

POST AUDIT DIVISION

LEGISLATIVE AUDIT REPORT

WV Department of Environmental Protection Division of Mining & Reclamation - Special Reclamation Funds Report

Legislative Auditor: Aaron Allred
Post Audit Division Director: Justin Robinson



MODIFIED GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS STATEMENT

We conducted this performance audit mostly in accordance with the Generally Accepted Government Auditing Standards issued by the United States Government Accountability Office. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. With the exception of sections 6.65 and 6.66 of the 2011 Generally Accepted Government Auditing Standards, all applicable standards were followed. The specific information concerning the deviation from those standards may be found in Appendix B of this report. Based on our professional judgment, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

POST AUDIT DIVISION
Justin Robinson, Director

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*WV Department of Environmental
Protection Division of Mining &
Reclamation - Special Reclamation
Funds Report*

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Report Foreword

This Legislative Auditor's report is the third in a series of reports concerning the WV Department of Environmental Protection (DEP). The audit focuses on the DEP's surface coal mining and reclamation bonding program and the long-term solvency of the Special Reclamation Funds (SRFs).

West Virginia's surface coal mining and reclamation program was established by Chapter 22, Article 3 of the West Virginia Code. The Legislative Rule that primarily governs the program is Title 38, Series 02 of the Code of State Rules (38CSR2). Once signed into law, the initial code, rules, and subsequent amendments applicable to the state's mine reclamation program must be submitted to the United States Office of Surface Mining Reclamation and Enforcement (OSMRE) for approval. The OSMRE was established by Congress with the passage of the 1977 *Surface Mining Reclamation and Control Act*.

The SRFs provide funding for reclamation when a coal company forfeits its coal mining permit. Forfeiture occurs when a mining company can no longer fulfill its reclamation duties, generally via bankruptcy or an inability to adhere to DEP requirements. The SRFs are funded primarily by a 27.9 cent tax levied on every short ton of coal produced within the state. Bond forfeitures and investment income comprise much of the remaining revenue for the funds.

The following issues are derived from data and information requested from the DEP, the WV State Tax Department, the WV Secretary of State, and the WV Governor's Office. The Legislative Auditor thanks all agencies and agency personnel for providing assistance and fulfilling documentation requests during the audit.

Executive Summary

The Legislative Auditor conducted this audit on the WV Department of Environmental Protection pursuant to W.Va. Code §4-2-5. The objective of this audit was to evaluate the solvency and efficacy of the state's surface coal mining reclamation bonding program.

Frequently Used Acronyms in This Report

CFR: Code of Federal Regulations

CSR: Code of State Rules

DEP: Department of Environmental Protection

DMR: Division of Mining and Reclamation

ERP: ERP Environmental Fund

ESS: Electronic Submission System

OSMRE: Office of Surface Mining Reclamation and Enforcement

SMCRA: Surface Mining Control and Reclamation Act

SRTF: Special Reclamation Trust Fund (Fund 3321)

SRFs: Special Reclamation Funds (Funds 3312, 3317, 3321, 3482)

SRFAC: Special Reclamation Fund Advisory Council

SRWTF: Special Reclamation Water Trust Fund (Fund 3482)

Report Highlights:

Issue 1: Current Per Acre Coal Mining Reclamation Bond Limits May Not Be Sufficient to Guarantee the Solvency of the State's Mining Reclamation Program.

- Bonds are set between \$1,000 and \$5,000 per acre.
- Increasing reclamation costs have devalued permit bonds since the current bonding limits were established by W.Va. Code §22-3-11(a) in September 2001, while the cost of reclamation has increased significantly since bond rates were established.
- The Legislative Auditor estimates bonds cover 10% of reclamation cost.
- The DEP filed a lawsuit installing a special receiver to handle the business of one mining company, ERP Environmental Fund¹ (ERP), due to the possibility the company's forfeiture would result in, "...*financially overwhelming the Special Reclamation Fund....*"

Recommendation:

- 1.1 The Legislative Auditor recommends the DEP consider the adequacy of the bonding rates currently in effect with regard to the requirements of Title 30, Section 733.11 of the Code

¹ Although the name of this company may imply otherwise, ERP Environmental Fund is a major coal mining company operating within West Virginia.

of Federal Regulations, and adjust the rates as necessary to ensure that the cost of reclamation does not become a greater financial liability to the state.

