

# BRIEFING NOTE:

## As U.S. Coal Markets Decline, Kayenta Mine Is Not Likely to Find New Customers When the Navajo Generating Station Closes

*Peabody Energy Can Help Plan an Economic Transition for Its Workforce and the Affected Community; Any New Owner Would Face Serious Financial Risks*



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## Introduction: The Kayenta Mine Will Lose its Only Customer When the Navajo Generating Station Closes

The Navajo Nation Council voted on Monday to approve a new lease with the plant's owners that will close the coal-fired Navajo Generating Station after December 31, 2019.

The four utilities that own the plant with the federal government have declared it no longer economically viable. Only an enormous federal subsidy could keep it open. Market forces have made the plant unprofitable and unsustainable.

When the plant closes, Peabody Energy's Kayenta mine, which supplies the coal for the plant, will lose its only customer. The mine ships coal to the plant on a dedicated 78-mile long railway line that has no other purpose.

Peabody Energy is working hard nonetheless to keep the plant open beyond 2019. Every year, the 4 to 6 million tons of coal Peabody sells to the Navajo Generating Station brings in \$160 to \$240 million. Peabody is counting on the revenues from Kayenta, the largest operating mine in the southwest U.S., as part of its recovery from bankruptcy.

The Kayenta mine was not covered by the terms of the new lease—at least not directly—so many questions about the mine remain: Might Peabody find a new owner for the plant, and then keep the mine open as its supplier? Might Peabody sell the mine to someone else, who would find new customers for its coal?

A look at electric power generation and coal mining in New Mexico, Utah, Colorado and Arizona suggests neither of those options is likely—or wise.

## Demand for Power from Coal-fired Plants is Declining in the Region

The Navajo Generating Station is closing because it can't compete with low energy market prices in the region, which are driven by low natural gas prices and the increasingly low cost of renewable energy.<sup>1</sup>

Coal-fired power plants in the Southwest are in a state of decline and, as a result, so is the regional coal-mining economy. IEEFA examined the performance of 15 coal-fired powered plants in the region,<sup>2</sup> and found that since 2010:

- Three small plants (Arapahoe and Cameo in Colorado and Clark in Nevada), with a combined capacity of 261 MW, have closed. In their last year of operation, these plants burned 700,000 tons of coal from western mines.

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<sup>1</sup> [http://ieefa.org/wp-content/uploads/2017/05/End-of-an-Era\\_Navajo-Generating-Station\\_May-2017.pdf](http://ieefa.org/wp-content/uploads/2017/05/End-of-an-Era_Navajo-Generating-Station_May-2017.pdf)

<sup>2</sup> Arapahoe Station, Cameo Station, Cherokee, Clark Station, Comanche Generating Station, Craig Station, Hayden Station, Martin Drake Power Plant, Nucla Station, Pawnee Station, Rawhide Energy Station, Ray Nixon Power Plant, TriGen Colorado Steam Electric Plant, Valmont Station, and Four Corners

- Four plants in Colorado (Cherokee, Craig, Martin Drake, Nucla), with a combined capacity of 2,511 MW, have announced retirements. In 2016, these plants burned 5.5 million tons of coal from western mines.
- The average capacity factor (a measure of how frequently the plant operates) of the remaining eight active plants in the region has declined by 14%, from 67% in 2010 to 58% in 2016. The amount of coal burned by these plants dropped from 15.4 million to 13.4 million tons from 2014 to 2016.

The decline is creating coal plant winners and losers. For example, the two largest coal plants in the region recently have performed quite differently: the Four Corners (1540 MW) plant in New Mexico lost 33% of its utilization from 2014 to 2016, while Comanche plant utilization in Colorado increased by almost 50%.

