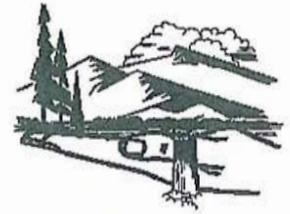




Department of Environmental Quality

To protect, conserve and enhance the quality of Wyoming's environment for the benefit of current and future generations.



Todd Parfitt, Director

Matthew H. Mead, Governor

February 22, 2016



HAND DELIVERED

Jeffrey Fleischman
Chief, Denver Field Division
150 East B St. RM 1018
Casper, WY 82601

RE: Ten Day Notice related to Arch Coal Inc. and its Subsidiaries' Mining Operations in Wyoming

Dear Mr. Fleischman,

On January 21, 2016, you sent the Wyoming Department of Environmental Quality (DEQ) a ten-day notice (TDN) related to the Wyoming operations of Arch Coal, Inc., and its subsidiaries. In that correspondence you stated that the Office of Surface Mining Reclamation and Enforcement (OSMRE) has reason to believe DEQ may be allowing Arch Coal Inc., Thunder Basin Coal Company, LLC, and Arch Western Resources, LLC (collectively Arch) to operate in violation of the Wyoming Approved State Program. TDN at 4. You stated that OSMRE was responding to a Citizen's Complaint, and that OSMRE

believes it is most appropriate to forward the Citizen's Complaint to your office via the Ten Day Notices (TDN) process in order to provide the opportunity for you to more fully respond to the allegation that the 2015 analysis done by your office no longer reflects the current self-bond eligibility of the company and that the self-bonding requirements of the approved State Program are violated because the guarantor's assets are being used by the parent company as collateral for secured corporate debt.

TDN at 2. Moreover, you indicated that "OSMRE has reason to believe that [DEQ] may be allowing Arch to operate in violation of the Wyoming Environmental Quality Act (Wyoming Act) and [DEQ] Coal Rules and Regulations by allowing Arch's Wyoming surface mining operations to continue to extract coal while failing to meet the criteria to qualify for self-bonding." *Id.* at 4. You further stated that DEQ's "response to the complaint and TDNs may address the bankruptcy petition(s) in relation to the issues raised in the complaint and TDNs, if warranted." *Id.* at 2.

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In response, DEQ will show that it properly responded to the Citizen's Complaint in the first instance. In fact, DEQ's response was consistent with OSMRE's previous finding that subsidiary companies like Arch Western Resources met the requirements for self-bonding irrespective of the financial condition of their parent corporations. DEQ's response was also consistent with OSMRE's pronouncement that DEQ's treatment of subsidiaries, including specifically Arch Western Resources, complied with Federal and state laws. OSMRE, like DEQ, was fully aware of the financial arrangements outlined in the Citizen's Complaint, before December 2015. However, when DEQ attempted to obtain guidance from OSMRE in June 2015 on the issue later raised in the Citizen's Complaint, OSMRE refused to discuss the issue with DEQ. Despite that disengagement by OSMRE, DEQ's determination in September 2015 that Arch Western Resources qualified for self-bonding complied with Chapter 11 of the Land Quality Division rules, and the Citizen's Complaint did not provide a good reason to revisit that determination.

Subsequently, Arch Coal and its subsidiaries, including Arch Western Resources, filed a voluntary petition for relief in bankruptcy court. In response, DEQ has taken a number of appropriate actions authorized under Wyoming's program to address the violation alleged by OSMRE. DEQ's actions have ensured that the public has not incurred one dollar in reclamation liability for Arch's operations in Wyoming. At the same time, not one miner has been put out of work as a result of DEQ's actions. Reclamation continues at all seven sites on schedule and there has been no harm to the environment, public health, or public safety. Nor will there be any harm because of Arch's bankruptcy as DEQ retains the right to take all appropriate enforcement action against the operator. If approved by the court, the agreement between Wyoming and Arch provides substantial additional security for Arch's reclamation obligations and a commitment that upon exiting the bankruptcy Arch will post substitute bonds sufficient to cover the full amount of its reclamation obligations in Wyoming. These substantial steps towards full compliance are appropriate "other actions" and establish "good cause," and therefore, OSMRE should find that no further action on the TDN is necessary or appropriate.

BACKGROUND

DEQ and OSMRE began grappling with the issues of off balance sheet contingent liabilities and the relevance of parent subsidiary relationships well in advance of the Citizen's Complaint and bankruptcy at issue. In fact, on February 9, 2015, OSMRE issued a "Self-Bonding Fact Sheet" describing its recently completed review of self-bonding amounts and the eligibility of several mining companies operating in Wyoming. In that Fact Sheet, OSMRE stated that "The pertinent Regulatory Authority (OSMRE for Federal Programs or States), evaluate qualifications for self-bonding on a regular basis—normally

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annually. OSMRE also periodically reviews self-bonding as a topic in the oversight process.” OSMRE Self-Bonding Fact Sheet (Feb. 9, 2015). OSMRE went on to state:

- OSMRE reviewed the aggregate self-bond amounts for Peabody’s mines in the West and Nationally. The self-bond guarantor is Peabody Investments Corporation, and they meet requirements for self-bonding.
- OSMRE reviewed the aggregate self-bond amounts for Arch Coal’s mines in the West and Nationally. Our review indicates that Arch Coal mines only self-bond in Wyoming. **The self-bond guarantor is Arch Western Resources, LLC, and they meet requirements for self-bonding.**
- **While it may be true that both Peabody Energy Company and Arch Coal, Inc. do not meet the requirements for self-bonding, they are not the guarantors for their mines’ self-bonds. There are subsidiary companies in both instances that do meet the requirements for self-bonds, and are the guarantors. This practice is in full compliance with Federal and State laws.**

OSMRE Self-Bonding Fact Sheet (Feb. 9, 2015) (emphasis and underline added).