Issue 2: A Lack of Limitations on Amounts Permitted to be Underwritten by Single Insurers for Mining Reclamation Surety Bonds Increases the Risk of Insolvency of the Special Reclamation Funds.

- Unlike multiple other states' mining reclamation programs, WV has no statutory limits on the amount of reclamation surety bond coverage a surety company may issue either in the case of individual bonds or in the aggregate.
- Five companies hold 90.7% of the state's coal mining reclamation bonds.
- Indemnity National Insurance Company holds approximately \$620 million in coal mining reclamation bonds, 66.9% of the total.
- Indemnity held \$125 million in reclamation bonds for ERP, a coal company operating in WV, when ERP walked off the job in March 2020. ERP's potential reclamation liability was so great the DEP was concerned ERP's forfeiture would bankrupt Indemnity resulting in a circumstance that could render the Special Reclamation Funds (SRFs) insolvent.
- Companies that are permitted to issue surety bonds without limitation expose the SRFs to potentially large liabilities that could result in the insolvency of the funds if mass forfeitures were to occur.

Recommendation:

- 2.1 The Legislative Auditor recommends the Legislature consider amending W.Va. Code §22-3-11 by imposing maximum thresholds on the face value of reclamation bonds permitted to be underwritten by a single surety company. Such limits should include both single bond issuances as well as the company's aggregate issuances of reclamation bonds.

Issue 3: The DEP Does Not Require Coal Companies to Maintain Bonds Equal to the Estimated Reclamation Cost as Required for Inactive Extensions. Further, the DEP Does Not Ensure that Applications for Inactive Status Extensions are Complete and Accurate as Required by Legislative Rule 38 CSR 2-14.11 and the Code of Federal Regulations 30 CFR §816.131.

- As of December 2020, there were 160 permits listed as *Inactive* in DEP's records. These permits were bonded for \$72.2 million.
- Legislative Rule 38CSR2 establishes specific requirements before a permit may be classified as *Inactive* and specifies time limits in which such inactive sites can remain inactive.
- Permit holders may request extensions beyond these timeframes. However, 38CSR2 requires permit holders to post full cost bonding" for extensions.
- 61 permits exceeded the initial approved timeframes as of December 2020; however, only five had full cost bonding. If the 56 permits that do not have full cost bonding were to forfeit, estimates based on historical data indicate the costs to reclaim these sites to be approximately \$279 million.

- Each inactive request must meet multiple federal requirements to be eligible for inactive status. However, we noted 171 separate instances on 100 applications² where requirements for inactive status were not satisfied.
- 320 permits were listed with permit statuses that indicate the sites are active, but not currently mining coal. Due to the lack of statutory definition for such statuses, the Legislative Auditor is unable to determine what activity, if any, is occurring at these sites.

Recommendations:

- 3.1 The Legislative Auditor recommends the DEP comply with the WV Surface Mining Reclamation Legislative Rule 38CSR2, Section 14.11; the Code of Federal Regulations 30 CFR §816.131-Cessation of Operations, and W.Va. Code §22-1-6(c), by:
 - (a.) Requiring mining permit holders submit reclamation bonds equal to the estimated reclamation costs for permit sites prior to granting extensions for inactive statuses;
 - (b.) Verifying that applications for extensions to inactive statuses are complete and accurate before such extensions are considered;
 - (c.) Ensuring permits do not remain inactive for periods longer than what is permissible as delineated in 38CSR2, Section 14.11; and,
 - (d.) Ensuring all mine status categories are properly defined by state statute or rule and that such categories are only implemented for use after consultation with, and approval of, the OSMRE.

