acceptable guarantees such as letters of credit. And some are seeking to exempt themselves from these requirements by seeking to lower or weaken cleanup standards or by gutting bonding requirements to be allowed to put up soft financial instruments such as so-called corporate "guarantees" that amount to nothing more than a promise. The public interest is not protected by granting exemptions, lowering standards, or softening regulations. This committee and this Administration have an interest in keeping the bar at an acceptable standard.

There is no doubt that prices are rising for legitimate financial guarantees, but these prices are rising for the right reasons. In my experience recent regulatory actions at the state and federal level have led to more realistic estimates of mine reclamation costs to financial guarantee providers. These new cost projections are substantial, but they are real. For example, the three largest copper and three largest gold mining companies operating in the United States have a potential combined un-guaranteed liability of $9 billion. Many in the industry have responded to these increased costs by seeking to avoid responsibility. Rather than pay the new, more accurate costs associated with the environmental risks of mining, some in the industry are essentially petitioning federal and state governments to shift the costs of risk to the taxpayer for cleanup.

Mine reclamation and closure addresses water quality, air quality, adjacent property owner impacts and land use in the aftermath of mining operations. As it pertains to modern mines it deals with large waste rock dumps, leach piles, tailings ponds, open pits and other mining facilities which may disturb 10,000 or more acres at a typical large mine site. Mine reclamation and closure tasks include regrading and reshaping mine features, applying covers to control water infiltration and provide growth media, and revegetation. The goal is to control and eliminate if possible ground water and surface water pollution, air pollution, and to restore the land to a suitable post-mining land use.

In addition, water treatment is often a necessary component of mine closure. At many mine sites acid drainage can result in the leaching of harmful contaminants such as lead, copper, zinc, arsenic and cadmium, which are known carcinogens and toxins that can cause cancer and reproductive disorders, into ground water and surface water, seriously impacting water quality. The incidence of acid drainage, which has been shown to be much more common than has been assumed, can increase the cost of reclamation and closure by ten times or more, and is the leading cause of insufficient reclamation and closure plans and cost estimates that exist today. In many cases water treatment will be required for hundred of years or more, resulting in a need to address financial guarantees that will last long into the future Altogether, mine reclamation and closure costs are extremely expensive, from tens of millions to almost a billion dollars—per mine.

In my experience, it should not come as a surprise that mining companies are having difficulty securing bonds today as this problem has been brewing for years. In a report that I authored two years ago entitled, Hardrock Reclamation and Bonding Practices in the Western United States, this problem was evident. While there are no doubt other factors that influence the price and availability of bonds, and are doing so today, we are now facing the reality that bonding companies are to a great degree adjusting price and availability to a more realistic assessment of risk. We don't expect insurance companies to charge the same for a policy covering a Honda Civic or a Jaguar, and nor should they charge the same for a low risk construction surety bond and a higher risk mine reclamation and closure bond.

Not to be a pessimist, but the worst isn't over. In my experience, there is even more uninsured risk out there than is being recognized by the insurance industry and regulators. What we are facing today is simply the symptom of a larger problem. The problem is the significant underestimation of the actual cost of modern hardrock mine reclamation and closure and the lack of financial guarantees to ensure that taxpayers will not foot the bill. This problem is likely to get worse before it gets better.

An example is the disparity that exists between the estimated amount for cleanup and the amount presently shown as reclamation liabilities in many mining company's annual statements. For example, according to Phelps Dodge Corporation's 2001 Annual Report, reclamation and closure reserve activities (funds accrued by the company for eventual reclamation and closure costs) at the end of the year totaled $135 million. While the report goes on to disclose the potential for significantly higher costs, and anticipates making significant capital and other expenditures in future years, the report concludes with the statement that "we are unable to reasonably estimate the total amount of such expenditures over the longer term, but it may be potentially material." Evidence suggests that the company can reasonably predict expenditures significantly in excess of the amount accrued so far, and that it may be highly material as to the company's ability to deal with its reclamation and closure liabilities, which could exceed $3 billion or more.

The present situation with respect to bonding difficulties is also only a symptom of the much larger problem that the mining industry faces in regard to corporate accountability and public disclosure. The total cost of clean-up that the mining industry has failed to recognize could be as high as $10 billion or more for the U.S. hardrock mining industry alone. This raises an important question, if we are aware of these potential risks, and no doubt many companies are, is this risk being fully and accurately reported to investors, insurers and regulators?

Unfortunately, today, instead of dealing with this situation in a pro-active and responsible manner, to many companies are seeking a special exemption or a short-term solution. Any efforts to weaken the Bureau of Land Management's 3809 regulations which were specifically intended to address the gap between expected costs and current financial guarantees fall into this category, as do efforts to weaken, soften or avoid state regulations. In fact, today we call on the committee and the Bush Administration to hold the line and enforce the current 3809 regulations as good public and environmental policy that is pro-taxpayer protection and pro-investor protection. We also recommend that the BLM significantly strengthen its closure requirements. They have simply not gone far enough. We are concerned that the task force recently created by the Bush Administration to review these issues, may only be responding to the interest of the extractive industries, rather than the interest of the public, taxpayers, the environment and investors. The task force should not consider any weakening of the current bonding rules. And, specifically, corporate self-guarantees (which amount to nothing more than a pledge to pay) should not be accepted. To do so would amount to shifting the cleanup risk from the mining company, where it is today, to the taxpayer. We are already seeing overburdened states with budget problems struggling to use taxpayer funds to pay for cleanup.

At a time when Enron and Worldcom scandals have rocked public confidence and demonstrated a need for much greater corporate accountability, transparency and fair dealing, the Bush Administration should reject any efforts that allow mining companies to under-report environmental liabilities or evade responsibility for paying to clean up toxic pollution from mines? Today we call on the Bush Administration to embrace its own public position by enforcing current regulations and seeking new tools to ensure that polluters pay, not taxpayers. And the mining industry should, because it's in their own interest, come forward and acknowledge its liabilities and support efforts to ensure that mines are cleaned up by mining companies, and not at taxpayer expense.