As is apparent, from the fact sheet, OSMRE, like DEQ, took the position that only the financial condition of the operator or guarantor matters for purposes of determining eligibility for self-bonding. OSMRE also specifically concluded that Arch Western Resources, LLC, met the requirements for self-bonding. This was true despite the fact that Arch Western Resources had guaranteed certain obligations of Arch Coal more than a year before, on December 17, 2013, as set forth in a Form 8-K filed with the Securities and Exchange Commission by Arch Coal.

Even after concluding that Arch Western Resources was eligible for self-bonding, OSMRE conducted an audit of DEQ’s self-bonding program on February 10, 2015. Representatives from OSMRE met with Deanna Hill and Kimber Wichmann from DEQ. They reviewed DEQ’s self-bond files and calculations for Arch Western Resources, Alpha Natural Resources, Peabody Investments Corp, and Cloud Peak Energy. They spent most of their time reviewing DEQ’s calculations, ratios, and spreadsheets. The OSMRE representatives commented positively on the expertise of the people conducting the bond reviews in Wyoming. They said that Wyoming was far ahead of other states and that the self-bonding program was on track. While OSMRE refused to issue specific written findings and conclusions from the audit, in late February 2015, an OSMRE representative

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advised Alan Edwards of DEQ that OSMRE had no issue with the way Wyoming calculated, documented, and ran its self-bonding program.

Later in 2015, DEQ reviewed Arch Western Resources self-bonding eligibility again. As part of that annual review, Ms. Wichmann reached out to Stephanie Varvell from OSMRE on June 9, 2015, to inquire about attending an upcoming call with OSMRE personnel where self-bonding by subsidiary corporations would be discussed. That call was scheduled to take place on June 17, 2015, and in advance of the call, Ms. Wichmann sent Ms. Varvell an email asking for guidance on a number of self-bonding issues. Ms. Wichmann wrote:

I am wondering if there has been discussion of how financial subsidiaries as guarantors are viewed by OSM in relation to self-bonding. Listed below is a summary of the issues I am seeking guidance upon.

- **Is there any OSM guidance regarding consideration of a subsidiary's legal commitments/obligations that do not appear on the subsidiary's financial statements such as the balance sheet?**
- Is there OSM guidance on how OSM provision CFR 30 Ch. VII Statute 800.23 (b)(4) that allows unaudited data and how that provision interacts with CFR 30 Ch. VII Statute 800.23 (g) that states if at any time the criteria if not satisfied alternate form of bond is necessary?
- **Is there OSM guidance on what, if any, consideration needs to be made of the parent entity's financial status when evaluating a subsidiary's qualifications to be a self-bond guarantor?**
- Is there OSM guidance on the recovery position of a self-bond that has a subsidiary as the guarantor should the parent entity declare bankruptcy?

Email from Wichmann to Varvell (June 12, 2015) (emphasis added).

The call occurred as scheduled, but OSMRE's representatives were not prepared to provide any answers to Ms. Wichmann's questions. Instead, on June 24, 2015, Ms. Varvell wrote to Ms. Wichmann:

Thanks again for the excellent information you provided the team last week. We have shared the final product Karen put together based on your input. We are scheduled to meet internally next Wednesday and a discussion of responses to your issues is number one on the agenda. The plan is to

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formulate a final response at that meeting. Please be patient with us a bit longer and we'll give you feedback as soon as possible.

Email from Varvell to Wichmann (June 24, 2015). Unfortunately, no answers were forthcoming from OSMRE, and after Ms. Wichmann inquired about the status of OSMRE's response, Ms. Varvell responded:

We most certainly haven't forgotten you. I have been away from my office all week. Many of the things you are asking about are novel and firsts. I wish we had quicker responses but we are trying to come to a national consensus on some of the aspects and that is proving to be very challenging. I'll be talking with Jeff F. of our office several times next week and will ask him about sending some of our responses to your original questions out to you. Meanwhile if you will hang in there with me a bit longer I'd be happy to seek answers or refer any other questions you might have as best I can.

Email from Varvell to Wichmann (Aug. 21, 2015).

In the meantime, Alpha Natural Resources, Inc., Alpha Coal West, Inc., and other related entities (collectively Alpha) filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code in the United States Bankruptcy Court for the Eastern District of Virginia. For no apparent reason, this bankruptcy filing caused OSMRE to disengage from discussions with DEQ related to the self-bonding issues Ms. Wichmann had raised. On August 27, 2015, Ms. Varvell informed Ms. Wichmann that because "Wyoming is in litigation on self-bonding and since her boss and [Ms. Wichmann's] bosses are involved with the litigation that OSM cannot supply a reply or guidance to [Ms. Wichmann's] questions at this time." Email from Wichmann to Wendtland (August 27, 2015).