Issue 4: Reclamation Awards That Result in Decreased Bond Amounts May Increase the State's Liability for Mining Reclamation and Potentially Contribute to the Insolvency of the Special Reclamation Fund. Additionally, the DEP Does Not Maintain a Complete Record of Companies That Have Received Reclamation Awards Resulting in Bond Reductions or the Reduction Amounts Received.

- The DEP currently accepts mining reclamation awards that can reduce the amount of bonding required to obtain coal mining permits.
- The DEP does not keep full records of various aspects of the reclamation awards program, which precludes the precise determination of actual bond reductions resulting from the program.
- At least 52 companies have a total of \$14.3 million in active coal mining performance bond reductions.
- Reclamation awards may be used indefinitely, and one award may be applied across all sites owned by the company that received it.
- Two companies with bond reductions are known to have 41 forfeited permits. The Legislative Auditor reviewed the bond calculations for nine permit sites and noted for these sites the DEP collected \$952,880 in forfeited bonds. However, as of August 2019, the DEP had expended \$4.5 million in reclamation costs for these nine permit sites. The reclamation

² Several inactive applications had multiple requirements that were not met; hence, the number of non-compliance issues noted exceed the number of applications audited.

costs for all 41 permits held by these two companies exceeded \$18.6 million as of August 2019, with reclamation ongoing.

Recommendations:

- 4.1 The Legislative Auditor recommends the DEP comply with W.Va. Code §5A-8-9 and develop a system to track and maintain a record of all reclamation awards submitted by coal companies including, but not necessarily limited to, a listing of all companies to whom the awards were given, the specific permits that received bond reductions resulting from awards, the amount of bond reductions resulting from the awards in the aggregate and for each individual permit, and the organizations from which the awards were received. The Legislative Auditor further recommends the DEP establish minimum eligibility requirements for entities that grant reclamation awards.
- 4.2 The Legislative Auditor recommends the DEP analyze the effect of accepting reclamation awards as a mechanism to reduce reclamation bonding; particularly, as it pertains to the solvency of the Special Reclamation Funds. It is further recommended the DEP report the results of this analysis and its methodology to the Post Audits Subcommittee no later than November 30, 2021.

Issue 5: According to the State Tax Department, as of May 21, 2021, 70 Mining Companies That Filed Coal Reclamation Tax Returns Had Delinquent Coal Reclamation Tax Accounts Totaling \$5.3 Million.

- A State Tax Department report listed a total of 70 different companies with reclamation tax delinquencies that had accrued over a 16-year period from December 2004 through April 2021.
- Ten companies are responsible for 80% of the \$5.3 million in total reclamation tax delinquencies.

Recommendations:

- 5.1 The Legislative Auditor recommends the DEP comply with the Division of Mining and Reclamation (DMR) *Permitting Handbook* and **not** approve applications for permit renewals and revisions or grant inactive statuses for companies found delinquent in paying Special Reclamation Taxes.
- 5.2 The Legislative Auditor recommends the Legislature consider amending W.Va. Code §22-3-11(l) to require the DEP monitor, on a monthly basis, the State Tax Department's reclamation tax reports and identify those companies that are delinquent in the remittance of reclamation taxes.
- 5.3 The Legislative Auditor recommends the Legislature, in conjunction with the DEP, consider establishing procedures within statute that would allow the DEP to impose actions such as the revocation of a company's mining permit in the event a company fails to properly file a tax return, a company's unpaid tax delinquencies exceed a stipulated amount, or a company's tax delinquency exceeds a specified duration to compel more prompt payment of special reclamation taxes and ensure the collection of those taxes.

Issue 6: The DEP Does Not Adequately Verify that Coal Companies Are Remitting the Proper Taxes to the Special Reclamation Fund.

