



PEABODY
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April 3, 2017

Salt River Project
Attention: Corporate Secretary
P.O. Box 52025
Mail Stop PAB215
Phoenix, Arizona 85072-2025
Facsimile: (602) 236-2188

Salt River Project
Attention: Manager Fuels Department
P.O. Box 52025
Mail Stop POB001
Phoenix, Arizona 85072-2025
Facsimile: (602) 236-4322

Arizona Public Service Company
Attention: Director, Fuels Procurement
P.O. Box 53999, Mail Station 8974
Phoenix, Arizona 85072-3999
Facsimile: (602) 250-3628

Department of Water and Power of the City of Los Angeles
P.O. Box 51111
Los Angeles, California 90051-0100

Nevada Power Company
Attention: General Counsel
P.O. Box 98910
Mail Station 2
Las Vegas, Nevada 89151

Tucson Electric Power Company
Attention: Secretary
P.O. Box 711
Tucson, Arizona 85702

Tucson Electric Power Company
Attention: Manager- Fuels
P.O. Box 711
Tucson, Arizona 85702

United States of America
Attention: Regional Director
Bureau of Reclamation
Lower Colorado Region
P.O. Box 61470
Boulder City, Nevada 89006-1470

**RE: NOTICE TO NAVAJO PARTICIPANTS OF RESPONSIBILITY FOR THE
FUNDING AND PAYMENT OF LIABILITIES UNDER THE CSA AND OTHER
RELATED DOCUMENTS**

To: Navajo Participants:

On or about February 13, 2017, certain of the Navajo Participants issued a “Statement of Position” providing that “the Non-US Owners do not currently intend to operate the Navajo Generating Station past the current term of the Lease with the Navajo Nation, which ends December 22, 2019.” The Navajo Participants are responsible for the funding and payment of certain liabilities pursuant to the Amended Navajo Station Coal Supply Agreement dated February 1977, as amended, (hereinafter “CSA”), the Settlement Agreement and Mutual Release dated June 30, 2008 (hereinafter the “SAMR”) and other related documents. This letter advises the Navajo Participants of these liabilities and the funding and payment issues associated with this contemplated premature plant and mine closure. The information herein assumes the CSA

between Peabody Western Coal Company (“Peabody”) and Navajo Participants expires on December 22, 2019.

I. LIABILITIES UNDER THE SAMR

A. Final Reclamation Costs

Pursuant to the SAMR, the Navajo Participants are responsible for the payment of certain of the Final Reclamation Costs (“FRC”) relating to the Kayenta Mine and the Joint Facilities (as defined in the SAMR). On December 22, 2015, pursuant to §3.8 of the SAMR, the Navajo Participants requested a Full Interim True-Up of the estimated FRC. The Full Interim True-Up final reclamation cost study prepared by Golder Associates (“Golder”) was released to SRP on January 13, 2017.

The Final Reclamation Cost Full Interim True-Up valuation prepared by Golder, utilizing a December 22, 2019 mine closure date, estimated the total FRC liability in 2017 constant dollars at \$177.7 million. Applying the agreed upon inflation rates and utilizing the latest FAS106 discount rate (4.15%), the estimated liability at December 22, 2019 is \$187.9 million. This estimate does not include the applicable Risk Premium of \$3.5 million (as defined in §1.38 of the SAMR) or the applicable royalties, taxes and fees provided for in §5.1 of the SAMR. The breakdown of the estimated liability into the various categories and percentages of responsibility agreed to by the parties in the SAMR is as follows:

FRC Component	12/22/2019 Total	Navajo Participants' Responsibility	
		%	12/22/2019 Total
Final Pit Closure	\$ 49.4	54	\$ 26.7
Final Pit Closure_LAWS	13.2	100	13.2
Facilities, Roads & Infrastructure Removal	26.0	53	13.8
Facilities, Roads & Infrastructure Removal_LAWS	4.5	100	4.5
Topsoil Replacement - Mined Areas	18.6	100	18.6
Revegetation & Maintenance	11.6	55	6.4
Post Reclamation Monitoring (to Phase 1 Bond Release)	0.7	100	0.7
Post Reclamation Monitoring (After Phase 1 Bond Release to Final Bond Release)	4.9 ⁽¹⁾	100	4.9
Bonding (to Phase 1 Bond Release)	8.2	100	8.2
Bonding (After Phase 1 Bond Release to Final Bond Release)	16.7 ⁽¹⁾	100	16.7
Overhead, Unallocated and Other (to Phase 1 Bond Release)	20.4	60	12.2
Overhead, Unallocated and Other (After Phase 1 Bond Release to Final Bond Release)	13.7 ⁽¹⁾	60	8.2
FRC Sub-Total	\$ 187.9 ⁽¹⁾	71.4%	\$ 134.1
Risk Premium	3.5	100%	3.5
Total FRC and Risk Premium	\$ 191.4		\$ 137.6

(1) The Risk Premium is ten percent (10%) of the net present value at Phase 1 Bond Release of the remaining estimated costs for Post-Reclamation Monitoring and Bonding, and overhead associated with these two FRC components

Note: Any values associated with FRC are subject to additions for Royalties and Taxes

This results in the estimated Participants liability of \$137.6 million. The breakdown of the estimated liability between the Navajo Participants and estimated remaining liability to be funded by each Navajo Participant is as follows:

SAMR - Final Reclamation Costs		Estimated	Participant	Calculated
<i>(\$ in millions)</i>		12/22/2019	Funding @	Remaining
% SAMR	Participant	Obligation	1/1/2017 (a)	Liability
24.3%	USA	\$ 33.4	\$ (6.6)	\$ 26.8
21.7%	SRP	29.9	(5.7)	24.2
21.2%	Department	29.2	(5.5)	23.7
14.0%	APS	19.3	(3.4)	15.9
11.3%	Nevada	15.5	(3.0)	12.5
7.5%	Tucson	10.3	(1.9)	8.4
100.0%	Total Participants	<u>\$ 137.6</u>	<u>\$ (26.1)</u>	<u>\$ 111.5</u>

(a) Includes contributions and related earnings (accrued interest or trust investment returns)

Note that the calculated remaining liability is an estimated remaining liability and funding levels will change over time, based on net present value accretion and other factors. Also, as noted earlier, the remaining liability numbers do not include the applicable royalties, taxes and fees. Finally, the estimated FRC is based on current obligations that could change before the CSA expires.

As you are aware, the Navajo Participants have been funding their FRC obligations based on the assumption that the CSA would expire on or about April 30, 2026. Given the Navajo Participants' recently issued Statement of Position, a funding end date of April 30, 2026 is no longer appropriate. Effective April 1, 2017, Peabody will begin calculating the appropriate monthly amounts for FRC and bill said amounts based on an assumption that the CSA will expire on December 22, 2019. Pursuant to §3.10.6 of the SAMR, we would like to set up a meeting to discuss the final mine plan that will cover mining through December 22, 2019, as provided via the Golder Final Reclamation Cost update. It is anticipated that the final reclamation cost evaluation will be finalized by July 1, 2017. Pursuant to §3.8.4, the adjusted liability will be utilized in the January 1, 2018 funding update.

Pursuant to §3.10 of the SAMR, a Final True-Up will be conducted starting sixteen months before the expiration of the CSA. If necessary, a Final True-Up #2 as provided for in §3.10.1.3 of the SAMR, will be conducted starting no later than one month after the expiration date of the CSA. Upon completion of the Final True-Ups, and any audit thereof under Article XI of the SAMR, the parties shall perform a final reconciliation and make any necessary payments to fulfill their obligations under the SAMR for FRC.