The Four Corners plant is the sole customer of the Navajo mine, which is also in New Mexico. Prior to 2014, the annual coal burn from Four Corners plant was in the 7-million-ton range. That figure has been dropping since then, from 5.6 million tons in 2015 to 3.8 million tons in 2016. During its first quarter of operation in 2017, the plant burned 1.3 million tons, which would pencil out to 5.2 million tons on an annualized basis. New management took over the mine in January 2017 and is promising to mine 6 million tons per year.<sup>3</sup>

Most of the coal plants in the region burn either locally mined coal or coal shipped in from the Powder River Basin of Montana and Wyoming. With demand declining and a loss of 5.5 million tons of demand from the four Colorado plants slated for closure (Cherokee, Craig, Martin Drake, Nucla), there are no market signals that additional coal supply is needed to meet electricity market need.

As more plants close, coal demand is likely to decline even as some coal plants maintain the support of state public service commissions and power officials.

## Coal Production at Southwestern Mines Is Declining

The overall coal market in the U.S. is declining and likely to continue in that general direction.<sup>4</sup>

There is little indication that demand for coal is rising anywhere in the Southwest and indeed coal production is in decline.<sup>5</sup> IEEFA surveyed production data on 20 of the largest coal mines in the four state region and found that coal production from these mines decreased from 66 million tons in 2014 to 45 million tons in 2016, a 32% decline.

Production at Peabody Energy's three mines in the region (Kayenta in Arizona, Twentymile in Colorado and El Segundo in New Mexico) dropped from 23 million in 2014 to 12.8 million in 2016, a 44% decline.

<sup>3</sup> [http://www.navajo-tec.com/assets/1\\_4\\_17-ntec-bisti-start-pr-final.pdf](http://www.navajo-tec.com/assets/1_4_17-ntec-bisti-start-pr-final.pdf)

<sup>4</sup> <https://pscdocs.utah.gov/electric/14docs/14035147/262520DirTestSchwartz12-15-2014.pdf>

<sup>5</sup> Joshua Learn, *Coal industry weighs heavily on jobs, output in Southwest U.S.*, SNL, July 14, 2017.

Only Bowie Resource Partners' Skyline No. 3 mine in Utah saw an increase, of 400,000 tons, during the period. Bowie's total production from all its holdings in the region (Bowie No. 2 in Colorado, and Dugout, Sufco and Skyline in Utah), however, declined by 3 million tons.

The region reported an increase in coal-mining activities in the first quarter of 2017 compared to the first quarter of 2016<sup>6</sup> (a low point for the U.S. coal industry), but production in the first quarter of 2017 was actually less than in the fourth quarter of 2016.

## Regional Coal Prices Are Flat

Any prospective new Kayenta mine operator will look at the capability of the market to generate prices that cover operations, new investment and profit.

There are no price signals to justify keeping the Kayenta mine open.

The U.S. Energy Information Administration predicts that the price of coal in New Mexico, Utah, Arizona and Colorado will stay flat for the next 10 years.<sup>7</sup>

The current regional price is in the \$40-per-ton range. As is the case with the Navajo Generating Station, this means the price of coal-generated electricity is uncompetitive with natural gas and wind and solar and that the market cannot bear a coal-price hike.

## A New Owner Would Face Steep Obstacles to Coal Export Markets

Many U.S. coal producers are hoping to make up for their shrinking revenues from domestic sales by developing a smaller but more lucrative portfolio of export customers from around the world. The problem with this approach is that the prospect for new markets on the international front are dim.

U.S. coal producers exported 73 million tons from the United States in 2015. This was a reasonably good year, but far below the peak levels of 125 million tons in 2012 and far below peak estimates of 500 million tons per year made by coal companies at that time.

Colorado exported 1.2 million tons in 2015, and Utah 700,000 tons. Arizona and New Mexico exported zero tons of coal.

The EIA expects the global market for coal to be flat for the next 10 years, and IEEFA<sup>8</sup> sees it declining. If a new owner were to invest in Kayenta with the intention of selling the coal for export that owner would face a tough road. At least a dozen U.S. coal producers with existing trade networks are already competing for foreign customers, and doing so in tough conditions. For example, Cloud Peak Energy, which mines coal in Montana, is losing money from its export operations, and the company says it remains committed nevertheless to the global market and will use profits from its domestic sales to support its export business.