While no longer willing to work collaboratively on questions related to self-bonding, OSMRE did issue its Annual Evaluation Report for the Regulatory Program Administered by the Department of Environmental Quality – Land Quality Division of Wyoming in August 2015. That report stated that, "The [Land Quality Division] continues to administer a rigorous and effective Title V reclamation program for the largest coal producing region in the country. The [Land Quality Division]'s permitting, compliance and inspection and enforcement programs are meeting all requirements expected of it by the [OSMRE]." 2015 Annual Evaluation at 1. With regard to self-bonding in particular, the report went on to state that:

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During the Evaluation Year, the OSMRE conducted and informed review of [the Land Quality Division's] implementation of their self-bonding program, to determine compliance [with] the requirements set forth in the Wyoming Coal Rules and Regulations, at Chapter 11. The OSMRE found that the [Land Quality Division] implements their self-bonding program in full compliance with their self-bonding rules.

Id. at 6. It is not clear whether this statement of full approval of DEQ's implementation of its self-bonding program constitutes the written findings from the February audit, but nevertheless, as of August 2015, OSMRE had no apparent concerns with DEQ's implementation of the program.

Without any engaged guidance from OSMRE, on September 10, 2015, DEQ approved the annual renewal of Arch Western Resource's self-bonds. DEQ's action conformed to its regulations and prior practice in all respects. And, of course, OSMRE had previously found DEQ's practice to be "in full compliance with Federal and State laws" and "in full compliance with their self-bonding rules." In particular, DEQ based its renewal decision on the 2014 year-end audited financial reports of Arch Western Resources as is required by Chapter 11 of the Land Quality Division rules.

Even though Arch Western Resources qualified for self-bonding based on its 2014 year-end financials, neither DEQ nor OSMRE was ignorant of the financial condition of Arch Coal or of the existence of Arch Western Resources' guarantees in favor of Arch Coal. On September 30, 2015, DEQ followed the annual renewal with four requests to Arch Western Resources for information during the interim between annual renewals. Letter from Wendtland to Beil and Mullarkey (Sept. 30, 2015). First, DEQ acknowledged that there were assets of Arch Western Resources that were obligated to Arch but not listed on Arch Western Resources' balance sheet. *Id.* DEQ requested to be notified of any changes in these obligations. *Id.* Second, DEQ requested to be notified if Arch Western Resources became responsible for or actually paid anything related to its obligations to Arch Coal. *Id.* Third, DEQ requested that in its next annual renewal application, Arch Western Resources specifically identify its off balance sheet contingent obligations. *Id.* Finally, DEQ requested to be notified of any negative changes in cash flow and/or negative equity distributions between subsidiaries and the parent company Arch Coal.

Arch Coal's financial condition deteriorated over the next several months, and DEQ met several times with Arch representatives in an attempt to obtain any additional information about Arch Western Resources' continuing eligibility to self-bond. However, Arch Western Resources did not submit any additional information to DEQ indicating that

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Arch Western Resources' potential liability for the off balance sheet contingent obligations had changed or was more probable than it had been in September 2015.

Despite no change in the financial condition of Arch Western Resources, on December 16, 2015, the Powder River Basin Resource Council and the Western Organization of Resource Councils submitted a Citizen's Complaint to DEQ and OSMRE. Those organizations asserted that they believed that Arch Coal, Inc., no longer qualified to self-bond its reclamation obligations. Complaint at 1. Notably, these organizations admitted that they were "unable to verify if Arch Western Resources itself meets the financial tests set forth in state and federal regulations." *Id.* at 3. They went on to assert, without any citation to authority, that Arch Coal, Inc., and Arch Western Resources "must be viewed in tandem and the financial condition of Arch Coal must be considered when determining whether Arch Western Resources qualifies for self-bonding to meet the full intent of SMCRA." *Id.* at 4. They asserted that this was so because Arch Western Resources assets were pledged as collateral for Arch Coal's secured corporate debt, and Arch Coal seemed poised to file for bankruptcy protection. *Id.* at 4-5.

DEQ responded to the Citizen's Complaint on December 21, 2015. DEQ first noted that the Citizen's Complaint did not allege that DEQ's prior renewal or any subsequent action by DEQ was injuring either group.¹ Next DEQ, in precise conformity with OSMRE's position as expressed in its Fact Sheet in February, advised the groups that Arch Western Resources, not Arch Coal, was the relevant guarantor. None of the information provided by the groups in the Citizen's Complaint demonstrated that Arch Western Resources was no longer eligible to self-bond, and therefore, DEQ declined to issue a notice of violation or conduct an inspection based on the allegations in the Citizen's Complaint. DEQ advised the groups that while DEQ would conduct the next annual review in 2016 based on Arch Western Resources' 2015 year-end financial statements; in the meantime DEQ had requested and would review quarterly financial reports from the company to expeditiously address any change in the company's financial condition.

On January 11, 2016, Arch Coal and its subsidiaries, including Arch Western Resources, filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code in the United States Bankruptcy Court for the Eastern District of Missouri. After significant negotiations, Arch filed a motion with the bankruptcy court on February

¹ The groups' failure to comply with Chapter 16, Section 1(d), of the Land Quality Division's rules provides sufficient independent good cause for DEQ's decision to decline to issue a notice of violation or conduct an inspection in response to the Citizen's Complaint.

