

Coal Market Report

Risks to US coal mining and export proposals

October 2015

This Coal Market Update summarizes general developments in the last financial quarter that raise the risk of investing in the US coal industry. All prices are in USD unless otherwise noted. The information in the report is not financial advice, investment advice, trading advice or any other advice.

This report was prepared by: Greenpeace, Sierra Club, Climate Solutions, Earthjustice, Rainforest Action Network, and Dogwood Initiative.



Summary:

The US coal industry is facing structural decline and companies pursuing coal export proposals in the Pacific Northwest and California are particularly at risk. This update highlights execution risks for coal export proposals on the West Coast, global coal market conditions including declining imports in major Asian coal consuming countries, risks related to bonding requirements for mine reclamation for particular companies like Arch Coal, and additional policy changes that may impact proposed coal infrastructure projects.

Coal companies mentioned include:

Arch Coal, Inc.

Alpha Natural Resources, Inc.

Bowie Resource Partners LP

Cloud Peak Energy, Inc.

Lighthouse Resources, Inc. (formerly Ambre Energy North America)

Peabody Energy Corporation

I. EXECUTION RISKS

Regulatory Uncertainties:

Millennium Bulk Terminals, Longview, WA: **New Delay**

Co-owned by Arch Coal and Lighthouse Resources, Millennium Bulk Terminals (MBT) is a 44 million-ton proposed coal export terminal project in Longview, Washington.

On October 16, MBT received a regulatory setback when the Department of Ecology, Army Corps of Engineers, and Cowlitz County announced a delay in the release of the project's draft environmental impact statement.¹ According to Ecology, MBT was partially responsible for the delay because the company repeatedly failed to submit requested information on time.² The release was originally scheduled for November 2015 but has been postponed to April 30, 2016.³

Gateway Pacific Terminal, Cherry Point, WA : **On-going**

Gateway Pacific Terminal (GPT) is a 54 million-ton proposed coal export terminal in Cherry Point/Bellingham, WA. It is a joint venture between Peabody Energy Corporation, SSA Marine, and, recently, Cloud Peak Energy.⁴

On January 5th, 2015, the Lummi Nation formally requested that the Army Corps of Engineers halt all federal permitting in order to honor and uphold treaty rights that GPT would harm.⁵ Communication is ongoing between the Lummi Nation, the Army Corps, and GPT. The Army Corps has repeatedly stated that their process to determine potential violations of treaty rights parallels the process of preparing their Draft Environmental Impact Statement (DEIS). However, GPT supporters have asked the Army Corps to complete the DEIS process before making any decisions related to treaty rights. Supporters have also made failed attempts to attach riders to federal legislation that would force the Army Corps to delay treaty rights decisions.⁶

Army Corps has not provided a timeline for their decision.

Fraser Surrey Docks, British Columbia, Canada: **On-going**

The coal transfer scheme for Fraser Surrey Docks and Texada Island faces several regulatory hurdles before construction could begin, with permitting processes slated to continue into, and possibly beyond, 2016. The project requires five permits and has only received two: one from the provincial government for the Texada facility and one from the federal port authority for the Surrey facility. Of those two, the port permit faces two existing legal challenges. The three remaining permits include:

- A liquid waste permit from the regional government (Metro Vancouver), which took public comments for the first time ever on this type of permit, and was inundated with letters opposing the application. A final permit decision is expected sometime in 2015; if approved, citizens' groups will almost certainly appeal the decision.
- An air quality permit from the regional government (Metro Vancouver), which Fraser Surrey Docks has not applied for because it decided to challenge Metro Vancouver's air quality jurisdiction in court. In May 2015 the company asked the court to adjourn its case until 2016, delaying a final permit decision by at least another year.⁷
- An approval from the provincial government to conduct work in and around a stream, for which Fraser Surrey Docks has not yet applied. The process will take several months and include inter-governmental and First Nations consultation once an application is made.