The Real Cost of Closure Lead to Higher Risk and Higher Bonds

The issues the industry faces today in regard to securing reclamation bonds can be directly attributed to the fact that for years mining companies have proposed and regulators have approved insufficient reclamation and closure plans and financial assurance amounts industry-wide. The net discrepancies between what should be secured for mine closure and what is on the books today could be as high as $10 billion or more. Although other factors are no doubt impacting the surety bond market, this is a key issue.

Progressive improvements have been made in the regulations and enforcement on these issues at the federal level and in some states. However, instead of moving forward in this direction, some are beginning to argue that the federal government should gut recent improvements to existing regulations. If the government accedes, industry could successfully avoid addressing and accounting for water pollution impacts, and could be allowed the use of so-called corporate guarantees—enabling industry to avoid corporate responsibility and shifting billions of dollars of clean-up costs from the industry to taxpayers.

Surety bonds, after corporate guarantees, have been the preferred form of financial assurance by the mining industry. The mining industry has utilized these instruments because the cost, typically limited to $5 to $15 per $1000 in value, is relatively low. However, the low cost has caused the mining industry to use financial assurances in place of actually conducting reclamation concurrently during mining (at least to the extent possible). The best means for mining companies to reduce their liability for cleanup is to simply perform the required reclamation and closure activities.

As a result, mining companies have left the cost of reclamation and closure entirely to the post-production period. There is little incentive for the mining company to conduct the agreed-upon tasks of reclamation and closure, so the use of surety bonds may actually exacerbate the problem rather than address it and in some cases may actually encourage eventual bankruptcy. The only effective means to ensure corporate accountability and that the polluter pays is to require cash or equivalent forms of financial assurance.

Industry's practice of leaving all reclamation costs until post-production has resulted in numerous environmental and financial disasters over the past 10 years that have cost taxpayers hundreds of millions of dollars. In response, the Bureau of Land Management and the states of Montana and New Mexico began requiring financial guarantees that more fully covered mine reclamation costs.

The Department of Interior's Bureau of Land Management (BLM) 3809 regulations describe the agency's requirements for mine regulation, including that of mine reclamation and closure planning and financial assurance. In an October 25, 2001 letter, Interior Secretary Gale Norton, in discussing her agency's and the Bush Administration's support for the revised BLM 3809 regulations, stated "Stringent financial guarantee requirements—the so-called bonding provisions—that will ensure that the full costs of any mine reclamation or environmental damage are borne by the mining operator, and not the U.S. taxpayer." In fact, the revised regulations do include requirements for water treatment in reclamation and closure plans, the calculation of agency oversight and contracting costs in financial assurances, and, most importantly, the elimination of corporate guarantees as an acceptable form of financial assurance. Secretary Norton and others in the Interior Department touted those measures as an example of the Bush administration's commitment to corporate responsibility. Proposals to continue or even enhance the ability to use corporate self-guarantees in response to the bonding situation would clearly decrease, not increase, corporate accountability.

Insurance companies providing surety bonds began to examine their risk exposure for mining industry guarantees as a result of the Pegasus, Alta Gold and other mining company bankruptcies and the increased evidence of higher clean-up costs and company bankruptcy risk because of the incidence of acid drainage at many mine sites long before the current so called "crisis." Evidence beginning in 1999 shows those surety bond providers began charging higher rates for mining surety bonds and reconsidered providing coverage at some mine sites and for some companies. The current "crisis" has as much or more to do with risk associated with the mining industry than anything else.

What are the real liabilities?

Table 1 (Source: data from Kuipers, J., Hardrock Reclamation Bonding Practices in the Western United States, February 2000) shows the estimated aggregate reclamation and closure financial assurance amounts for the three largest gold and copper mining companies. The third column in the table shows the estimated range of actual liability for reclamation and closure costs faced by those companies. The estimated range of potential costs was estimated by taking 60% of the existing financial assurance cost as the "Low," and estimating the "High" costs based on the sites owned by each company and professional experience in estimating costs at similar mine sites where actual cleanup has been proposed and undertaken. The "Mid" cost, based on experience at other mine sites, represents the typical cost resulting from actual cleanup determined and/or conducted by state and federal agencies in response to an abandoned or bankrupt mine cleanup situation.

As the range demonstrates, while it may be possible for the companies to conduct the actual reclamation and closure tasks for less than the cost estimated in their existing financial assurances (by deducting agency oversight and contracting costs and realizing company efficiencies), those estimates typically represent the lowest cost of all possible reclamation and closure outcomes. The actual cost may be significantly higher as history has shown that in most cases, typically because of failure to address acid drainage, actual costs are higher than the amount of financial assurance available once actual site conditions are assessed upon mine closure. If the mid cost within the range shown is the actual realized cost for reclamation and closure by the responsible state and federal agencies, then the total estimated shortfall amount for the major companies in the gold and copper industries would be approximately $4.3 billion. Taxpayers may unfortunately wind up footing that bill, or the mining pollution may be left unaddressed.

Of the amount of existing total financial assurances shown ($682 million), approximately half of the total is presently in the form of corporate guarantees (primarily at mines in Arizona and Nevada), 40% is in the form of surety bonds, and the remainder (less than 10 percent) in various forms of cash. If those corporate guarantees are not honored, potential taxpayer costs for clean-up would be even greater.