B. Retiree Health Care Costs

Pursuant to the SAMR, the Navajo Participants are responsible for the payment of Retiree Health Care Costs ("RHCC") relating to the Kayenta Mine and the Joint Facilities (as defined in the SAMR). The latest estimate of the RHCC relating to the Navajo Participants' obligations under the SAMR as of December 22, 2019 is a net present value of \$130.0 million (based upon the 1/1/2016 actuarial valuation). This estimate does not include the applicable royalties, taxes and fees provided for in §5.1 of the SAMR. The breakdown of the \$130.0

million estimated liability between the Navajo Participants and remaining liability to be funded by Navajo Participant is as follows:

SAMR - Retiree Health Care Costs				
<i>(\$ in millions)</i>				
% SAMR Participation	Participant	Estimated 12/22/2019 Obligation*	Participant Funding @ 1/1/2017 (a)	Calculated Remaining Liability
24.30%	USA	\$ 31.2	\$ (9.8)	\$ 21.4
21.70%	SRP	29.5	(8.9)	20.6
21.20%	Department	27.2	(8.1)	19.1
14.00%	APS	18.0	(5.0)	13.0
11.30%	Nevada	14.5	(4.4)	10.1
7.50%	Tucson	9.6	(2.8)	6.8
100.00%	Total Participants	<u>\$ 130.0</u>	<u>\$ (39.0)</u>	<u>\$ 91.0</u>

**Note the 1/1/2016 Actuarial Valuation Obligation for Participants funding via a trust is \$125.3M versus the Non-Trust Participants of \$118.4M*

(a) Includes contributions and related earnings (accrued interest or trust investment returns)

Note that the calculated remaining liability at is an estimated liability, and funding levels will change over time based on net present value accretion and other factors. Also, as noted earlier, the remaining liability numbers do not include the applicable royalties, taxes and fees. Finally, the estimated RHCC is based on current obligations that could change before the CSA expires.

As with FRC, the Navajo Participants have been funding their RHCC obligations based on the assumption that the CSA would expire on or about April 30, 2026. Given the Navajo Participants’ recently issued Statement of Position, a funding end date of April 30, 2026 is no longer appropriate. Effective April 1, 2017, Peabody will begin calculating the appropriate monthly amounts for RHCC and bill said amounts based on the assumption the CSA will expire on December 22, 2019.

Pursuant to §2.8 of the SAMR, a Final True-Up will be conducted starting no later than one month following the Cutoff Date which, if no Navajo Participant elects its option under §2.7, will be the expiration date of the CSA. Upon completion of the Final True-Up and any audit thereof under Article XI of the SAMR, the parties shall perform a final reconciliation and make any necessary payments to fulfill their obligations under the SAMR for RHCC.

C. Settled Tail Costs

Pursuant to the SAMR, the Navajo Participants are responsible for the payment of certain costs defined in §1.39 of the SAMR as “Settled Tail Costs.” These costs include Electrical Demand Costs (defined in §1.7), Ad Valorem Type Taxes and Insurance Costs (defined in §1.1), Post-Mining Ongoing Reclamation Costs (defined in §1.34), and Water Demand Costs (as defined in §1.43). In addition, the applicable royalties, taxes and fees provided for in §5.1 of the SAMR will be added to these liabilities.

Pursuant to §4.2 of the SAMR, Peabody will provide final estimates and bill these Settled Tail Costs on a pro-rated basis over the last three months of the CSA. Peabody also will issue monthly invoices after the CSA ends, with supporting documentation to reflect updating of the estimates to the actual costs, if known, prior to the completion of the final audit under Article XI of the SAMR, and refund any overage pursuant to Article XI.

II. ADDITIONAL LIABILITIES UNDER THE CSA

In addition to the monthly costs billed under the CSA, there are other liabilities due and owing by the Navajo Participants that cannot be estimated and billed at this time. During the negotiations of the SAMR, Peabody informed you of these other “tail issues.” These “tail issues” represent costs incurred by Peabody in mining coal for the Navajo Participants under the CSA, but the payment of which does not occur until after the CSA ends. At the time of the negotiations of the SAMR, SRP, on behalf of the Navajo Participants, asked that Peabody defer the discussions of these liabilities until it was better known when the CSA would end. Given the Statement of Position issued by the Navajo Participants, that time has now come.