Litigation Risks

Pacificorp/Bowie Resource Contract and Asset Purchase: **New Legal Challenge**

On June 5, 2015, Bowie Resource Partners, LLC (Bowie) announced that it had closed a 15-year coal supply and asset purchase agreement with PacifiCorp,⁸ a multi-state utility with service territory in six states, including California. PacifiCorp had entered into a preliminary agreement to obtain coal from Bowie's mines in Utah to supply the Huntington coal plant following the utility's closure of the Deer Creek mine. Part of the deal included the sale of various assets, for which PacifiCorp sought the approval of the California Public Utilities Commission. However, PacifiCorp and Bowie closed the deal before the California PUC acted on PacifiCorp's request to approve the asset transfer, and on July 24, 2015, the California PUC rejected PacifiCorp's request.⁹

Sierra Club filed a complaint alleging that PacifiCorp violated Section 851 of the California Public Utilities Code, which states that any agreement completed in violation of the statute is void. PacifiCorp has re-filed its request to transfer the assets and is asking for *nunc pro tunc* (i.e. retroactive) approval of the deal.¹⁰ If the PUC denies the application or if it finds PacifiCorp violated Section 851, the status of the transfer of mining assets to Bowie and the status of the long-term coal agreement could be thrown into chaos.

The Oakland Bulk and Oversized Terminal, Oakland, California: **New Litigation**

The Oakland Bulk and Oversized Terminal (OBOT) is a proposed export project between Oakland developer Phil Tagami and Terminal Logistic Solutions. The new proposed project at the Oakland Army Base could handle approximate 5-10 million tons of coal a year. Previously, Tagami made a number of public statements that the company had "no interest or involvement in the pursuit of coal-related operations at the former Oakland Army Base."¹¹ However, in April 2015, community members learned that the developers had privately cut a funding deal with four Utah counties: In exchange for \$53 million in project funding, the counties would receive shipping rights to at least 49% of the bulk terminal's annual shipping capacity.¹²

On October 2, Earthjustice, on behalf of Communities for a Better Environment, Asian

Pacific Environmental Network, the Sierra Club, and San Francisco Baykeeper, filed a California Environmental Quality Act (CEQA) lawsuit to challenge the proposed terminal.¹³ The suit argues that the environmental review did not meet fundamental CEQA requirements by failing to include any discussion or analysis of how transporting, handling, or exporting coal from Oakland might impact surrounding neighborhoods or the environment. This is particularly problematic given the project's disproportionate impact on Oakland's most vulnerable communities of color.

Port of Morrow, Oregon: **On-going**

The Port of Morrow is an 8 million-ton proposed coal to barge export facility owned by Lighthouse Resources. In August of 2014, the Oregon Department of State Lands denied a critical permit to Coyote Island Terminals, LLC (a subsidiary of Lighthouse Resources) to construct a covered 8 million ton/year coal terminal on the Columbia River based on potential impacts to treaty-protected fisheries and aquatic resources.¹⁴

Coyote Island and the Port of Morrow filed administrative appeals of the denial. The state of Wyoming also sought to file an appeal but they were rejected on jurisdictional grounds.¹⁵ Environmental organizations and four treaty-protected American Indian tribes intervened in the appeal to support the state's decision.

The proceeding is moving very slowly, perhaps because Coyote Island appears ambivalent about continuing a lengthy and expensive proceeding with a narrow path for success. Currently, a trial is scheduled for fall 2016. Several more months would pass before any ruling and an all-but-certain judicial appeal of the result would require an additional 18 to 24 months. Additional appeals could follow.

Fraser Surrey Docks, British Columbia, Canada: **On-going**

The Fraser Surrey Docks export proposal faces two significant legal challenges. Ecojustice, two local residents, and citizens' groups Voters Taking Action on Climate Change and Communities and Coal are working together to block the project permit that Port Metro Vancouver issued for the project in 2014. Two municipal governments—the cities of Surrey and New Westminster—have been granted intervener status in the case. It is likely to go to trial in early 2016.¹⁶

The Musqueam First Nation has also filed a challenge against the port authority approval for the project, citing violations of Aboriginal cultural rights and the duty to consult.¹⁷

Political Challenges:

The Oakland Bulk and Oversized Terminal, Oakland, CA: **New Resolution**

On September 21, the Oakland City Council held a public hearing on the health and safety impacts of the OBOT proposal. Oakland is considering banning coal from the army base project or otherwise conditioning such exports. Around 600 people signed up to speak, 75% of them turned out to say “no coal in Oakland”.¹⁸ Council passed a resolution to research its options to regulate and to undertake action by December 8, 2015.¹⁹

Tongue River Railroad, Montana: **New Resolutions**

Arch Coal’s proposed Otter Creek Mine would require construction of a new railroad line to move coal from southeast Montana to the proposed coal export terminal in Washington. The railroad requires a permit from the federal Surface Transportation Board (STB), which released a draft Environmental Impact Statement (DEIS) for public comment in April.²⁰

On September 21, 2015, the Northern Cheyenne Tribal Council unanimously passed a resolution opposing the Tongue River Railroad and urging the STB to adopt the “No Action Alternative” proposed in the draft EIS. The Council is the governing body of the sovereign Northern Cheyenne Nation. The resolution noted the “undue burden and stress” that the railroad would place on local community resources.²¹

Hours after the Tribal Council vote, the Missoula City Council voted to adopt a similar resolution. Ward 3 council member Jordan Hess, who prepared the resolution, told the Missoulian that “[t]he [STB’s] draft environmental impact analysis has major deficiencies. We’re left in a position where, really, our best action is to oppose the project.”²² The STB previously ignored a direct request from several municipalities, including the Missoula City Council, to host public hearings on the draft EIS in down-rail cities.

Under the National Environmental Policy Act, the STB is required to respond to every substantive comment generated during the public comment period in a final EIS. The agency is under no deadline to produce the final document.

II. MARKET RISKS

Global Markets

Global coal market outlook remain depressed as the world's biggest coal consumers continue to decrease their imports. The latest data points from China, Japan and India, which together account for 51 percent of globally traded thermal coal, reinforce the view that coal is in permanent decline and peak coal is coming 'much sooner than expected'.²³ With three leading global thermal coal price benchmarks now below price levels not seen since the global financial crisis, Morgan Stanley has listed thermal coal one of the two weakest commodities in its autumn outlook.²⁴ Goldman Sachs concluded that there is no longer any viable case for continued investments in global mining or export infrastructure, given the predicted low prices and excess capacity.²⁵

China

As China transitions toward a less energy intensive, more consumer oriented growth profile, every new data set paints the picture that the nation's coal use is flattening and its transition to renewable energy is occurring at a faster rate than expected.

China's coal production fell by 5% in January-August²⁶, while imports plummeted by 31%.²⁷ Overall, there has been an estimated 4% fall in apparent coal consumption. The Chinese National Coal Association also reported that meaningful declines in investment in both the production and use of coal, down 12.8 percent in 1H 2015 compared to 1H 2014.²⁸

China's wide use of administrative action to shut down coal power plants and increase enforcement of existing environmental regulations demonstrates the government's strong commitment to reducing the nation's reliance on coal. Reportedly, even coal fired power plants within compliance with pollution regulations have been ordered to shut down immediately in and around major cities.²⁹

Meanwhile the Yuan devaluation has also thrown another wrench in global commodities trade, with increasing speculation from analysts that China will soon become a net exporter of coal.³⁰

India

India's coal imports have slowed from 20-30% growth rates in the past years to approximately 7% in January–August. In September, thermal coal imports for utilities were down 14 percent year on year, suggesting mid-2015 was a "turning point in India's coal import appetite."³¹ If India achieves its ambitious renewable investment targets, it will further weaken coal import markets.