Table 1
Reclamation and Closure Liability of Major Copper and Gold Producers

Company	Reclamation and Closure Liability (all figures shown in Billions of U.S. Dollars)			
	Existing Financial Assurance	Estimated Range of Potential Costs		
		Low	Mid	High
Copper				
Phelps Dodge	$0.248	$0.149	$1.867	$3.585
ASARCO	$0.022	$0.013	$0.705	$1.397
Rio Tinto	$0.038	$0.023	$0.738	$1.454
Gold				
Newmont	$0.211	$0.126	$1.177	$2.227
Placer Dome	$0.099	$0.059	$0.226	$0.392
Barrick Gold	$0.066	$0.040	$0.299	$0.558
Total	$0.682	$0.409	$5.011	$9.612

(Source: Kuipers, J., Hardrock Reclamation Bonding Practices in the Western United States, February 2000)

Note: The figures shown in Table 1 are for mine reclamation and closure only and do not include additional liabilities for smelters, refineries and other industrial sites. ASARCO, Phelps Dodge and Rio Tinto all own major smelting and refining facilities with additional significant costs for clean-up.

Is Financial Assurance Really Necessary?

Both historic and modern mining operations have demonstrated that the mining industry has failed to adequately consider reclamation and closure requirements and costs prior to mining, and have failed to pay for those costs post-mining. The legacy and cost of abandoned mine sites is known all too well by the industry, government, and the public. We are seeing today that cleanup of a specific mine site can cost tens to hundreds of millions and often requires pollution treatment systems that will be required to operate for hundreds of years.

While the intent of regulations enforced before 2002 was to prevent a similar situation at modern mines, at an even greater scale due to their methods and size, the following examples show how that system failed. The examples demonstrate that the system failed due to both inadequate regulation requirements and inadequate enforcement.

In 1998, Pegasus Gold Corp. filed for bankruptcy protection. At the time, Pegasus owned and operated at least eight different gold or base metals mines in the states of Montana (six mines), Nevada (one mine) and Idaho (one mine). As a part of the bankruptcy restructuring, those properties deemed valuable by the company were formed into Apollo Gold, and the remainder of the mines (four in Montana and one in Idaho) were relegated to the bankruptcy court for disposal with the responsibility for reclamation and closure activities and costs left to the responsible state and federal regulatory agencies to resolve.

In Montana and Idaho, the regulators had existing financial assurance at all the mines in the form of either cash or bonds. The Zortman and Landusky mines in Montana, the world's first large-scale open pit cyanide heap leach mines, had financial assurances of approximately $80 million in face value. The state was forced to negotiate the bonds and trust fund accruals that had not yet been placed by the company prior to bankruptcy and as a result received approximately $70 million in actual cash value after negotiations, less reclamation and closure work (approximately $20 million) actually done by the mining company prior to its foreclosure. Subsequent analysis by the Bureau of Land Management and Montana Department of Environmental Quality determined that the actual amount needed for reclamation and closure will total approximately $103 million due in part to acid mine drainage pollution that will continue for hundreds of years. $103 million represents a shortfall of about $33 million that must be paid for by taxpayers.

Similarly, Pegasus's Beal Mountain mine in Montana has revealed that the existing $6 million financial assurance is inadequate. Reclamation and closure tasks required to clean up and provide water treatment in perpetuity for mine discharges are likely to cost $12 million or more, representing a shortfall in the bond amount of 50% or greater. That shortfall has been paid for by the Montana Department of Environmental Quality (DEQ) and the U.S. Forest Service, which had not predicted any long term water treatment requirements. According to Warren McCullough, Bureau Chief of the Montana DEQ's Permitting and Compliance Division, "It's not going to be something that we're ever going to be able to walk away from, ... and people should realize that no one really understands all the chemistry that occurs after reclamation begins on the pile of ore where the cyanide milling process had been used. It's a very complex thing," he said. In total, the shortfalls in Montana alone are approximately $40 million or more, which will be shouldered by state and federal taxpayers.

However, it should be noted that had Montana accepted corporate guarantees, which their regulations did not allow for, the shortfall would have been much greater (BLM did accept corporate guarantees at the time, but Montana and the federal agencies were able to rely on stricter state requirements to determine the financial assurance amounts and forms).

In the mid–1990s FMC Gold Corp./Meridian Gold Corp. sold to Arimetco Mining Co. its Nevada assets, which included the reclamation and closure liability for the closed Paradise Peak and other mines. Arimetco also owned the Yerington Copper mine, which had been operated for a number of years by others including the Anaconda Mining Company. Arimetco subsequently declared bankruptcy in 1999 and it was determined that the company lacked any assets to back its financial assurance for the Yerington and Paradise Peak projects, which not only was significantly less in amount than was actually necessary to effect reclamation and closure, but was also primarily in the form of corporate guarantees. While the State of Nevada and responsible federal agencies (primarily the Environmental Protection Agency) have yet to determine how to address reclamation and closure at these sites (the Yerington mine has been proposed as an EPA Superfund site), it is probable that the financial assurance shortfall will be at least $10 million or more and could be more than $100 million (site investigations are currently underway). The State of Nevada's regulations, because they result in underestimation of reclamation and closure costs and allow financial assurance in the form of corporate guarantees, exposes state and federal regulators and taxpayers to an unreasonable degree of risk and actually serves to discourage corporate accountability.

These experiences highlight the consequences to taxpayers and the environment from inadequate financial assurances, combined with the recent spate of bankruptcies and incidences of inadequate reclamation and closure plans throughout the Western U.S. Insufficient money means less protection for communities, water, wildlife, etc. Other similar examples exist in South Dakota at the Brohm Mine owned by bankrupt Dakota Mining Company, the Cunningham Hill mine in New Mexico (also owned at one time by Pegasus), the Grouse Creek mine in Idaho, and Illinois Creek mine in Alaska to name just a few.

So far these have been mostly limited to small and medium size mining companies, with a limited aggregate liability. However, the situations leading to and resulting from these bankruptcies are highly similar to those that are now occurring with some of the largest copper mining companies with extensive operations in the U.S. and potentially additional gold mining companies.