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9, 2016, requesting that the court enter a stipulation and order concerning reclamation bonding for Arch's surface coal mining operations in Wyoming. As set forth in that motion, Arch and DEQ strongly disagreed whether the automatic stay bars DEQ from issuing a substitution demand to Arch Western Resources under Chapter 11, Section 5 of the Land Quality Division regulations. *See In re Arch Coal, Inc.*, Doc. 289 at ¶ 22 (Bankr. D. Mo. 2016). To settle this serious dispute and put Arch on a path towards compliance, DEQ and the State of Wyoming stipulated to the entry of the order pursuant to the authority vested in the Administrator of the Land Quality Division in Wyo. Stat. Ann. § 35-11-701(c). Although it had ample opportunity to do so, OSMRE did not object to Arch's motion.

The order, which remains subject to approval by the bankruptcy court, provides that for the duration of the bankruptcy proceedings, Arch may satisfy its bonding requirements in Wyoming by complying with the obligations outlined in the stipulation and order. *In re Arch Coal*, Doc. 289 Ex. A at ¶ 3. In addition to its claim for the full amount of Arch's reclamation obligation should it become due as specified in the order, Wyoming will be granted a superpriority claim for \$75 million dollars related to the Black Thunder, Coal Creek, and Vanguard mines. *Id.* at ¶ 1. In addition, within 90 days Arch will substitute the existing self-bonds with financial assurance in the form of third-party collateral support that meets Wyoming's statutory and regulatory requirements in the amount of \$17,004,600 for the Medicine Bow, Seminoe II, Izita, and Carbon Basin mines. *Id.* at ¶ 2. Wyoming will be precluded from seeking additional collateral or revoking, terminating, refusing to grant, amending, or taking any other adverse action with respect to Arch's mining permits on account of Arch's current ineligibility to self-bond. *Id.* at ¶ 3. Arch must comply with all its reclamation obligations, and Wyoming will continue to take any necessary regulatory action to ensure that these obligations are met. *Id.* at ¶¶ 5-6. Upon confirmation of the plan of reorganization Arch, or the successor to its Wyoming mining operations, must satisfy Wyoming's bonding requirements, or DEQ will immediately issue a substitution demand, and if necessary, a notice of violation and order.

Thus, Arch remains liable under the existing self-bond, indemnity, and corporate guarantee agreements, as further secured by the settlement agreement, for the entirety of its reclamation obligations in Wyoming. In addition, the reclamation obligation related to four of its seven properties in Wyoming will transition completely away from self-bonds within 90 days of the entry of the order. Consequently, DEQ has not allowed the bond amount to fall below the amount necessary to ensure Arch's compliance with its reclamation obligations. Any notion that Arch continues to mine without a bond or with a bond that is less than the full reclamation obligation is incorrect.

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The agreement between DEQ and Arch is substantially similar to the agreement the State of West Virginia and the West Virginia Department of Environmental Protection reached with Alpha in its bankruptcy proceedings. *See In re Alpha Nat. Res.*, Doc. 1049. West Virginia, like Wyoming in its agreement with Arch, accepted additional security from Alpha in the bankruptcy proceedings to temporarily satisfy Alpha's bonding obligations in that state and placed Alpha on a similar path towards compliance.

Several environmental groups challenged that order on the grounds that it violated West Virginia law. In resolving the challenge, the bankruptcy court issued a ruling of significant applicability to the TDN issued to Wyoming. There the court found:

... DEP did not violate West Virginia law when it entered into the West Virginia Settlement. West Virginia law clearly permitted DEP to negotiate a compromise and enter into a consent agreement following initiation of the enforcement action. See W. Va. Code. R. § 38-2-20.40.j (authorizing DEP to enter into a settlement "at any point in the enforcement process following the issuance of a notice of violation, a cessation order, or a show cause order").

Id. Doc. 1332 at 15. In addition, the bankruptcy court found:

[T]hat the West Virginia Settlement represents a fair and equitable deal for all parties, and is well above the lowest point of reasonableness. Absent the West Virginia settlement, the Debtors and the state of West Virginia would have become embroiled in time consuming, expensive, and distracting litigation over whether West Virginia's substitution demand violated the automatic stay. The Debtors have admitted that this litigation would be "hotly contested." The Debtor's likelihood of success in such litigation is hardly assured, given the regulatory and police power exception to the automatic stay. *See* 11 U.S.C. § 362(b)(4). If the Debtors were to lose the litigation with West Virginia, they would be required to immediately post over \$244 million in substitute bonds in order to continue mining in West Virginia. Given the Debtor's limited liquidity, this could be a substantial hurdle that could impair the Debtor's reorganization efforts. The West Virginia Settlement avoids such a result and allows the Debtors to gradually transition away from the self-bonding program while still upholding their reclamation obligations to the state of West Virginia. The Court is convinced that this agreement will best preserve the value of the Debtor's bankruptcy estates, maximize the return to creditors, help preserve jobs, and give the Debtor's the opportunity to reorganize their business affairs. Indeed, the

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Environmental Parties do not dispute that this settlement results in a substantial benefit to the Debtors and to the State of West Virginia.

Id. at 13. The settlement of the “hotly contested” dispute between Wyoming and Arch is similarly fair, equitable, reasonable, and authorized by Wyoming law.