Japan

Remarkably, Japan's use of coal for power generation was down 3.3% in January-July according to the Ministry of Economy, Trade and Industry.³²

Glutted Market Are Likely to Remain

Meanwhile, the coal market failed to adjust to falling demand; the world's five largest exporters increased sales with combined shipments from Indonesia, Australia, Russia, Colombia and South Africa gaining 0.1 percent to 343 million tons, earlier this year.³³ Without output easing from export nations, the downward pressure on coal prices remains strong, making any exports from the US highly uncompetitive. Cloud Peak Energy, likely the best positioned exporter from the Powder River Basin, has estimated that it needs to see prices in the \$80-90 range before it can break even on exports.³⁴

Financial Risks

Arch Coal Debt Exchange:

Arch Coal, the second largest US coal company and part-owner of the proposed Millennium Bulk Terminals in Longview, Washington, faces further bankruptcy risk as a result of its debt exchange being blocked by a group of lenders.

The New York Supreme Court recently ruled against a lender seeking to enforce a debt-to-debt swap for the company, essentially “halting a transaction that advocates have said would keep the coal company out of bankruptcy.”³⁵

In September 2015, disagreements between lenders over Arch Coal’s debt restructure led to a civil lawsuit against group of senior lenders, claiming that their stance was likely to trigger the company’s bankruptcy.

‘It is near certainty that Arch Coal will land in bankruptcy if the debt exchange offer doesn’t go through’, court documents filed by the Plaintiff GSO Special Situations, asserted.

Among other arguments, the Plaintiff in the lawsuit argued

*‘the past two years have been devastating for the coal market. Coal prices at historically low levels...And environmental regulations become more and more burdensome.... The company’s highly leveraged capital structure, consisting of more than \$5 billion in outstanding indebtednessrenders it ill-equipped to survive these challenging market conditions’.*³⁶

III. FEDERAL AND STATE POLICY UPDATES

Bureau of Land Management Hosts Listening Session on Federal Coal Leasing:

On July 8, 2015, Secretary of Interior Sally Jewell followed up on her earlier call for an “honest and open conversation about modernizing the federal coal [leasing] program” by announcing five public listening sessions in late July and early August.³⁷ In response, an extraordinary coalition effort involving over two dozen local, state and national organizations mobilized strong turnout and statements in support of coal leasing reform at each session. The five sessions were held in Washington, D.C.; Billings, Mont.; Gillette, Wyo.; Denver, Colo.; and Farmington, N.M.

High-level Interior Department staff attended all sessions, including Secretary Jewell, Deputy Secretary Mike Connor, Assistant Secretary for Land and Minerals Management Janice Schneider, and Bureau of Land Management Director Neil Kornze. Officials heard from 177 speakers over the course of the five sessions, with nearly two-thirds in support of reform of the federal coal leasing program, according to the Western Organization of Resource Councils.³⁸ Following the sessions, Secretary Jewell and Office of Management and Budget Director Shaun Donovan by-lined an op-ed in the Farmington Daily Times highlighting the Interior Department and White House’s ongoing commitment to “squarely focus[] on responsibly managing the nation’s energy resources, protecting taxpayer interests and getting a fair return to our citizens when public assets are sold.”³⁹

The Interior Department has begun to explore changes to the coal leasing program. Its Office of Natural Resources Revenue is considering closing loopholes to prevent underpayment of royalties through non-arm’s length transactions with affiliates⁴⁰, and the Bureau of Land Management is considering whether to raise royalty rates for coal mined from public lands.⁴¹

Failures force carbon capture and sequestration projects to return federal subsidies:

Four carbon capture and sequestration (CCS) projects had to return over \$1 billion in federal subsidies because the projects failed to meet key deadlines. Politico Pro reports the development as “emblematic of the struggles ‘clean coal’ has faced in recent years. Of the money that DOE is returning, \$1.27 billion was set aside for carbon capture projects that failed to win agency approval because of cost overruns, tricky negotiations and lengthy regulatory hurdles.”⁴²

Some coal mining companies have touted CCS to argue that coal could remain viable despite global efforts to reduce carbon pollution. But many CCS efforts have failed or been cancelled, costs remain high, and their use to date is just a fraction of other emissions reductions strategies, such as renewable energy. Over the last five years, just 692 MW of coal generation has been (or is being) fitted with carbon capture; around 300 GW of solar and wind have been installed in the same period.⁴³

