



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@osa.state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

March 13, 2014

Lisa Fay
EIS Project Manager
MN DNR, Division of Ecological and Water Resources
Environmental Review Unit
500 Lafayette Road, Box 25
Saint Paul, MN 55115-4025

Dear Ms. Fay,

I submit this comment to the Supplemental Draft Environmental Impact Statement (EIS) for the proposed PolyMet NorthMet project. My comments will focus on the financial assurances.

Nonferrous Mining Activity Has Documented Financial Risks

The financial risks to taxpayers from nonferrous mining are well documented. The United States Government Accountability Office (GAO) has issued a series of reports on the adequacy of financial assurances and hardrock mines, and found methods used to date inadequate.¹ The International Council on Mining and Metals commissioned a study on financial assurances and hardrock mining through surveying members of the organization.² The industry understands the importance of the need for financial

¹ GAO-05-377 [Hardrock Mining: BLM Need to Better Manage Financial Assurances to Guarantee Coverage of Reclamation Costs, June 20, 2005](#). GAO-06-884T [Environmental Liabilities: Hardrock Mining Cleanup Obligations, June 14, 2006](#). GAO-08-574T [Hardrock Mining: Information on Abandoned Mines and Value and Coverage of Financial Assurances on BLM Land, March 12, 2008](#). GAO-11-834T [Abandoned Mines: Information on the Number of Hardrock Mines, Cost of Cleanup, and Value of Financial Assurances, July 14, 2011](#). GAO-13-633T [Hazardous Waste Cleanup: Observations on States' Role, Liabilities at DOD and Hardrock Mining Sites, and Litigation Issues, May 23, 2013](#).

² C. George Miller, [Financial Assurance for Mine Closure and Reclamation](#) (Ottawa, Canada February 2005).

assurances to make mining viable. It is clear from both government and industry perspectives that Minnesota needs to proceed cautiously when it comes to protecting the taxpayers from having to assume any cleanup costs associated with the proposed mine.

The DNR is required to promote mining and regulate it at the same time. The promotion of mining is intended for the benefit of the taxpayers and should not in any way reduce or diminish protecting the taxpayers and their other valuable natural resources. Minnesota rules allow the Commissioner of the DNR to exercise discretion when determining the size and types of financial assurances that will be acceptable, with some guidance in the rules.

In exercising the Commissioner's discretion, it is not acceptable to burden or degrade current or future generations of taxpayers. The following discussion lays out the risks of any proposed financial assurances mentioned in the SDEIS and how they tie into the Minnesota rules. These risks should be taken into consideration when the Commissioner analyzes the financial assurances finally proposed.

Risks Associated With Various Financial Assurance Instruments

Minnesota rules require financial assurance instruments for nonferrous mining to meet several criteria:

- Sufficient to cover the estimated costs necessary to implement the contingency reclamation plan should mining operations cease in the upcoming year, including closure and post closure maintenance, and sufficient to perform corrective action if noncompliance with design and operating criteria in the permit to mine occurs;
- Liquid, *i.e.*, available when needed and made payable to the Commissioner of DNR;
- In an instrument that is fully valid, binding and enforceable under state and federal law;
- Not dischargeable through bankruptcy; and,
- With terms and conditions that have been approved by the DNR Commissioner after consultation with "individuals with documented experience".³

³ Minn. R. 6132.1200, subps. 2 and 3.

The criterion that the instrument not be dischargeable through bankruptcy or “bankruptcy-proof” is difficult to enforce. Solvency of the third party issuer and the solvency of the mining company must be known. The instruments must be appropriately drafted. Even then, bankruptcy laws and environmental laws often apply to the same actions but have different and conflicting purposes, and it is difficult to predict how the two will play out in a court of law.

Environmental statutes create liabilities that bankruptcy laws will discharge. However, some obligations that environmental laws create directly conflict with the bankruptcy policy of a “fresh start” for the debtors. For instance, the environmental concept of obligations does not necessarily fit into the Bankruptcy Code’s definition of a “claim.” An environmental liability can either be an obligation to remediate property under a consent order or injunction, which may not give rise to a claim, or an obligation to pay a third party or the government for remediation already conducted, which can give rise to a “claim.” Also, it can be difficult to properly assess when an environmental claim “arises,” which directly impacts whether it will be addressed in the Debtor’s plan of reorganization or whether the Debtor will have post-petition liability regardless of the bankruptcy.⁴

Whether the financial assurance instrument is truly bankruptcy-proof may not be known until the judge issues the opinion. The very best legal experts with years of experience in corporate bankruptcy should be consulted when analyzing the details of any instrument. The financial risk with nonferrous mining is high and the taxpayers deserve nothing less than the best to represent them.