OSMRE’S LIMITED AUTHORITY

The Surface Mining Reclamation and Control Act of 1977 (SMCRA), struck “a balance between protection of the environment and agricultural productivity and the Nation’s need for coal as an essential source of energy.” 30 U.S.C. § 1202(f). In enacting SMCRA, Congress found it “essential to the national interest to insure the existence of an expanding and economically healthy underground coal mining industry,” and also provided that “the primary governmental responsibility for developing, authorizing, issuing, and enforcing regulations for surface mining and reclamation operations . . . should rest with the States.” 30 U.S.C. § 1201(f). To achieve this goal, the statute established “a program of cooperative federalism that allows the States, within limits established by federal minimum standards, to enact and administer their own regulatory programs, structured to meet their own particular needs.” *Hodel v. Va. Surface Mining & Reclamation Ass’n*, 452 U.S. 264, 289 (1981).

SMCRA adopted a two-step approach. First, the Secretary of the Interior was required to implement a federal regulatory program setting minimum standards for surface coal-mining operations within six months of August 3, 1977. 30 U.S.C. § 1252(e). Second, the states were authorized to propose and receive approval for their own individual programs. 30 U.S.C. § 1253. The Secretary introduced an initial regulatory program on December 17, 1977. 42 Fed. Reg. 62639. Wyoming received approval to implement its own program effective November 26, 1980. 30 C.F.R. § 950.10.

States with approved regulatory programs exercise exclusive jurisdiction over surface coal-mining operations, while the Secretary exercises exclusive jurisdiction in States with federal plans. 30 U.S.C. §§ 1253(a), 1254(a). A State with an approved program maintains exclusive authority except in certain limited situations, such as if the State fails to enforce its program. 30 U.S.C. § 1271. As the Fourth Circuit has noted, “SMCRA provides for *either* State regulation of surface coal mining within its borders *or* federal regulation, but not both.” *Bragg v. West Virginia Coal Ass’n*, 248 F.3d 275, 289 (4th Cir. 2001) (emphasis in original). “Under this arrangement, . . . the Secretary retains a limited and ordered federal oversight role to ensure that the minimum requirements of SMCRA

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are being satisfied[.]” *Pennsylvania Fed’n of Sportsmen’s Clubs, Inc. v. Hess*, 297 F.3d 310, 317 (3d Cir. 2002) (internal citation omitted).

OSMRE’s oversight authority is authorized and limited by 30 U.S.C. § 1271. Subsection (a) of that statute addresses individual violations by a specific permittee, and authorizes OSMRE to issue a notice to a state regulatory authority if it “has reason to believe that any person is in violation of any requirement of this chapter or any permit condition required by this chapter.” 30 U.S.C. § 1271(a)(1). Once such a notice is issued, the state regulatory authority has ten days “to take appropriate action to cause said violation to be corrected or to show good cause for such failure[.]” *Id.*

Appropriate action under 30 U.S.C. § 1271(a)(1) includes any “enforcement or *other action* authorized under the State program to cause the violation to be corrected.” 30 C.F.R. § 842.11(b)(1)(ii)(B)(3) (emphasis added). This provision of OSMRE’s regulations

focuses on the goal of the Act itself—to see that violations are corrected. In doing so, the rule allows state discretion in how best to accomplish that goal—but only if those means are authorized under the state program. OSM is not permitting a “free bite,” but is simply saying that the federal government will not substitute its judgment and second-guess the states on a case-by-case basis, unless the state action is arbitrary, capricious or an abuse of discretion under its program.

53 Fed. Reg. 26733, 26734 (July 14, 1988) (emphasis added).

When it proposed this regulation, OSMRE recognized a distinction between enforcement and other actions to correct a possible violation. “[E]nforcement would include, but would not be limited to, the issuance of an NOV to the operator” and an “other action” could include a permit revision or a proceeding to forfeit a bond, but noting that these “examples are not meant to be an exhaustive list of acceptable responses.” 52 Fed. Reg. 34050, 34051 (Sept. 9, 1987). It added:

By this rule, OSMRE would reject the concept that appropriate action to cause a violation to be corrected would only include responses showing that at the time of the State response either the condition constituting the possible violation of the Act no longer exists or the State has issued an NOV or cessation order.... Direct OSMRE enforcement against an operation would not be utilized ... when the State is acting reasonably to correct a possible violation. Under the proposed rule, *appropriate action would mean that*

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certain conditions may continue in the short term, but ultimately the violation of the State program will be resolved.

Id. (emphasis added). In the final rulemaking OSMRE went even further, and stated that “actual abatement of a violation is not the standard for determining whether a state response is appropriate,” provided the state response would “lead to abatement within a reasonable time.” 53 Fed. Reg. at 26734.

“Good cause” for failing to correct a violation includes circumstances in which “[u]nder the State program, the possible violation does not exist.” 30 C.F.R. § 842.11(b)(1)(ii)(B)(4)(i). It also includes circumstances in which “State regulatory authority is precluded by an administrative or judicial order from an administrative body or court of competent jurisdiction from acting on the possible violation, ... where the temporary relief standards of section ... 526(c) of the Act have been met[.]” 30 C.F.R. § 842.11(b)(1)(ii)(B)(4)(iv).