The additional tail issues include, but are not limited to, the following:

1. **Severance/Separation Pay** – Compensation paid to Exempt and Non-exempt Peabody Western and Peabody Energy employees that are separated from employment due to the permanent shutdown of Kayenta Mine. This would include, but not be limited to, payments made based on position, length of service, payments made “in lieu of advance notice” or other payments made at the discretion of management in conjunction with the permanent shutdown of the Kayenta Mine or required by a collective bargain agreement. Also included in this category would be payments for vacation, holiday, personal and/or sick leave, incentive compensation or other payments to which the employee is entitled to receive in accordance with company practices or a collective bargaining agreement, but had not been paid at the time of permanent shutdown of Kayenta Mine.
2. **Severance/Separation Pay – Employer Related Payments** – Employer costs related to Severance/Separation Payments made to employees required by local, state, federal, tribal or other governmental authority for taxes, fees, or other similar assessments, including but not limited to, Unemployment, Social Security, Medicare, Old Aged Disability Insurance and Workers’ Injury Compensation Insurance. Also included would be employer related costs for certain employee participative programs, including matching contributions to employee retirement accounts (e.g. 401(k)).
3. **Continuation Costs for Exempt and Non-Exempt Benefit Plans** – Employer related costs for continuing Exempt and Non-Exempt Benefit Plans for group health, dental, vision insurance, life and accidental death & dismemberment insurance or other similar benefit plans maintained in accordance with company practices or through a collective bargaining agreement or other similar arrangement for employees that are separated from employment due to the permanent shutdown of Kayenta Mine.
4. **Pension Plan Curtailment Charges** – The amount of the cost obligation of a curtailment event arising from the permanent shutdown of Kayenta Mine for the Peabody Western Coal Company Western Surface Agreement Pension Plan accounted for on a historically consistent basis under Financial Accounting Standards (FAS) Nos. 87, 88 and 132.

5. **Mined and Unsold Coal Charges** – The gross realization that would have been billable, including all applicable taxes, fees, royalties and assessments, to NGS under the terms and conditions of the Coal Supply Agreement with the NGS along with the disposal costs for coal that was mined and stored but was unsold at the time of the permanent shutdown of Kayenta Mine.
6. **Dragline Disposal Costs** – The estimated cost to dismantle and dispose of draglines that were used at Kayenta Mine and are at the mine at the time of the permanent shutdown of Kayenta Mine. The costs include, but are not limited to, planning and executing the dismantling and disposal of the draglines or draglines, extraction and disposal of any component parts including all waste oils, greases, lubricants and chemical compounds, disposal fees, taxes, permits, licenses and disposal related transportation costs.
7. **Materials & Supplies Inventory Removal** – The estimated cost to remove Materials & Supplies Inventory located at Kayenta Mine at the time of permanent shutdown. The cost of removal will be estimated based on the cost of the inventory at the mine plus the cost to dispose of the inventory including disposal fees, taxes, permits, licenses and disposal related transportation costs.

In addition, the amortization methodology utilized for the actuarial adjustments provided for in the annual Western Surface Agreement pension valuations will be adjusted to align with the communicated 2019 closure.

Also, as Salt River Project is aware, the Navajo Nation sent an audit letter dated April 17, 2015 stating that Peabody is not in compliance with the 2:1 mining proportions requirements contained in the coal lease. The lease provides exceptions for the requirement, including meeting quality requirements under the CSA as requested from time to time by the Navajo Participants, which we believe justify the imbalance. Additionally, mining could mitigate this issue over time. Regardless, the Navajo Nation may claim that royalties are due now or upon expiration of the CSA. In its audit letter, the Navajo Nation stated that the imbalance resulted in a royalty shortfall of an estimated \$26.1 million being paid to the Navajo Nation, and claimed interest due on the shortfall.

Also, there may be other matters that arise before the expiration of the CSA that could result in additional liabilities of the Navajo Participants under the CSA.

Peabody reserves all rights it may have and does not waive any rights it may have under the applicable agreements and the law to add to the matters asserted herein.

Sincerely,



Chris Walker
Vice President – Contract Management & Marketing Support
Peabody