# Coal Mining

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# Coal Mining Primer and Major Restructuring Issues

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# What is coal?

- Coal is a fossil fuel, primarily composed of carbon, burned for the production of electricity and/or heat, and also for industrial purposes, such as steel refining
- Not all coal is the same – variables include heat value, sulfur, ash, moisture content, and volatility, all of which play an important role in determining its end use
- Coal for electricity generation is referred to as steam or thermal coal, while coal for steel production is typically referred to as coking or metallurgical coal

# Why is coal important?

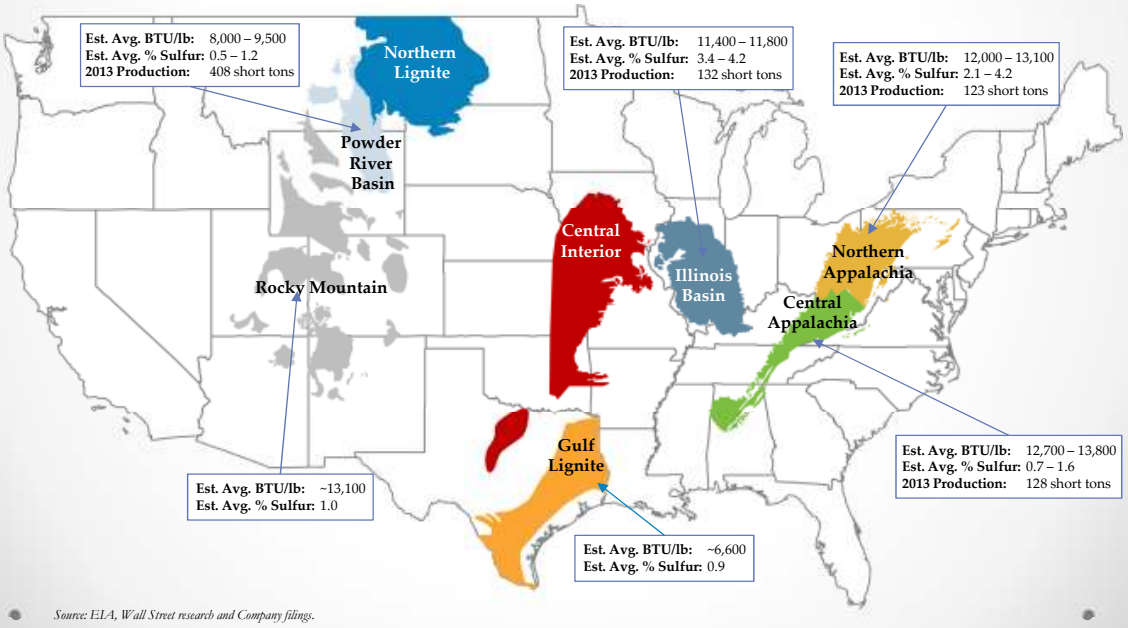
- Approximately 68% of coal is used for generation of electricity and commercial heat
- According to the International Energy Agency, coal fueled over 41% of the world's electric power in 2013
  - 33% for OECD countries and 49% for non-OECD countries
- Within the U.S., coal accounted for 36% of electricity generation for the 12 months ended July 2015, per the Energy Information Administration
  - Has dropped from 50% in 2005
- Metallurgical coal has unique properties, for example a higher heat rate, and approximately 13% of worldwide coal mined is metallurgical coal

# Where is coal mined?

- Globally, but China produces almost half of world production, and nearly 4x as much as U.S., which is second largest producer in the world
- Major coal producing regions in the U.S. include:
  - Powder River Basin (Wyoming / Montana) – largest coal producing region in the U.S. (~41%), characterized by generally lower heat rate, lower cost of production, and thus lower pricing
  - Appalachia (Pennsylvania, West Virginia, Maryland, Ohio, Kentucky, Tennessee, Virginia, Alabama) (~27%) – high heat value, but generally higher cost of production due to depletion of economically attractive reserves
  - Illinois Basin (Illinois, Indiana, Kentucky) (~13%) – high heat value and sulfur content, requiring customers with scrubbers, but lower cost of production than Appalachia

# Where is coal mined in the U.S. today?

- In the U.S., most coal is mined in on of four basins: Powder River Basin ("PRB"), Illinois Basin ("ILB"), Northern Appalachia ("NAPP") or Central Appalachia ("CAPP")




*Source: EIA, Wall Street research and Company filings.*

# What is the typical process for mining coal?

- In the U.S., approximately 65% of production is via surface mining and 35% via underground mining, each of which is a very unique and complex process
- Surface mining (open pit)
  - Remove topsoil, drill and blast overburden (earth and rock covering coal) with explosives, remove overburden with heavy equipment, extract coal
  - Requires reclamation – backfill pits with overburden, replace topsoil, reestablish vegetation and plant life into natural habitat
- Underground mining (room-and-pillar)
  - Network of rooms cut into coal seam, leaving pillars of coal to support the roof of the mine
  - Continuous miners are used to cut coal – think of a giant snow blower

# What is the typical process for mining coal?

- Underground mining (longwall)
  - Continuous miners develop access to long rectangular coal blocks – think of a picture frame with the long rectangular coal block in the center
  - Mechanical shearer extracts coal from the long rectangular block of coal, while hydraulically powered supports temporarily hold up the roof of the mine
  - As drum advances across the face, the roof is allowed to collapse behind the supports
- Shuttle cars and conveyor belts transport coal mined underground, in some cases for several miles
- Some coal requires preparation, including the removal of impurities such as rock, or blending to meet specifications of customer, e.g. sulfur content