OSMRE considers appropriate action to cause a violation to be corrected or good cause for failure to do so to be “an action or response by a State regulatory authority that is not arbitrary, capricious, or an abuse of discretion under the state program. 30 C.F.R. § 842.11 (b)(1)(ii)(B)(2). OSMRE internally defines “arbitrary, capricious, or an abuse of discretion” as essentially irrationality or the failure to follow correct procedures or applicable law. OSMRE Directive INE-35 § 3.b. (Jan. 31, 2011). “In general, OSM[RE] will make a finding of appropriate action or good cause if the [regulatory authority] presents a rational basis for its decision, even if OSM[RE] might have decided it differently.” *Id.* at § 4.d.

THE CITIZEN COMPLAINT PRESENTED NO VIOLATION

The gravamen of the Citizen’s Complaint is that DEQ improperly allowed Arch Western Resources to continue mining because its parent company was not eligible to self-bond and because Arch Western Resources has off balance sheet contingent liabilities in favor of Arch Coal. Neither of these assertions demonstrate that a violation occurred before the bankruptcy petition was filed. DEQ followed the applicable rules governing eligibility, generally accepted accounting principles, and prior practice that had been reviewed and approved by OSMRE.

Chapter 11 of the Land Quality Division rules governs eligibility for self-bonding in Wyoming. Section 2 of those rules sets out the requirements for an initial application to self-bond, and provides in pertinent part that the application shall contain:

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(vi) A statement, in detail, so as to show a history of financial solvency. For an initial bond, each operator must provide:

(A) Audited financial statements supporting the following comparative documents, prepared and certified by an independent Certified Public Accountant who, by reason of education, experience or special training, and disinterest, is competent to analyze and interpret the operator's financial solvency. **All statements shall be prepared following generally accepted principles of accounting:**

(I) A comparative balance sheet which shows assets, **liabilities** and owner equity for five years. The operator may provide common size documents for confidentiality.

(II) A comparative income statement which shows all revenues and expenses for five years. The operator may provide common size documents for confidentiality.

(III) A report for the most recently completed fiscal year containing the accountant's audit opinion or review opinion of the balance sheet and income statement with no adverse opinion.

(IV) Notwithstanding the language in (A) above, unaudited financial statements may be submitted to support the comparative documents where current fiscal year quarters have ended but a CPA opinion has not yet been obtained because the fiscal year has not yet ended.

Chapter 11, Section 2(a)(vi)(A)(I)-(IV) (emphasis added). For subsequent renewals, the "Administrator may request financial statements for the most recently completed fiscal year together with an independent certified public accountant's audit opinion or review opinion of the financial statements with no adverse opinion. Additional unaudited information may be requested by the Administrator". Chapter 11, Section 4(a)(ii).

The operator submits the audited financial statements to DEQ who compares them to the following criteria to determine if the company is eligible for self-bonding:

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(vii) For coal mining operations, financial information in sufficient detail to show that the operator meets one of the following criteria (the specific criterion relied upon shall be identified):

(A) The operator has a rating for all bond issuance actions over the past five years of "A" or higher as issued by Moody's Investor Service, Standard and Poor's Corporation or any other nationally recognized rating organization that is acceptable to the regulatory authority. Any additional rating organization must be a "nationally recognized statistical rating organization" as approved by the Securities and Exchange Commission. If the additional rating organization uses a different rating system, only ratings that are equivalent to a rating of "A" or higher by either Moody's Investor Service or Standard and Poor's Corporation will qualify (the rating organization should be identified together with any further breakdown of specific ratings).

(B) The operator has a tangible net worth of at least 10 million dollars, and a ratio of total **liabilities** to net worth of 2.5 times or less, and a ratio of current assets to current liabilities of 1.2 times or greater. The two ratio requirements must be met for the past year, and documented for the four years preceding the past year. Explanations should be included for any year where the ratios fall below the stated limits.

(C) The operator's fixed assets in the United States total at least 20 million dollars, and the operator has a ratio of total **liabilities** to net worth of 2.5 times or less, and a ratio of current assets to current liabilities of 1.2 times or greater. The two ratio requirements must be met for the past year and documented for the four years preceding the past year. Explanations should be included for any year where the ratios fall below the stated limits.

(D) If the operator chooses (B) or (C), the two ratios shall be calculated with the proposed self-bond amount added to the current or total liabilities for the current year. The operator may deduct the costs currently accrued for reclamation which appear on the balance sheet.

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Rather than rely on its own financial condition, the operator may choose to submit either a parent or non-parent corporate guaranty instead. Chapter 11, Section 2(a)(x),(xi), and (xii). The Administrator can accept a parent or non-parent guaranty if the guarantor meets all of the same criteria required of the operator, and the guarantor agrees to complete the reclamation plan or provide the funds for the state to do so in the event the operator fails to do so. *Id.*

As is apparent from the foregoing, the focus of DEQ's inquiry is on the operator, and where applicable, the guarantor. The regulations, which have been approved by OSMRE, do not require DEQ to consider the financial condition of other related entities as it determines whether the operator or guarantor is eligible to self-bond. OSMRE recognized as much in its Fact Sheet when it noted that neither Peabody nor Arch Coal were the guarantors of the self-bonds, and therefore, the fact that they were not eligible to self-bond was irrelevant. Accordingly, the citizens' complaint that Arch Coal's financial condition was declining rapidly in December 2015 failed to identify any violation of DEQ's rules.