We now have an opportunity to learn from past problems and ensure that regulators require strong corporate responsibility at current and future mines through enforcement and strengthening of financial assurance requirements. The Bush Administration should not now turn its back on the taxpayers or the communities that have been burdened by corporate irresponsibility and inadequate regulatory controls.

Financial Assurance—Where does bonding fit?

Bonding, or more correctly, "surety bonding," is just one of many forms of financial assurance that are recognized by the various state and federal agencies. The types of financial assurance and their various forms can be listed in three general categories as follow:

1.Forms of Cash or Equivalent
2.Surety Bonds
3.Corporate Guarantees

Forms of cash or equivalent are the preferred form of financial assurance since they are the most secure and are readily available in the event they are necessary. The regulatory community, much of the financial community, and public interest groups agree that these forms of financial assurance are the best protection against taxpayers paying for the cost of clean-up. Where closure costs are long-term (in many water-treatment situations, costs are "in perpetuity"), forms of cash are the only practical way to provide a financial guarantee. Forms of cash include irrevocable letters of credit (bank guarantees), CD's, and trust funds.

Surety bonds are essentially guarantees from an insurance company or its equivalent for the performance of the work. Surety bonds are generally assumed to be applicable to low-risk circumstances where the surety bond company, in the event of forfeiture, can expect to be able to hire another contractor to perform the work in the event the original contractor defaults on the job. Surety bonds are for a set amount of money and have the option of being cancelled or renewed on a regular (typically yearly) basis. Although surety bonds are considered an acceptable form of financial assurance, experience has shown that the amount of payout is likely to be reduced by 10–20% or more as a result of seemingly inevitable negotiation by the surety company.

Corporate guarantees are essentially self-guarantees or more accurately pledges made by the mine or mining company, or parent company (typically also a mining company). Although corporate guarantees are sometimes accompanied by financial tests as a measure of qualification, in some states the financial tests amount to little more than the existence of a business license. In cases where financial tests do exist, experience has shown that companies that have gone bankrupt continued to meet those tests right up to the moment of their filing. Corporate guarantees, although allowed in some states, should not be considered an acceptable form of financial assurance since any payout at all is doubtful, and replacing a corporate guarantee with another form of financial assurance once a company experiences financial difficulty is problematic. The evidence is compelling that corporate guarantees do not protect the taxpayer.

Principles of Financial Assurance

While the government and regulators need to work with industry and public interest groups to resolve the short-term and long-term mine reclamation and closure planning and financial assurance issues, certain principles of corporate responsibility and accountability must be strictly adhered to in formulating a response to the current situation. These principles include the following:

- Enforcement of existing state and federal laws that ensure against taxpayer cost for clean-up of mine pollution where already established (such as in the revised BLM 3809 rules and Montana statutes and regulatory practice), and improvement of other state and federal laws as necessary to provide equivalent protection to all state and federal jurisdictions.
- Polluter provides a cash or equivalent financial guarantee; no corporate or third party guarantees or transfer of risk to taxpayers.
- Financial assurance should cover the entire cost of reclamation and closure including source control, surface reclamation, contaminated water capture and treatment, and monitoring, with allowances for agency oversight and management should it become necessary.

By adhering to these principles the mining industry and government can ensure that the responsible corporation and its shareholders shoulder the burden of liability created by their activities, and that adjacent landowners and the public at large can be assured that no significant harm will occur to their health, natural resources or quality of life as a result of corporate malfeasance.

Mining Industry Response to Surety Bond Market

While some mining companies have indicated difficulty obtaining surety bonds and voiced concerns about their ability to provide alternative forms of assurance that are considered acceptable, there are ready solutions to the problem. Many companies, even facing difficult financial situations, have managed to provide both increased and acceptable financial assurances. For example, Stillwater Mining Company in Montana recently saw its financial assurance requirement for its East Boulder platinum group metals mine increase from about $4 million to nearly $12 million. Kennecott Greens Creek Mining just secured an $18 million letter of credit to fill out its $24.4 million surety obligation for the Greens Creek mine in Alaska (the remainder of the surety is a $6.4 million surety bond already in place). Despite financial difficulties and the inability to obtain a surety bond, these companies agreed to put up letters of credit for the amount necessary. Similarly, other companies such as Placer Dome and Barrick Gold, the second and third largest gold producers in the U.S. respectively with significant operations in Nevada and other western states, have reportedly experienced little difficulty in retaining their existing surety bonds or replacing them with forms of cash or its equivalent.

The companies complaining the most about the current situation are the largest companies with the greatest amount of unrealized liability associated with the cost of clean-up. These companies are responsible for some of the largest modern mining sites that require extensive reclamation and closure measures, and at this time the costs for those measures are either drastically underestimated or have been largely ensured by corporate guarantees. These costs are a direct result of the companies" own poor environmental practices during operations and the lack of environmental controls to encourage the companies to have conducted their operations differently.

Does the Industry Recognize This Problem?

The present actions of the U.S. mining industry suggest that it neither acknowledges nor is prepared to address the problem of inadequate reclamation and closure plans and financial assurance. However, the world-wide mining industry has specifically recognized it as a priority issue. The world mining industry has been undertaking a concerted project to address the specific steps that the industry needs to take to change mining/minerals related activities to the broader societal trend towards sustainable development. Towards this end the mining industry formulated the Mining, Minerals and Sustainable Development (MMSD) process, which recently culminated with the Global Mining Initiative conference held in Toronto, Canada. It should be noted that all the major copper and gold mining companies doing business in the U.S. participated in the MMSD process and conference.