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<sup>6</sup> Joshua Learn, Q1 coal production in Uinta Basin up nearly 30% over Q1 '16, SNL May 4, 2017.

<sup>7</sup> <https://www.eia.gov/outlooks/aeo/data/browser/#/?id=99-AEO2017&cases=ref2017&sourcekey=0>

<sup>8</sup> <http://ieefa.org/ieefa-asia-evidence-stark-change-seaborne-thermal-coal-markets/>

## Peabody Energy's Plans to Sell Mines in the Region Last Year Failed; Bowie Required a Cash Infusion From Trafigura

What is the acquisition market like for coal mines in the Southwest and how are investors looking at coal opportunities there?

In 2016, Peabody Energy announced the sale of three of its mines in the region—El Segundo, Twentymile and Lee Ranch—to Bowie Resource Partners. The deal was never closed, however, as Bowie could not find financial backing for the transaction. The loss of the sale helped trigger Peabody's bankruptcy filing in April 2016.

During this same period, Bowie Resource Partners received a cash infusion from its principal investor, Trafigura/Galena, a global commodity trading company with headquarters in Amsterdam. Bowie issued an IPO in 2016 that was to create revenue to be used in part to pay off some or all Trafigura's initial investment,<sup>9</sup> but withdrew it a few months later.<sup>10</sup> In April 2017, Bowie received another cash injection from Trafigura that came as the company replaced its management with a co-CEO arrangement that included a new director who represents Trafigura. Bowie and Trafigura continue to maintain a bullish position on U.S. coal exports. Trafigura's worldwide operations include oil, gas and coal interests with very close ties to Russia.<sup>11</sup>

## Peabody Energy's Track Record in Working with Communities is Troubling

The new lease for the Navajo Generating Station in theory puts the continuation of mining at Kayenta at risk after 2019, when the coal plant closes. The lease addresses the cleanup of the plant site, as well as preparation for new uses, to take place over a 35-year period. However, the lease does not cover the disposition of the mine, its closing and cleanup. These topics have not yet been broadly discussed by the Navajo Nation Council and the public. How Peabody Energy and the Navajo Nation will interact in the future is unknown, but Peabody Energy's track record on working with local communities raises troubling signals.

In a recent letter to the editor in the Gallup Independent, Roberta Wade, a former law director and council member in the City of Galion, Ohio, described how her town was taken for a ride by Peabody Energy's Prairie State Energy Campus Project.<sup>12</sup> Peabody developed the coal-fired power plant project a decade ago, with the purpose of selling coal from its Lively Grove coal mine next door to the plant. Peabody Energy profited substantially by selling the Lively Grove mine to the plant and providing various mine related services. While it had originally intended to own the plant, Peabody sold 95 percent of the ownership to municipal electric authorities across the Midwest with the promise of providing an affordable supply of electricity.

<sup>9</sup> <https://www.sec.gov/Archives/edgar/data/1631790/000104746915005595/a2225124zs-1.htm>

<sup>10</sup> <https://www.law360.com/articles/831016/bowie-resource-partners-pulls-ipo-citing-market-conditions>

<sup>11</sup> <https://www.bloomberg.com/news/articles/2016-10-17/trafigura-deepens-ties-to-rosneft-with-record-indian-acquisition>

<sup>12</sup> <http://gallupindependent.nm.newsmemory.com/publink.php?shareid=1162e7b33>

Peabody failed to deliver on this promise, exposing Galion and 200 other communities in the Midwest who bought into the plant to face long-term financial stress. As IEEFA has documented, communities are paying far higher prices for electricity from the plant than what Peabody promised, and many have been forced to raise rates and, as a result, are unable to attract new businesses.<sup>13</sup> Last year, Peabody sold its remaining 5 percent stake in the plant, apparently profiting from the sale.