The amount of oversight and enforcement effort needed by the DNR for the duration of a specific financial instrument should also be taken into account. Special expertise may also be needed.

The following financial assurance instruments are identified in the SDEIS, at page 3-139. Not all forms currently named in the SDEIS are necessarily bankruptcy-proof. Also, although they may be “available” to the Commissioner, they will only be as good as the legal language in them.

1) A Surety bond is obtained from an approved surety company guaranteeing that the obligation will be met. However, “[b]onding underwriters will not provide a surety bond

⁴ Timothy A. Millon, [Environmental Issues in Bankruptcy](#), Munsch Hardt Kopf & Harr PC January 31, 2011.

if it is determined that a site will have long term pollutional discharges since it is clear that the bond will not be released.”⁵ Another risk of bonds to the State and ultimately the taxpayers is that the Commissioner probably has little experience with them.

Members of the regulated community and the regulatory agency often do not appreciate or have little experience with the legal and practical framework of suretyship in the event of the default and/or bankruptcy of the mining company. Although the regulations provide a bare bones framework for ‘bond forfeiture’ there is much more to the equation when balancing the needs and obligations of getting a mine (or very often a family of mines) reclaimed, creditors paid and land owners satisfied. The failure of a mining company leads to absolute legal and regulatory chaos and impacts many parties including vendors, landowners, mineral owners, financial institutions, the community and the environment by proxy through the regulatory agencies. The bonding company or “**Surety**” plays a unique and very important role in how the regulatory requirements are or can be met under many circumstances which are discussed below. It is important to understand how the Surety fits into the reclamation program structure.⁶

Because Minnesota rules require the instruments be bankruptcy-proof, this information needs to be thoroughly, transparently, and satisfactorily addressed when determining if a surety bond will truly be bankruptcy-proof to protect the taxpayers.

2) An Irrevocable letter of credit is typically issued by a bank or other lending institution. The DNR would need to monitor the letter of credit for the duration of the exposure to ensure that it has not expired. Another risk the Commissioner needs to consider and do further research on is what would happen if the bank that issued the letter of credit goes into receivership. During the most recent downturn in the financial markets, there was a question as to whether the Federal Deposit Insurance Corporation (FDIC) would honor letters of credit issued by banks that had gone into receivership.⁷ According to the FDIC website, 157 banks failed in 2010, 92 banks failed in 2011, 51 banks failed in 2012, 24 banks failed in 2013 and, as of March 2014, 5 have failed.

⁵ William T. Gorton III, Esq., [Understanding the Reclamation Surety Relationship Before and After Operator Default](#), Special Institute on Mine Closure, Financial Assurance and Final Reclamation (Colo. 2009).

⁶ Ibid.

⁷ [Will Your Letters of Credit Be Honored? FDIC Warns It Will Not Honor Letters of Credit Issued By Banks in Receivership](#). Allen Matkins, Legal Alert, 2009.

Under various circumstances, the FDIC may not honor a letter of credit issued by a bank that has been placed in receivership.⁸

The above scenario falls into the “failure or limitations on the ability of third parties to pay reclamation costs” as identified on page 3-138, section 3.2.2.4.2 Financial Assurance Instruments. It is very probable that over the next 20 years, there will be more bank failures. The Commissioner needs to do further research to adequately assess the appropriateness and risks of this type of financial assurance instrument.

PolyMet acknowledges these risks related to the financial markets in its financial statements:

We may be subject to risks relating to the global economy. Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions could impede our access to capital or increase the cost of capital. These unprecedented disruptions in the current credit and financial markets have had a significant material adverse impact on a number of financial institutions and have limited access to capital and credit for many companies. These disruptions could, among other things, make it more difficult for us to obtain, or increase our cost of obtaining capital and financing for our operations. Our access to additional capital may not be available on terms acceptable to us or at all. As a result of current global financial conditions, numerous financial institutions have gone into bankruptcy or have been rescued by government authorities. As such, we are subject to the risk of loss of our deposits with financial institutions that hold our cash.⁹

3) Cash and cash equivalents can take a number of forms. The risks related to cash and cash equivalents are low if the cash is within the custody and control of the State and is not available to pay creditors should a bankruptcy occur. This is a desirable form of assurance for the taxpayers.

4) A Trust fund is established with an independent third party. Unless the trust is irrevocable, it may not be bankruptcy-proof. Money is frequently set aside in

⁸ See [Credit Life Insurance v. FDIC, 870 F. Supp. 417](#) (D. N.H. 1993) (Because triggering event had not occurred at the time bank became insolvent, FDIC could “disaffirm” the “irrevocable and unconditional” letter of credit.).