By the end of the process priority issues and actions emerged, with the Mining Legacy Issue, that of dealing with reclamation and closure of both historic and modern mines, identified as a top priority. Among the final recommendations was to enhance efforts to address the legacy of past mining and mineral activities, and to strengthen the basket of legislated rules, market incentives, and voluntary programs to prevent the same problem from continuing into the future. A key feature of the recommendations was adherence to the principle that the "polluter pays" all costs for reclamation and closure. The process also recognized that, in order to ensure the government and taxpayers do not inherit these costs, financial guarantees such as cash or bonds are necessary to ensure that they will comply with reclamation and closure plans. By requiring real financial guarantees, the specific obligations for mine closure will be carried out; costs will be internalized, and economic efficiency will be promoted. The report concludes that "Without such surety, the legacy of abandoned sites and their attendant problems are certain to grow" (from Final MMSD report, pp 408–409).

The present use of corporate guarantees is in stark contrast to the priorities and actions identified by the mining industry as a whole to address what it considers to be a key issue to its future survival as a business sector, and also all too often fails to protect taxpayers, or communities faced with mining pollution.

Conclusion

The so-called surety bond "crisis" is related to the much larger and significant issue of underestimated and unguaranteed hardrock mine reclamation and closure costs. The lack of corporate accountability has resulted in a potential risk to taxpayers for mine cleanup of billions of dollars for modern mine sites. This has resulted both from a lack of adequate regulation as well as weak enforcement of existing regulations. At a time when corporate accountability is being seriously questioned, and when increased costs for and unavailability of surety bonds are a perfectly logical free market response, weakening existing regulations and accepting self-guarantees appears to be highly inappropriate.

Serious efforts should be undertaken to address reclamation and closure planning and financial assurance estimation to avoid taxpayers paying for clean-up at the nation's mine sites. Regulations such as the revised BLM 3809 rules, which were intended to address and remedy this situation, should be retained and enforced, rather than weakened as has been suggested by the mining industry and being considered by the Bush Administration. The solution involves not weakening protections against corporate irresponsibility. Instead, the government should work with the industry and other stakeholders to ensure that adequate financial guarantees are in place so that the industry is able to pay for mine pollution clean-up and spare taxpayers the cost.

Mrs. CUBIN. Thank you. I will start my questioning with Mr. Jeannes. Does Glamis use professionals to estimate reclamation and closure costs?

Mr. JEANNES Yes, certainly professional engineers on staff and in some cases third-party independent consultants. But in all cases, the regulatory agency is the one who ultimately determines the amount of the bond, not the company.

Mrs. CUBIN. Would you comment on Glamis' experience with reclamation and planning costing? Do you find it difficult to accurately estimate reclamation and closure costs and is it also your practice to do reclamation as you move along in a site?

Mr. JEANNES Yes. We call it concurrent reclamation and absolutely, we do that at all of our mines. We actually have quite a bit of experience at reclamation. Because Glamis operates only heap leach oxide minutes above the water table, no pit lakes, no acid drainage, it is quite simple to estimate the costs of reclamation because you are simply talking about the time of rinsing a heap and then of moving a certain number of yards of dirt and then reseeding and revegetating.

So, we have done a lot of it and we think we are very good at estimating the cost, yes.

Mrs. CUBIN. How come this is not practiced in the industry? Isn't' that what is required?

Mr. JEANNES Certainly in my experience in Nevada, everybody does concurrent reclamation. Because most of the operations there are fairly mature, everyone has a pretty good idea of the cost of doing it.

Mrs. CUBIN. In Mr. Kuipers' testimony, in his written testimony anyway, it says that a mine site may disturb 10,000 or more acres, which is about 15 square mines of land. How many mines in the

United States do you think disturbs 15 square miles of land at any given time?

Mr. JEANNES I am really not qualified to say. I can certainly say that ours are many magnitudes smaller than that. I can't imagine that even Gold Striker, one of the big ones, is disturbing that much ground.

Mrs. CUBIN. Could you comment on that, Mr. Kuipers?

Mr. KUIPERS. Yes, I would. Mostly copper mines, major copper mines, for example, the Chino and Tyrone Copper mines owned by Phelps Dodge in New Mexico. The Kennecott operations, or I should say the Rio Tinto operations in Utah and a number of different mining operations in Arizona do have mine sites that large or larger. There are at least ten in the U.S. that I am aware of.

Mrs. CUBIN. I have seen the one in Utah and it certainly didn't look like a 15 square mile site.

Mr. KUIPERS. I have the figures and it is over 10,000 acres.

Mrs. CUBIN. I think we will ask for those figures and we will also get that information from the companies, actually, how big their footprint is. We thank you for that.

Lastly, Mr. Jeannes, what is currently the general practice regarding reclamation and closure in the mining industry.

Mr. JEANNES That is very strong. As I said, everybody does concurrent reclamation. It makes financial sense in addition to being the right thing to do because you don't want to be hit with a large and time consuming effort to close a mine when you are not reporting revenues at the end of production.

Mrs. CUBIN. That is one of the problems that the long tail on the surety bonding doesn't take into consideration, that reclamation has gone on and part of that obligation also, I think, speaks to the problem that has been addressed on the other side of that, "appropriate bookkeeping" and how the liability of reclamation isn't included in the books and so the liability isn't the same as you go because you are cleaning up as you go.

Mr. JEANNES Well, it is certainly included in our books and that accrued reclamation liability changes every year as we continue to do work. I would say that one of the problems is that it is so difficult to get a bond modified or released, when you do finish an amount of work and want to go in to get that changed, your surety would love to be able to see you do that because that would take them off the hook for some new amount of work that has been completed to the satisfaction of the agency.

But it is such a difficult process that I am afraid many operators simply wait until the end of the mine to do it all at once.

Mrs. CUBIN. Mr. Done, I referred to this problem earlier, but I would like you to go into an explanation about the bonding requirement for lease by application program.

Tell me everything you know about that and especially, what is the risk of the Federal Government in requiring that bonding?

Mr. DONE. Well, there is a big difference between an LBA type bond and a reclamation bond. The release by application bond is going to be a bond which guarantees the company is going to pay for the coal that they are leasing.

The company will pay 20 percent down and then on an annual basis for the next 4 years, make another payment of the 20 percent. So that within 4 years you have purchased the lease.