A recent report from Citibank also recognized the trend, noting, “If progress is not made quickly with CCS, it is difficult to see it playing a major role in emissions reductions.”⁴⁴ Many observers don’t expect to see a meaningful role for CCS, as a Bloomberg Intelligence energy policy analyst explained: “CCS is just a lot more expensive and technologically challenging and very location-specific. It’s a very challenging environment to build a CCS project and I don’t think that it’s going to get any less challenging.”⁴⁵

US/China Bilateral Climate Agreement

On Sept 25, US President Obama and Chinese President Xi announced a second bilateral climate agreement in advance of the UNFCCC COP 21 in Paris. China announced a national cap and trade program for major industries including cement, steel, and electric power, pledged \$3.1 billion in climate finance, and committed to “strongly controlling public investment flowing into projects with high pollution and carbon emissions both domestically and internationally.”⁴⁶ The US highlighted the Clean Power Plan and committed to finalize additional regulations on heavy duty trucks, buildings, and other sectors.

Arch Coal’s Self-Bonding Status Questioned in Wyoming

On October 16, Powder River Basin Resource Council (Resource Council) sent a letter to the Wyoming Department of Environmental Quality (DEQ) asking them to revoke Arch Coal Inc.’s—and its subsidiaries’—ability to self-bond at its Wyoming coal mines.⁴⁷ Arch owns and operates Coal Creek and Black Thunder, the second largest mining complex in the country. Production from Black Thunder totaled 101.2 million tons in 2014, 76% of Arch’s total tons sold.⁴⁸

Self-bonding is a practice that allows companies to mine coal without a financial guarantee (such as a surety or irrevocable letter of credit) that land disturbed during mining will be reclaimed to its original state as required by law. Some states, including Wyoming, allow self-bonding for companies that meet certain financial tests and demonstrate histories of “financial solvency.”

Arch Coal currently carries \$457 million in reclamation liability in the Wyoming.⁴⁹ The Resource Council letter expressed concern that, given the company’s financial downturn, Arch no longer qualifies for self-bonding status in Wyoming. If the DEQ sides with the Resource Council, Arch Coal would be required to provide bonds with third-party financial guarantees for its nearly half-billion dollars of mine-site reclamation obligations.

This would not be the first time Wyoming DEQ rejected self-bonding status for a struggling coal company. On April 26, 2015, Wyoming DEQ notified Alpha Natural Resources, Inc., that it no longer qualified for \$411 million in mine site reclamation self-insurance under the state’s self-bonding program. In a letter dated May 26, 2015, Wyoming DEQ required the company to provide replacement reclamation bonds within 90 days from the notice.⁵⁰ Alpha filed for Chapter 11 bankruptcy protection on August 3, 2015, before the 90-day period expired.

Alpha bankruptcy: Deal struck with Wyoming DEQ on reclamation obligations may violate federal law

On September 8, Alpha Natural Resources and the State of Wyoming motioned a federal bankruptcy judge to approve a settlement between the parties that resolves the State’s May 26, 2015, order to the company to replace its self-bonds, which guarantee performance of minesite reclamation (i.e., cleanup) activities. Following a hearing before the bankruptcy court on October 6, the court entered the proposed order approving the settlement.⁵¹

Under the terms of the settlement, the State of Wyoming has received a \$61 million superpriority claim on DIP assets. The stake is contingent on non-enforcement of the State’s previous order to replace Alpha’s \$411 million self-bond obligation with a surety bond or collateral.

Reclamation bonding is a centerpiece of state and federal strip mine legislation and a requirement to receive a mining permit. Alpha argued before the court, however, that complying with the State of Wyoming's order to replace collateral of \$411 million would have "impose[d] a significant burden on the Debtors' liquidity."⁵² While federal mine regulators at the Office of Surface Mining Reclamation and Enforcement did not object to the deal moving forward, the agency did file a reservation of rights to enforce federal law regarding reclamation bonding before the court.⁵³

Wyoming DEQ denies mandatory conference with coalfield stakeholders over Alpha permit concerns