Turning to the citizen's second concern, DEQ does not disagree that Arch Western Resources' off balance sheet contingent liabilities in favor of Arch Coal were concerning. In fact, DEQ sought to collaborate with OSMRE about this very issue to develop an appropriate response to the situation throughout the summer of 2015 until OSMRE chose to disengage from those discussions. At the time of the annual renewal and the Citizen's Complaint, however, Arch Western Resources obligations to Arch Coal were properly excluded from Arch Western Resources financial statements. This is true, for the 2014 year-end audited financial statements and for any other interim or uncertified financial statements DEQ could have considered before or after the 2015 annual renewal.

When making determinations of eligibility, DEQ's rules require it to follow generally accepted accounting principles and to consider, among other variables, "liabilities" as reported on the operator or guarantor's audited financial statements. Generally accepted accounting principles do not require Arch Western Resources to accrue these contingent liabilities to Arch Coal on its financial statements. *See, generally,* Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 450-20. Those accounting standards provide:

When a **loss contingency** exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from **probable** to **remote**. As indicated in the definition of **contingency**, the term *loss* is used for convenience to include many

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charges against income that are commonly referred to as expenses and others that are commonly referred to as losses. The Contingencies Topic uses the terms *probable*, **reasonably possible**, and *remote* to identify three areas within that range.

FASB ASC 450-20-25-1 (2011) (emphasis in original).

An estimated loss from a loss contingency shall be accrued by a charge to income if both of the following conditions are met:

- a. Information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- b. The amount of loss can be reasonably estimated.

The purpose of those conditions is to require accrual of losses when they are reasonably estimable and relate to the current or a prior period.

FASB ASC 450-20-25-2 (2011).

Thus, if a loss contingency such as a guarantee is probable and can be reasonably estimated before a financial statement is issued, it should be identified as a liability in that statement. However, not all guarantees have to be identified as a liability, even if they are probable to occur before the financial statement is issued and reasonably estimable.

The following types of guarantees are not subject to the recognition provisions of this Subsection:

- f. A guarantee issued either between parents and their subsidiaries or between corporations under common control.
- h. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

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FASB ASC 460-10-25-1 (2011). Instead, such guarantees by subsidiaries must be disclosed by the company, but need not be identified as a liability on its balance sheet. *See* FASB Interpretation No. 45.

Here, in approving the September 2015 renewal, DEQ relied on the most recent audited financial statements available for Arch Western Resources. Those statements did not and were not required to list Arch Western Resources' guarantees in favor of Arch Coal as liabilities, whether or not the loss was probable before the statements were issued. Of course, the loss was not probable during the period covered by those statements. DEQ's reliance on those audited statements was proper under Chapter 11, Section 4(a)(ii) of its rules. In addition, DEQ requested additional unaudited information, pursuant to the same section of its rules, but none was available prior to the bankruptcy filing. Even if additional unaudited financial statements had been available, Arch Western Resources still would not have been required to identify its guarantees as liabilities, and therefore, those additional financial statements could not lead to enforcement action by DEQ as requested in the Citizen's Complaint.

Accordingly, the assertion in the Citizen's Complaint that Arch Coal and Arch Western Resources must be viewed in tandem is unsupported by either DEQ's regulations or generally accepted accounting principles. Whether DEQ and OSMRE should deviate from generally accepted accounting principles and require operators and guarantors to treat these off balance sheet contingent liabilities differently in the future is an important question, and one DEQ hoped to address before OSMRE disengaged. At this juncture, however, the evidence amply demonstrates that DEQ complied with its approved regulations and properly declined to take enforcement action based on the allegations in the Citizen's Complaint and OSMRE should withdraw the TDN.

DEQ'S SETTLEMENT AGREEMENT IS APPROPRIATE ACTION

Unlike December 2015, when the Citizen's Complaint was lodged, now that Arch Western Resources has filed for relief in the bankruptcy court its eligibility to self-bond is in serious doubt. There is no dispute that DEQ has an obligation to act in response to this potential violation. However, the bankruptcy filing has created a serious dispute between Arch and DEQ about whether DEQ can take any enforcement action related to Arch Western Resources self-bonds. In light of this dispute, DEQ has chosen to exercise its authority under Wyo. Stat. Ann. § 35-11-701 to negotiate a settlement that will ultimately eliminate any potential violation. That statute provides that if "the director or the administrators have cause to believe that any persons are violating any provision of this act

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or any rule, regulation, standard, permit, license, or variance issued pursuant hereto, ... the director through the appropriate administrator, shall cause a prompt investigation to be made.” Wyo. Stat. Ann. § 35-11-701(a). If, as a result of DEQ’s investigation, it appears that a violation exists, “the administrator of the proper division may, by conference, conciliation, and persuasion, endeavor promptly to eliminate the source or cause of the violation.” Wyo. Stat. Ann. § 35-11-701(c). This authorization to enter into settlements is similar to West Virginia’s settlement authority which the bankruptcy court found to be a lawful source of its authority to enter into a substantially similar settlement agreement.

