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Testimony before the

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Subcommittee on Energy & Mineral Resources

The Non-Availability of Surety Bonds or Other Financial Guarantees for Mining

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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 underlined and material to be removed **[bracketed bold]**:

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.

Sincerely,

Steven C. Borell, P.E.

Executive Director

enclosure - APPENDIX A

cc: Senator Ted Stevens

Senator Frank Murkowski

Congressman Don Young

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**.

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