Some members of the Navajo community may remember how Peabody shortchanged the Navajo Nation on coal royalties. That issue was decided by the U.S. Supreme Court in 2003 in *United States v. Navajo*.<sup>14</sup> Justice Ruth Bader Ginsberg's opinion in the case documented Peabody Energy's successful attempt to lobby the secretary of the Interior and reverse a staff decision that would have required Peabody Energy to pay a higher coal royalty to the nation. The secretary's actions, stemming from the Peabody *ex parte* intervention, were deemed by the lower courts to be a breach of the Interior Department's fiduciary duty. This lower court ruling was reversed by the Supreme Court on a technicality. The Navajo Nation has lost revenue as a result.

Earlier this month, E & E News<sup>15</sup> detailed Peabody Energy's aggressive lobbying to have the Trump administration keep the Navajo Generating Station open. Peabody Energy seeks special treatment, either to have a new plant owner come in (presumably with a very large subsidy) or to have the federal government take over the plant. In either case, the federal government would be directly subsidizing an operating coal plant for the first time ever.

Federal support for coal has been waning for years.

In 2008, under the Bush-Cheney administration, the federal government reversed a 70-year-old policy that provided federal support for the development of coal-fired generation plants by rural electric cooperatives.<sup>16</sup> The U.S. Department of Agriculture concluded at the time that coal plants were largely unprofitable and posed risks that made it impossible for the federal government to establish a prudent interest rate to charge prospective owners.

## **Will Peabody Energy Offer Jobs to Kayenta Workers If the Mine Closes?**

The four utility owners of the Navajo Generating Station have offered employment to all the men and women who currently work at the power plant when it closes. Together, these utilities hold over 30,000 MW of power generation throughout the southwest and have an employment base that can absorb many of the NGS workers.

By contrast, Peabody Energy has made no such public offer of employment to Kayenta mine workers.

However, Peabody CEO Glenn Kellow has stated that Peabody Energy is in a hiring cycle at other venues. With a mine portfolio that extends from Colorado to Wyoming in the West and throughout the Illinois Basin in the Midwest, the company is in a position to assist its own

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<sup>13</sup> <http://ieefa.org/category/subject/prairie-state-energy-campus/>

<sup>14</sup> <https://www.law.cornell.edu/supct/html/01-1375.ZO.html>

<sup>15</sup> <https://www.eenews.net/climatewire/stories/1060055812>

<sup>16</sup> Government Suspends Lending for Coal Plants: Risks Cited to Economy, Environment, Washington Post, March 13, 2008

workforce. And as a coal industry leader, Peabody is able to connect its workers with employment opportunities at several other coal companies that have said they are hiring.

## Conclusion

In lobbying to keep the Navajo Generating Station running, Peabody Energy is pursuing its own interests without regard for the potential cost to the Navajo Nation or federal taxpayers. The overall coal sector, which includes coal plants and mines, is in structural decline. There is no market for the power from the plant or for coal from the mine.

The reality that has led the four utility owners to opt to close the Navajo Generating Station is that it simply cannot compete with natural gas and renewable energy.

By lobbying the federal government for large, unprecedented and unwarranted subsidies, Peabody Energy is trying to achieve through political means what it cannot accomplish through the market. Peabody has demonstrated that its interest so far has been limited to selling coal, not helping the Navajo Nation plan for the economic, employment, fiscal, environmental and social problems caused by the closing of the plant.

IEEFA estimates that a subsidy of \$1.4 billion to \$2.4 billion would be required to keep the plant open through 2030. A more prudent—and considerably less expensive—use of federal funds would be toward a forward-looking economic transition plan that would help the Navajo Nation and the State of Arizona turn the page on this coal-fired plant and the Kayenta mine.<sup>17</sup>

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<sup>17</sup> <http://ieefa.org/wp-content/uploads/2017/06/IEEFA-Transition-Plan-for-Navajo-Generating-Station-and-Kayenta-Mine-060617.pdf>