⁹ [PolyMet’s Financial Statements](#) 2012.

increments according to a set schedule. One of the risks of a trust fund is the timing of funding required by the Commissioner. If the Commissioner allows a “payment plan” for PolyMet to fund the trust fund, there is a substantial risk to the taxpayers. If a trust fund is not fully funded and PolyMet goes bankrupt, or walks away because commodity prices drop, we have opened the ground, and water treatment will be required, but we will not have the funds to pay for it for the estimated 200-500 years. The burden then gets shifted onto the taxpayers. Also, the discount rate chosen can impact whether there will be adequate funds available to pay for water treatment and maintenance and replacement costs of the equipment. Taxpayers also bear a higher risk with trust funds that require payments as there is a risk that payments will not be made.

5) An Insurance policy is no better or worse than the company writing the policy. There are risks for taxpayers associated with insurance policies, if PolyMet can even obtain one. The insurance company must be solvent. The insurance policy itself must be carefully reviewed by someone with sufficient expertise to verify it fully covers all anticipated claims. Use of an insurance instrument requires the DNR have an understanding of claims that should be made and the timing and procedures required to make them. The financial risk to government varies, depending on the specifics of the policy and the solvency of the insurance company.

For example, since insurance policies may contain exclusions that limit their coverage, the regulator must carefully review a policy being used as financial assurance to verify that it fully covers the anticipated environmental claims. Also, the regulator must remain aware of the insurer’s status—under current EPA requirements, the insurer is not required to inform the regulator if its license to operate is revoked or it becomes insolvent. In addition, EPA officials noted that insurers will sometimes include language in the policy that conflicts with EPA’s regulatory requirements, which may delay recovery on the policy. The Association of State and Territorial Solid Waste Management Officials has voiced concerns about the level of oversight required of insurance as financial assurance, and in 2003, recommended that EPA update its guidance on financial assurances, particularly its guidance on insurance issues, such as how to make claims on policies.¹⁰

Of particular concern are policies that are written by “captive” insurance companies, which are wholly-owned subsidiaries controlled by parent companies in existence to insure the parent company and its subsidiaries. In 2001, the EPA’s Office of Inspector

¹⁰ GAO-05-658 [Environmental Liabilities: EPA Should Do More To Ensure That Liable Parties Meet Their Cleanup Obligations, August 17, 2005.](#)

General found that financial assurances provided by a “captive” company did not provide adequate assurance of funding for closure and post-closure activities at hazardous waste facilities.¹¹ The financial health of the captive insurance company is too closely related to the financial health of the parent and subsidiaries that it insures for it to be sufficiently reliable as financial assurance. The EPA also recognizes in the report that it takes a specialized expertise to oversee an insurance policy, expertise the DNR may not have or retain on staff.

In its Financial Statements for 2011, PolyMet identified a number of unanticipated risks and insurance exposures:

PolyMet may not have adequate, if any insurance coverage for some business risks that could lead to economically harmful consequences to the Company. The Company’s businesses are generally subject to a number of risks and hazards, including:

- industrial accidents;
- railroad accidents;
- labor disputes;
- environmental hazards;
- electricity stoppages;
- equipment failure, and
- severe weather and other natural phenomena.

These occurrences could result in damage to, or destruction of, mineral properties, production facilities, transportation facilities, or equipment. They could also result in personal injury or death, environmental damage, waste of resources or intermediate products, delays or interruption in mining, production or transportation activities, monetary losses and possible legal liability.¹²

In Form 20F submitted to the SEC, PolyMet describes additional unanticipated risks:¹³

¹¹ GAO-05-658 [Environmental Liabilities: EPA Should Do More To Ensure That Liable Parties Meet Their Cleanup Obligations, August 17, 2005.](#)

¹² [PolyMet’s Financial Statements](#) 2011

¹³ [PolyMet’s Form 20F for the SEC](#) (Risks)

In the development stage of a mining operation, our mining activities could be subject to substantial operating risks and hazards, including metal bullion losses, environmental hazards, industrial accidents, labor disputes, encountering unusual or unexpected geologic formations or other geological or grade problems, encountering unanticipated ground or water conditions, cave-ins, pit-wall failures, flooding, rock falls, periodic interruptions due to inclement weather conditions or other unfavorable operating conditions and other acts of God. Some of these risks and hazards are not insurable or may be subject to exclusion or limitation in any coverage which we obtain or may not be insured due to economic considerations.¹⁴

Some of the risks identified above, *i.e.*, environmental hazards and pit wall failures should be covered by the financial assurance. PolyMet, however, acknowledges “some of these risks and hazards are not insurable or may be subject to exclusion or limitation in any coverage which we obtain or may not be insured due to economic considerations.”¹⁵ If these risks are not insurable, alternative financial assurance arrangements must be found, or the project should not proceed.