- A 2012 Post Audit report found the DEP was not recording the coal tonnage mined by companies.
- If the DEP enacted an auditing procedure whereby the coal tonnage mined in the state was reconciled to the taxes remitted for a given period, the DEP could significantly bolster the confidence that reclamation taxes are being paid as required by law.

Recommendation:

- 6.1 The Legislative Auditor recommends the DEP fulfill its responsibility under W.Va. Code §22-3-2 by developing a method to properly track coal production and periodically reconcile the production to the special reclamation taxes collected to verify the Special Reclamation Trust Fund and the Special Reclamation Water Trust Fund are properly funded.

Issue 7: The DEP and the State Tax Department Granted Several Million Dollars in Reclamation Tax Credits Prior to the Tax Credit Program Receiving the Required Approval From the OSMRE in Violation of Federal Law.

- The DEP implemented an amendment before OSMRE approval that allowed companies to reclaim sites forfeited by other companies and claim the cost of the reclamation as a reclamation tax credit. Federal law dictates amendments to a state's reclamation program must be approved by the OSMRE prior to the implementation.
- The DEP did not notify the State Tax Department of the federal law requiring amendments be approved before implementation.
- The Legislative Auditor cannot determine the extent to which the DEP has implemented amendments without approval but has identified two additional situations in which the DEP has implemented amendments without obtaining OSMRE approval. One issue involves inactive permit extension approvals (Issue 3), and the other pertains to tax credits (Issue 8).

Recommendations:

- 7.1 The Legislative Auditor recommends the DEP comply with §30 CFR 732.17 and not implement amendments to the W.Va. Code and the Code of State Rules until approved by the OSMRE.
- 7.2 The Legislative Auditor recommends the DEP officially notify other state agencies or departments that perform functions associated with the state's mining reclamation program of the OSMRE requirements pertaining to the approval process for amendments to the state's regulatory program.

Issue 8: The DEP is Not Commencing Reclamation Proceedings for Forfeited Coal Mining Sites Within One Hundred Eighty Days as Required by 38CSR2 12.4.c (Legislative Rule).

- The Legislature passed legislation removing the requirement to begin reclamation within 180 days of forfeiture. However, this legislation has not been approved by the OSMRE which must occur prior to the DEP enacting this requirement.
- The DEP produced data for 512 permits with completed land reclamation. The median starting time for reclamation was 67 months. Only 46 permits began reclamation within 180 days, and the longest time for reclamation to commence was 345 months.

- In a 2012 Post Audit report, the DEP acknowledged the backlog and planned to have reclamation current as of 2015. Since then, reclamation commenced within six months for 17 of the 19 sites with completed reclamation. However, documents indicate another 36 sites forfeited before August 2018 have not yet commenced reclamation.
- The longer sites remain unclaimed, the greater the risk of pollution and environmental damage to the local community. Further, due to increasing reclamation costs the percentage of reclamation on forfeited sites covered by reclamation bonds will decrease over time.

Recommendation:

- 8.1 The Legislative Auditor recommends the DEP commence reclamation of forfeited sites within 180 days as stipulated by current OSMRE approved 38CSR2 12.4.c. until the revision removing the 180-day requirement is approved by the OSMRE.

Issue 9: The DEP is Not in Compliance with State and Federal Laws that Require the Use of Funds Collected for Forfeited Bonds be Used to Reclaim Those Properties for which the Bond was Posted.

- W.Va. Code requires forfeited funds to be expended upon the sites for which they were forfeited. However, collected bond monies are not encumbered by the DEP for a specific site.
- The median length of time between forfeiture and commencement of reclamation operations is 67 months.
- In the event of insolvency of the Special Reclamation Fund during this intervening period, there is a risk collected bond monies may not be available to contribute to the reclamation of properties for which they were posted.

Recommendation:

- 9.1 The Legislative Auditor recommends the DEP adhere to W.Va. Code §22-3-17(b) and properly encumber forfeited bond funds to ensure the funds are used for reclamation costs for which the bonds were posted.