Mrs. CUBIN. Could I interrupt for just a second?

Mr. DONE. Sure.

Mrs. CUBIN. So, within 4 years you have purchased the lease. Where along that timeline does production actually start, before the 4 years are up or after the 4 years are up?

Mr. DONE. In most cases, I would believe it would always be before the 4 years are up. You may not produce, but you would start developing. As soon as you get the lease, you are going to start developing that as part of your game plan, at least that has been part of our practice.

On a reclamation bond, we have talked about the tail is very long and surety companies are not prepared at this point in time to go out that long. The problem we had on the lease bond was very simple. The terms of the lease indicate that if the mining company defaults, the entire amount of the bond defaults with it. This, by the estimation of our surety underwriters unduly enriches the government, point blank.

Let me give you the example that I have been using. In Kennecott's situation, we purchased the coal for about $380 million; $75 million down and $75 million more four more times.

Mrs. CUBIN. And half of that went to the Federal Treasury and half of that went to the State Treasury.

Mr. DONE. I believe that is correct. Now, the issue becomes, let us just make the assumption that Rio Tinto goes away in that period of time, like a Worldcom. What happens is the surety company pays for that coal, but they don't get the coal because they are not a qualified coal buyer.

The government gets the money, gets the lease back, and then can re-lease that coal. Now, they may not re-lease it again for $380 million because you have taken a Rio Tinto out of the equation. But they are going to lease it for some fair market value at that time based on who can bid.

But the Federal Government therefore will get $380 million from Kennecott and its surety, plus whatever they're going to get from the new guy. The surety underwriter is saying unless that rule is changed, we will not write that type of surety bond again because that is a default, penalty, punitive bond. All they are asking is that the Federal Government at the end of the day not be put in a position that it makes them better off than if Kennecott had paid for the $380 million up front. There are ways to do that.

Mrs. CUBIN. Well, I wonder if that is not maybe where—if that isn't where the breakdown comes with Mr. Inslee's assumption that we are asking for a weakening of bonding for reclamation when, in fact, what we do need to do is something about this unreasonable enrichment of the Government .

Tell me what effect that that will have on future leases.

Mr. DONE. Great question. In the fall of 2003, Kennecott and other mining companies will be bidding on a tract that is fairly close to the tract that was just awarded. If we go into this bidding process knowing that we will not be able to secure a surety bond and our competitors go into that also with the same background information, I firmly believe that each company will have to assess the risks associated with securing that lease and the risk would be tying up corporate assets, similar to what we have done on the North Jacobs Ranch.

Ultimately, without putting probability on it, you could have a serious reduction in the amount that a coal company was willing to pay for coal, which does have, any way you want to cut it, a severe impact on the Federal economy and the State economy where that coal is coming from.

Mrs. CUBIN. In Mr. Kuipers' testimony—and, believe me, Mr. Kuipers, I am going to give you a chance to respond to all of this—he says in his written testimony that based on professional experience, Rio Tinto may be liable for nearly $1.5 billion in mine closure costs.

I asked Mr. Jeannes this question. I will ask it of you. Does Rio Tinto use professionals to estimate these costs? And how do your estimates differ from Mr. Kuipers'?

Mr. DONE. I will tell you, I can answer half of that question. The half I can answer is, yes, we do use professionals both internal and external to estimate our reclamation responsibilities. And we record our reclamation responsibilities in our financial statements as an accrued liability on an annual basis, adjusted annually, and our auditors are involved in the process of signing off on that.

Can I tell you the difference between Kennecott's or Rio Tinto's numbers and Mr. Kuipers'? I can at a later date. I don't have that information in front of me at this time.

Mrs. CUBIN. We will ask you to provide that to us in written questions and follow-up.

[The information referred to follows:]

Dear Chairman Cubin:

Thank you for allowing me to testify before the Energy and Mineral Resources Subcommittee on behalf of Rio Tinto, Kennecott Energy and Coal Company and the National Mining Association. I wanted to follow up regarding a few questions that you asked during the hearing.

As you know, Kennecott Utah Copper Corporation (KUCC) is a copper operation located near Salt Lake City, Utah. KUCC owns approximately 95,000 acres of which 7,700 are associated with the open pit mine and the mine's related waste dumps, and 9,700 are associated with the tailings impoundment. KUCC has established a reserve for reclamation costs of several hundred million dollars and over the last several years has spent in excess of $200 million on environmental cleanup.

Again, thank you for allowing me to testify. If you need any additional information, please do not hesitate to contact me.

Regards,

Ken Done
Director Treasury Services
Rio Tinto Services, Inc.

Mrs. CUBIN. Mr. Kuipers, would you like to comment on that?

Mr. KUIPERS. Yes, I would. When I say that there is a potential higher liability, it is primarily associated with acid drainage. I would like to point out that the testimony of the gentleman from Glamis I think is very accurate. There are companies out there that are doing a good job. They don't mine below the water table. They haven't been involved in mining sulfides. They do concurrent reclamation. That is not the case with many of the copper mining companies and at least some of the gold mining companies that we are talking of today.

In the case of Rio Tinto's Bingham Canyon operation, my records show that there is a total disturbance area of approximately 27,000 acres, and their existing reclamation assurance amount for those properties in combined total is about $36 million.

Recently, I was involved at the Chino Mine in New Mexico working out a cooperative agreement with the New Mexico State Governor's Office, the Phelps Dodge Mining Company, and others, and we came up with a $385 million number for a mine of about 12,000 total acres. These two mines have many similar characteristics, and the difference is that the assessment in New Mexico included the cost of acid drainage which resulted in a requirement of water treatment in perpetuity, which, of course, is one of the things that are affecting the availability of bonds.

But the need for long-term assurance—and, really, the only way you can do it is in the form of cash—is very much there. The actual amount of these liabilities I just based upon an average amount typical for increases in the cost for acid drainage. It may be even higher than what I have estimated.