Risk of Inadequacy of Assurances

A guiding principal in determining the amount of financial assurance is this: The greater the risk, the larger the financial assurance must be. When assessing risk, one must first look at the type company. PolyMet is a Canadian “junior” company. It has never operated a mine, and has no experience mining. It has no track record, and has very few assets. According to the International Council on Mining and Metals’ own study, “The thousands of small junior companies have little financial and managerial depth but can and do have the capability to create significant environmental problems.”¹⁶ There will be a greater chance of “unanticipated liabilities” with a Junior company (see 3.2.2.4.2 page 3-138 of the SDEIS). Because of this, the Commissioner should require a greater amount of financial assurances to adequately protect taxpayers from unanticipated liabilities.

When assessing risk, a second factor to consider is major shareholders. Glencore Xstrata is a major shareholder of PolyMet, giving it some control of the project. Glencore Xstrata is a large multinational mining company that does have assets from which to

¹⁴ [PolyMet’s Form 20F for the SEC](#) (Risks)

¹⁵ *Ibid.*

¹⁶ International Council on Mining and Metals [Financial Assurance for Mine Closure and Reclamation](#), page 44, February 2005.

draw from if needed. If Glencore Xstrata could be put on the permit to mine for the project, their assets could provide some assurance to taxpayers.

Risk to Other Natural Resources

The SDEIS does discuss the geology of the site. It is important to note that Minnesota's surface and groundwater are valuable assets of the state. Clean water is becoming a more scarce resource for other states, and already has significant market value as a commodity¹⁷ that will be more and more in demand over the next decades. This mine is proposed in a water-rich environment. When determining the size of the assurances required, protection against degradation of other valuable commodities and resources is critical. Like the nonferrous minerals, this water belongs to all Minnesotans, and should be protected by larger assurances. This will help incent PolyMet to mine with care, and protect the taxpayers from being saddled with a large financial liability and/or degradation of a valuable commodity.

Risk of Failure of Political Will

The Commissioner is required to review the mine annually to see if assurance amounts need to be adjusted. This is acceptable to a point. There is great risk if the Commissioner, in "his discretion", accepts only what PolyMet says they can afford, assuming the DNR can collect more later. The DNR has assured the public that they can pull permits from mining companies if they owe more in assurances and do not pay or have other violations. The risk with this approach is that it exposes the state and taxpayers to political will failure. What Governor or administration is going to have the political will to pull permits and kill existing jobs at a mine in the future? When have they ever had the political will? The DNR needs to reflect on how they have handled ferrous mines that were not in compliance with regulations or with their assurances. If they have not pulled permits before, there is not credible evidence to suggest they will in the future. Due to the political will risk, the Commissioner must get an adequate amount up front to protect taxpayers and not assume more can be secured later.

Risk of Predictive Failure

In determining the size of assurances required, there is significant risk of settling for too little because of predictive failure. The ability of the Commissioner to determine how to calculate the cost for reclamation of the site is probably not a difficult task with the help of experts familiar with this type of work. However, the Commissioner's or anyone's

¹⁷ Paul B Farrell, ["Water is the new gold, a big commodity bet" Market Watch Wall Street Journal](#) (July 24, 2012).

ability to calculate the cost of water treatment for 500 years is probably impossible. The further out one tries to “predict” or estimate water pollution based on modeling gets less and less reliable the further into the future one models. No one knows what the financial markets will be like in 500 years, how much technology will have changed, the rate of inflation, the proper discount rate, and many other factors. Government’s ability to keep track of records for the assurances for that long a period of time is similarly uncertain. The probability of predictive failure should raise serious ethical and financial questions about whether Minnesota should be entering into a project where short term benefits are realized, but the potential pollution from waste rock will be in our state hundreds or perhaps thousands of years.

Need For Expert Advice

Finally, the State does not have the expertise necessary on staff to adequately protect taxpayers when assessing the types of assurance instruments and the size and adequacy of the assurances or the legal language in the assurances. The Commissioner of the DNR should hire top outside financial, legal and scientific experts who practice regularly in their respective areas and who have experience with nonferrous mining, to represent the State and the taxpayers’ interests to fully mitigate the risks described herein.

Respectfully submitted,

Rebecca Otto
Minnesota State Auditor