DEQ’s decision to enter into the settlement agreement is appropriate other action and not arbitrary, capricious, or an abuse of discretion. The settlement is as eminently reasonable, equitable, and lawful as the bankruptcy court found the West Virginia settlement agreement. In fact, the decision of the bankruptcy court likely establishes that DEQ’s settlement is per se appropriate other action. The agreement settled a “hotly contested” dispute in a way that provided additional interim security to Wyoming, and set Arch on a path to comply with its bonding obligations at the conclusion of the bankruptcy proceedings. Absent the settlement, Arch would be required to post the full amount of its reclamation bond obligation within 90 days of the substitution demand, which it is obviously unable to do during the pendency of the bankruptcy. Instead, the settlement allows Arch to transition away from its self-bonds over the limited duration of the bankruptcy to the benefit of the company, the state, and the public. This is exactly the situation envisioned by OSMRE when it drafted its regulations to allow for certain conditions in the short term, so that the violation will ultimately be resolved within a reasonable time.

Having cleared the low bar of rationality and lawfulness, OSMRE is not permitted to second-guess the wisdom of DEQ’s settlement agreement. While OSMRE might have chosen not to settle or to settle on other terms, the fact that Wyoming has an approved program means that DEQ has exclusive jurisdiction to make these decisions.

THE BANKRUPTCY STAY PROVIDES GOOD CAUSE

In addition to being appropriate other action, if the proposed order is issued by the bankruptcy court it will provide good cause for DEQ’s decision not to take further enforcement action at this time. A stay of any enforcement action by DEQ entered by the bankruptcy court would satisfy the temporary relief standards of section 526(c) of SMCRA. As a result, no further action on the TDN is warranted.

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OSMRE regulations allow for the possibility that certain administrative and judicial actions can prevent enforcement actions by state regulatory authorities. *See* 30 C.F.R. § 842.11(b)(1)(ii)(B)(4)(iv). While the proposed bankruptcy order does not purport to determine whether or not the violation exists, it does satisfy the temporary relief standard set forth in Section 526(c) of SMCRA. 30 U.S.C. § 1276(c). That section governs temporary injunctions of Secretarial acts so long as the following three standards are met:

- (1) all parties to the proceedings have been notified and given an opportunity to be heard on a request for temporary relief;
- (2) the person requesting such relief shows that there is a substantial likelihood that he will prevail on the merits of the final determination of the proceeding; and
- (3) such relief will not adversely affect the public health or safety or cause significant imminent environmental harm to land, air, or water resources.

These standards will be met if the bankruptcy court enters the stay. Arch's bankruptcy filing has been widely reported both locally in Wyoming and across the nation. Similarly, when Arch and DEQ reached a settlement subject to approval by the bankruptcy court, that fact was also widely reported. *See, e.g., Wyoming and Arch Coal reach self-bonding deal*, Casper Star-Tribune (Feb. 10, 2016). In fact, the group that filed the December Citizen's Complaint has appeared in the bankruptcy proceedings and will be heard at the hearing on Arch's motion for entry of the stipulation and order on February 23, 2015.

In its motion to the bankruptcy court, Arch demonstrated a substantial likelihood of success on the merits of the final determination that the automatic stay precludes DEQ from issuing a substitution demand followed by an NOV and order. It is worth noting here, that based on OSMRE's preference; Arch did not seek relief under Section 105 of the bankruptcy code irrespective of whether the automatic stay applied. As evidenced by the bankruptcy court's favorable view of the West Virginia settlement, a request for stay pursuant to the court's equitable powers would in all likelihood be granted whether DEQ objected or not. Finally, the fact that DEQ consented to the entry of the stay is inconsequential to the objective likelihood of success demonstrated by Arch.

In turn, there can be no dispute that the proposed stay will not adversely affect the public health or safety or cause any imminent environmental harm. To the contrary, the order ensures that reclamation will continue unabated for the duration of the bankruptcy proceeding and that DEQ will have full enforcement power over Arch's mining operations.

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Because any interested person will have an opportunity to be heard before the bankruptcy court enters the stay, it is substantially likely that Arch would obtain the stay in any event, and no harm results to the public or the environment, DEQ's compliance with the stay will constitute good cause not to take additional enforcement action against Arch.

CONCLUSION

The dramatic decline in Arch's financial condition within a short period of time culminating in bankruptcy proceedings creates a series of challenges for both DEQ and OSMRE. These events highlight certain systemic problems with self-bonding, but had to be addressed individually and in a timely manner. DEQ, as the entity with exclusive jurisdiction over the matter, exercised its considered discretion to enter a settlement that protects the public, the environment, and sets a firm timetable for Arch's transition away from self-bonds. This resolution, while not ideal in every respect, was lawful, reasonable, and meets the goal of SMCRA to see that violations are corrected. OSMRE has no basis for second guessing DEQ's judgment.

Accordingly, DEQ requests that OSMRE respond to this response to the TDN by finding that DEQ properly declined to take enforcement action in response to the Citizen's Complaint, took appropriate other action in response to the bankruptcy filing, and has good cause for deciding not to take enforcement action against Arch related to its self-bonding status. Please let me know if you have questions or concerns about anything in this response. Again, we believe that both parties would benefit from a meeting to discuss the issues raised in the TDN and this response before OSMRE responds. DEQ hereby renews its request to meet at a time that is mutually convenient for OSMRE and DEQ.

Sincerely,



Kyle Wendtland
Administrator, Land Quality Division

cc: Matthew H. Mead
Michael Enzi
John Barrasso
Cynthia Lummis
Peter K. Michael
Janice M. Schnieder

Tim Mullarkey
Marshall Huebner
Todd Parfitt