Mrs. CUBIN. Back to you, Mr. Done. How long does it usually take for OSM to release a reclamation bond once the mining is complete?

Mr. DONE. Well, right now, we are having difficulty getting anything released. It has to do with the fact that when many of the bonds were issued, it was for certain requirements that existed at the time when the bond was issued. And as those regulations have changed and now acid mine drainage has become a problem, there has been a reluctance to release bonds. And I am not privy to exactly the numbers for the entire mining industry, but for the Kennecott family, it has been an awful long time since we had a release of a bond, even though reclamation has been completed for the work that was anticipated when a bond was originally issued.

Mrs. CUBIN. So it would appear that shortening that time period without jeopardizing the purpose of the bonding is pretty impossible?

Mr. DONE. There is an impasse on that issue, yes.

Mrs. CUBIN. In his written testimony—and, again, I hate—my mother always taught me you don't refer to somebody when they are sitting in the room. It reminds me of during the Watergate hearings, I think it was, where they said, "What do you think I am, a house plant?" Anyway, so I hate to be asking these questions about your testimony, but I do want to have all sides on the record, so I will get back to you again, Mr. Kuipers.

In his written testimony, he argues that the mining industry is not facing a crisis because many companies, including Rio Tinto, continue to secure bonds for their operations. I understand that recently Rio Tinto was unable to obtain bonding for a talc operation in Montana and was forced to post $10 million in cash.

Would you please comment on the current problem that your company is having with that operation in Montana?

Mr. DONE. Yes. In the Montana operation, Luzenac, one of our companies, had a $10 million plus bond that was underwritten by a surety company, and the surety company elected to leave the business, and they asked our operation, Luzenac, if they could get off the bond, and they also asked the State government if they could get off the bond.

At the time they asked, our Luzenac people were not aware, as maybe they should have been, of the crisis, and so they elected to get off that bond without having a back-up bond in place.

We have been unable to secure a bond for that operation, and we have also been unable to secure a letter of credit at this time due to the language that has been required by the State of Montana for a letter of credit. We have been unable to find a bank that would be willing to write that letter of credit.

We are working with the State of Montana and hopefully we can come to some type of resolution very quickly for a letter of credit. But we are unable to find a bond from any underwriter up there.

And let me add one other thing. That $10 million in the State of Montana has been posted for several months now and is non-interest-earning to the mining company. So we have handed them $10 million plus in cash. We are getting nothing other than we continue to mine from that. The risk to the taxpayers of the State of Montana to reclaim that operation has not changed.

Mrs. CUBIN. Thank you very much.

In your testimony, Mr. Kuipers, on page 12, you refer to this so-called surety bond crisis, and you have "crisis" in parentheses. Does that mean that you don't believe the surety bond market is in crisis?

Mr. KUIPERS. No, I don't believe this is a crisis, though the mining industry is portraying it to be. I have been involved in the mining industry for over 20 years, and I think at least 10 years ago, if not long before that, most of the mining companies knew this situation was going to happen sooner or later. Many companies changed their practices. Many companies began accruing funds. Many companies looked forward to this situation. Others didn't.

I think the crisis is being called by those companies who really are in a situation that they haven't taken care of the reclamation closure obligations, and I don't believe they have an intention to.

Mrs. CUBIN. On page 4 of your written testimony, you said that at a time when Enron and WorldCom scandals have rocked public confidence, the Bush administration should reject any efforts to underreport environmental liabilities.

Are you saying that mining companies are engaging in fraud to hide environmental liabilities on their balance sheet? And if so, what evidence do you have of that?

Mr. KUIPERS. I don't know that I would call it fraud because I am not an attorney and I don't know how to actually define that. But I can tell you that the way mining companies are reporting their potential liabilities appears to be far short of what is real. Take Phelps Dodge, for example. Their current 2001 annual report shows that they have an accrual of approximately $135 million in reclamation liabilities. At the same time, they go on to state that they are recognizing the State of New Mexico has looked at their Chino and Tyrone Mines and recognized an aggregate potential probable reclamation closure amount of approximately $800 to $900 million.

Now they aren't saying anything on their books anywhere about needing to spend $800 or $900 million over the next ten or twenty years. All they say is the costs may go up, may go up, when in fact their books, I believe, should show that there is a certainty that their reclamation and closure costs will rise substantially.

Mrs. CUBIN. Would you respond to that, Mr. Done?

Mr. DONE. I can't respond as to what Phelps Dodge is doing and what their books say, but I can tell you like both of us have said earlier, we do an annual estimate of what our reclamation obligations are and it is recorded in our financial statements and fully disclosed.

Mrs. CUBIN. Mr. Jeannes?

Mr. JEANNES I don't know the Phelps Dodge situation, but I could probably offer that it might be the difference between the third party contractor costs of clean up that might be assessed or anticipated by the State versus Phelps Dodge internal costs which are usually about one third, in our experience at least.

When the BLM sets up a bond, they have to base it on third-party contracted costs in the event that we are not around. Our actual costs to clean up are generally about one third of that amount.

Mrs. CUBIN. Thank you.

Mr. Done expressed the desire to make suggestions to help solve this problem. So, Mr. Kuipers, I am going to start with you, but since you don't think there is a problem, maybe you don't have anything to say.

Mr. KUIPERS. Well, I do have quite a bit to say. It is not that I am saying there isn't a problem. There certainly is a problem, but the problem is not just the surety bond situation. It is the overall situation facing the mining industry and needing to deal with reclamation and closure costs.

I just spent the last two and a half months in negotiations representing a public interest group in the State of New Mexico with the Governor's office, with the Mining and Mineral Division, the Environment Department and Phelps Dodge, trying to come up with a solution to their existing problem.