Issue 10: The DEP Records Regarding Mining Permit Statuses are Inadequate, and Thus, Deter Auditing the State's Reclamation Program and Assessing the Future Solvency of the Special Reclamation Funds.

- The DEP maintains records on its website and in its in-house database. However, these records do not fully document all mine status changes, especially changes from *Inactive* to *Active* status. This does not allow the DEP to accurately track the history of mining permits.
- Lack of record-keeping has been identified by the Special Reclamation Fund Advisory Council (SRFAC) as a detriment to its ability to analyze the SRFs, provide proper information to the independent actuary, and make proper recommendations.

Recommendation:

- 10.1 The Legislative Auditor recommends the DEP comply with W.Va. Code §5A-8-9 and maintain and make public a full historical record of permit changes to allow for proper oversight and analysis of mining sites.

Issue 11: The Special Reclamation Fund Advisory Council (SRFAC) Has Experienced Extended Vacancies and Expired Terms for Council Members Due to a Lack of Timely Appointments.

- The SRFAC is composed of eight members who analyze the state of the Special Reclamation Funds and make recommendations to the Legislature.
- One position, representing the interests of the general public, was vacant for at least four years.
- The member representing the environmental groups was documented to have been removed by the Governor via letter issued to the Senate Confirmations Chair on January 8, 2018. However, this individual continues to serve on the SRFAC.
- Members may remain in their seats until their terms are renewed or reappointed. Two members are still actively serving on the SRFAC, although their oaths expired in June 2018. A third member's term expired June 2020.

Recommendation:

- 11.1 The Legislative Auditor recommends the Governor's Office fill SRFAC vacancies in a more expeditious manner to reduce the number of SRFAC meetings occurring when the SRFAC is not fully represented by all council member positions established by W.Va. Code §22-1-17.

Report Conclusion

The issues highlighted in this audit report are largely interconnected, emphasizing the benefits of a concerted study or analysis that may provide a more in-depth picture of the coal mining reclamation program. One example of this interconnectivity occurs when reclamation awards are applied for discounted bonding rates. Historical data and future projections indicate only a small fraction of reclamation costs are covered by forfeited bonds. The discounts provided by reclamation awards reduce that fraction even further. Although each issue presented in the report should be addressed individually, further analysis could uncover more relationships, or provide a method for the Legislature to properly analyze the issues presented herein.

Legislative studies have not been conducted to analyze the efficacy and solvency of the state's reclamation program. The 2017, 2018, and 2019 Special Reclamation Fund Advisory Council (SRFAC) annual reports stated the following regarding the need for such a study:

*...The SRFAC further recommends that the State Legislature **form a panel to examine the elements of our State code that result in uncontrolled liabilities**, how other states deal with such issues and finally to propose a State legislative initiative to rationalize water quality regulation to meet the conditions of the Federal Clean Water Act while adding rationality and certainty to the process.... **(emphasis added)***

West Virginia's coal mining reclamation program will continue to require hundreds of millions of dollars to reclaim permit sites in accordance with federal regulations. The program has no known contingency plans if the reclamation funds were to become insolvent. If the current funding sources for the program were to prove insufficient to meet the demands of reclamation, **the resulting additional financial obligations could prove to be detrimental to the state's**

budget. Further, such conditions present the risk that the state's program may be taken over by the Federal OSMRE due to the state's inability to adequately manage and provide funds for the SRF. Therefore, it is the opinion of the Legislative Auditor that it would be fiscally prudent for the Legislature to authorize a panel to perform an analysis of the state's reclamation program for the purpose of aiding the DEP and the SRFAC in formulating recommendations designed to ensure long-term program solvency.

Recommendation:

The Legislative Auditor recommends the Legislature commission a study to evaluate the state's coal mining reclamation program and, as deemed necessary, provide recommendations to ensure the long-term solvency of the program.