In early October, the Powder River Basin Resource Council, which represents landowners and agriculturists in Wyoming, objected to the Wyoming Department of Environmental Quality's (DEQ) proposed renewal of Alpha Natural Resources' permit for its Eagle Butte Mine near Gillette, Wyoming.⁵⁴ The Resource Council objected to the permit on the grounds that the company had not posted a valid and legally sufficient reclamation bond, a central requirement of Wyoming and federal mining laws. Instead, DEQ proposed to renew the permit with "self-bonds" as the only financial assurance for the mine—despite the May 2015 DEQ decision that the company no longer qualifies for self-bond status. The Resource Council requested an informal conference before the DEQ Director to work out its differences with the agency and the company, in the hopes of coming to a resolution about Alpha's bond status that would protect the public from being responsible for the almost \$200 million in coal mine cleanup liability at the mine.

In a letter dated October 15, 2015, Wyoming DEQ Director Todd Parfitt denied the Resource Council's request for an informal conference.⁵⁵ Instead, DEQ claimed it was bound by Alpha's pending bankruptcy proceedings. While there is significant dispute over what DEQ is in fact bound by—or what perhaps the agency bound themselves to by entering into a voluntary agreement with Alpha as part of the bankruptcy proceedings—there is no dispute that under Wyoming and federal mining law, the right to an informal conference is absolute and must be granted if an interested party requests one as part of a permit objection, like the Resource Council did in this instance. Informal conferences are necessary for public participation in the permitting process.⁵⁶ The Resource Council is evaluating its next steps in response to DEQ's decision, including possible legal recourse against the state.

IV: REPUTATIONAL RISKS:

Coal Industry Lobby Group Downsizes DC Office, Cuts Half its Staff

The US coal industry's diminishing resources and influences are forcing its main lobbying organization to scale back. Politico reported that the American Coalition of Clean Coal Electricity (ACCCE) "is cutting half its staff and reorganizing to reflect the U.S. coal industry's market losses and the industry's continued financial struggles."⁵⁷ ACCCE historically manages lobbying and public relations efforts on behalf of coal mining companies and some coal-heavy utilities, but the Politico story also notes that several utilities, including "MidAmerican, DTE, Duke and First Energy, have dropped out of the group."⁵⁸ The Wall Street Journal also looked at the growing divide between utilities and coal mining companies' lobbying strategies, noting that while US coal mining companies are challenging "the Obama administration's new rule limiting carbon emissions from power plants. Most electric utilities have a different strategy: They are embracing it." PricewaterhouseCoopers LLP's power and utilities deals leader Jeremy Fago told the Journal, "The bulk of utilities have already started to make the transition away from coal."⁵⁹

New York City Considering Divesting from Coal

Last month, New York City Mayor Bill de Blasio launched a campaign for the city's five pension funds to divest from coal, which include approximately \$33 million in assets associated with the industry. In a statement, the mayor wrote: "New York City is a global leader when it comes to taking on climate change and reducing our environmental footprint. It's time that our investments catch up—and divestment from coal is where we must start...I'm also asking the five pension funds to develop a long-term strategy on all fossil fuel investments, as New York City continues to move toward renewables and away from fossil fuels."⁶⁰

New York City could follow California, which in early September passed a bill to divest the state's two largest pension funds from coal. The funds combined are worth nearly \$500 billion, with coal assets estimated around \$40 million.⁶¹

Rainforest Action Network Launches New Campaign Targeting Morgan Stanley

Earlier this year, Bank of America, the second largest bank in the U.S., and Crédit Agricole, the third largest in Europe, announced policies to cut financing for coal mining. In October, French bank Natixis went further than its existing policy against funding mountaintop removal mining (MTR), with a commitment to stop financing coal mining and coal-fired power worldwide.⁶² Also in October, Citigroup announced it would reduce its lending exposure to the coal industry, citing climate change as a driving risk factor in its decision.⁶³

Now, Rainforest Action Network has launched a campaign targeting investment bank Morgan Stanley on its coal financing practices. In 2014 alone, Morgan Stanley financed \$477 million for coal mining.⁶⁴ Morgan Stanley is a longtime financier of Peabody Energy, the world's largest private sector coal mining company, as well as several power generation companies.

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