The company has refused to put up any forms of cash or other guarantees and instead wants a very, very large corporate guarantee. I can tell you I told my client who represents the public interest in the State and to the agencies in the State, that situation is not acceptable.

So, I think there are ways to work at this. We are trying to work closely with the mining companies. Those companies are willing to discuss this matter and work creatively. We are looking at things like collateral, getting things where they can go ahead and put their land up, their water up to an insurance company and use that as part of the bonding mechanism.

I think there are a number of different ways to address this problem. What we can't do is put together a situation where we go backwards and where we are beginning to address the problem over the last five or 10 years, we now go back and act like there isn't a problem. That would be a great failure.

Mrs. CUBIN. Mr. Done, would you suggest what regulators and Congress should examine and your suggestions to help solve this problem?

Mr. DONE. I appreciate the opportunity to address this is. I think that the formation of this task force by the Department of Interior is a great idea. It needs to have input from both the mining industry, from citizens, from the surety industry to see if there is some type of solution we can come to collectively that meets the needs of protecting the taxpayer.

I don't think any group, including myself or the National Mining Association will at this point in time tell you we have done any more than basically kicked over the first stone to try to come up with ideas. So, there are lots of things and lots of discussions that need to take place.

But we have come up with some general areas that we think merit some additional consideration.

The first is, we need to establish and maintain reasonable bond amounts. We also need to make sure that once a bond is written, that if sureties are willing to write a bond, that the rules it was written under need to apply throughout the duration of that bond. The continual adding of new requirements for release of the bond after the bond is written is going to provide a barrier to keep the surety industry out of this business.

We need to consider how we can find a way to impose some time limitations onto these bonds. That would entice the re-insurance business to maybe take a look back at this business. It also would be nice if the Department of Interior would issue some type of a policy statement to the field encouraging timely release of reclamation bonds. This would show the surety industry a positive step that they can eventually get their bonds back.

The last thing I would like to address is that there may be mechanisms outside of surety bonding that should be considered. Self bonding is an acceptable alternative under current regulations.

However, some of the government entities that are in charge of allowing self bonding have chosen not to accept it, even though it is allowed in some cases.

I would hope that if we do get to a position where we could look at the strength of a company and maybe even compare it to the strength of maybe an insurance company, we may find out that some mining companies are just as strong, if not stronger, than the surety companies that are providing support.

I would hope that both domestic and foreign parents would be allowed to self bond.

Another idea is to standardize the acceptance of letter of credit and standardize the types of letter of credit and the form of the letter of credit so that each government entity would not set up their own type of letter of credit form.

It is very difficult to go to a bank with numerous different forms and say, can you provide it here? They may be able to. Then you go there, "No, we can't write that."

If we could standardize both bond forms and letter of credit forms, it may be beneficial to enticing the surety industry and enticing banks to provide financial insurance.

The last thing I would like to address is that there may be a way, instead of saying it is an all or nothing, it is for one particular site to say you have to provide me a reclamation bond, maybe it can be a combination, maybe some surety bonding, maybe some letters of credit and maybe some self-bonding so that the government is not completely exposed to a self-bond, but also the surety industry realizes that the company has got a stake in this also.

Thank you very much.

Mrs. CUBIN. Thank you.

Mr. Jeannes, do you have anything to add to that?

Mr. JEANNES Nothing in addition to what I have already said or what Mr. Done provided. Thank you.

Mrs. CUBIN. Thank you. One last question, I meant to ask this earlier on, Mr. Done. I asked Mr. Fulton and he is going to provide written information later.

Do you know how the Interior Department goes about selecting which leases will be included in the lease-by-application program?

Mr. DONE. That caught me so off-guard because I thought everybody had to post cash or sureties. I did not know there was some mechanism that maybe you didn't. I was under the LBA Program where those rules are very firm and that you either post a surety or you post case or U.S. Treasuries. There was no option available other than that.

If I am unaware of those regulations, I need to be informed.

Mrs. CUBIN. This is the first one I have ever heard of, not that I know in-depth the practices or in great depth. But I have not even heard of this happening before.

I had to check with staff to make sure. It isn't common practice. I just wondered how that selection was made. We will inquire of the department about that as well and then you will want to read the record.

I want to thank all of you for your valuable testimony and taking the time to come and helping the Committee out. I do look forward to having some good results from the task force to try to see if we can protect our environment to the utmost and still be able to produce the rich resources that we were given by God.

So, thank you very much.

The record will be kept open for 10 days in case any member of the Subcommittee has further questions of the panel. Having no more business, the Subcommittee is adjourned.

[Whereupon at 11:53 a.m., the Subcommittee was adjourned.]

[The prepared statement of Mr. Rahall follows:]

Statement of Hon. Nick J. Rahall, a Representative in Congress from the State of West Virginia

This is indeed a timely hearing and I would like to thank the distinguished gentle lady from Wyoming for scheduling it.

In my view this hearing is timely for two reasons. First, it is providing the public with an opportunity to learn about yet another Administration task force that has apparently been operating behind closed doors in relative secrecy.

This task force on an alleged "bonding crisis" has met with industry, has solicited industry's input, but has not met with representatives of public interest or environmental groups. Whether or not this task force will get around to soliciting input from entities other than industries the Interior Department regulates remains to be seen.

I would simply hope that these consultations occur prior to the task force sending any recommendations it may make to the Government Printing Office.

This hearing is also timely because the topic is fundamentally about corporate responsibility, which is an issue that is very much in the news these days.

A cynic would perhaps suspect that a "bonding crisis" may be used as an excuse to rollback environmental regulations governing the mining, oil and gas industries starting with what is left of the '3809' regulations for hardrock mining on federal lands.

For my part, I would prefer to take the view that as a result of the changes taking place in the surety industry, the mining industry would become even better corporate citizens, more fully internalize the costs of conducting its business, and vow to no longer leave a legacy of acidified streams and tortured landscapes for future generations to cope with.