# What are the key coal sector themes?

- While structural headwinds provide for a subdued long-term outlook for U.S. thermal coal demand, increasing urbanization and industrialization in emerging markets will serve as the primary growth engine for seaborne met and thermal coal markets

## MARKET DYNAMICS

**Depressed Coal Prices**
- Increasing supply as peak-market projects come online
- Weak Chinese demand growth
- Weak Australian dollar

**Supply Rationalization**
- ~35 Mt of global met supply curtailments; further rationalization needed

**Competition from Natural Gas in U.S. Thermal Market**
- Relative economics driving coal-to-gas switching
- PRB / ILB coal relatively competitive; Appalachian coal remains pressured

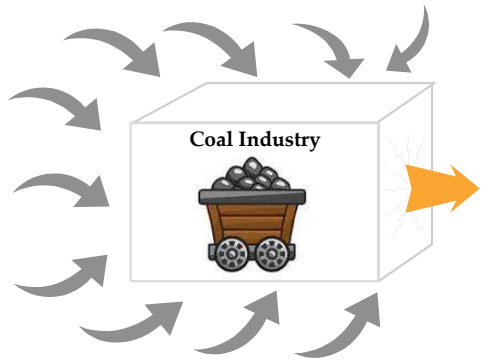
**Emerging Challenges to Nascent Thermal Recovery**
- Rail network congestion in U.S.
- Challenges from low-cost Colombian producers

## SECULAR THEMES

**Supportive Long-Term Global Demand Fundamentals**
- Increasing urbanization and industrialization in emerging markets
- Coal still most affordable energy source in large parts of developing world

**Environmental Regulation in U.S.**
- Confirmed retirements of ~41 GW of coal-fired generating capacity through 2020
- Potential for significant incremental retirements depending on carbon regulations

**Elevated Sector Leverage**
- Large debt-financed acquisitions near peak of met coal market
- Pricing deterioration




## KEY RISKS/UNCERTAINTIES

- Impact of Carbon Regulations
- Trajectory of Natural Gas Prices and Exchange Rates
- Impact of El Niño Weather Pattern
- Timing and Extent of U.S. Pacific Coast Export Capacity Expansion
- Producer Discipline in Seaborne Met Markets
- Demand Growth in Emerging Markets

## KEY THEMES

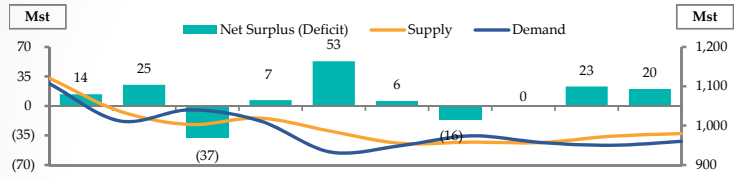
- SEABORNE OVERSUPPLY
- PERSISTENT LOW PRICE ENVIRONMENT
- HIGH LEVERAGE LEVELS
- COMPETITION FROM NATURAL GAS
- DEMAND IMPACT OF ENVIRONMENTAL REGULATIONS

# What is the supply/demand outlook for the U.S. coal industry?

- Secular and cyclical factors (*e.g.*, environmental regulations, competition from natural gas, mild weather, rail congestion) provide for a challenging outlook for U.S. coal markets

## U.S. COAL SUPPLY AND DEMAND OUTLOOK

### U.S. COAL SUPPLY/ DEMAND BALANCE

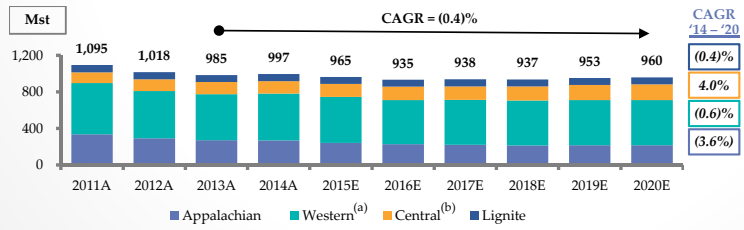



| | 2011A | 2012A | 2013A | 2014A | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|---|---|---|---|
| Exports | 107 | 126 | 118 | 97 | 91 | 89 | 85 | 82 | 82 | 81 |
| Imports | 13 | 9 | 9 | 11 | 11 | 11 | 11 | 11 | 11 | 11 |
| **Net** | **94** | **117** | **109** | **86** | **80** | **78** | **74** | **71** | **71** | **70** |

### COMMENTARY

- Competition from abundant and cheap natural gas and environmental regulation-driven plant retirements will continue to pressure thermal coal demand
- Ongoing supply curtailments eliminate production that is uneconomical
- Mild weather and rail congestion limiting near-term volume and pricing upside resulting from tighter utility inventories
- Domestic competition from natural gas may stimulate U.S. thermal exports
  - Export potential to Pacific Basin constrained by port infrastructure

### U.S. COAL PRODUCTION BY REGION




CAGR '14 – '20

- (0.4)%
- 4.0%
- (0.6)%
- (3.6%)

- U.S. coal production is expected to remain largely flat from 2013A – 2020E, but decline in the near term
- Central (ILB) basin expected to continue taking market share at the expense of higher cost Appalachian producers, especially CAPP
- PRB and ILB less sensitive to natural gas prices due to lower cost position

*Source: EIA and Wall Street research.*

(a) Western includes western bituminous, Powder River Basin and other.

(b) Central includes Illinois Basin.

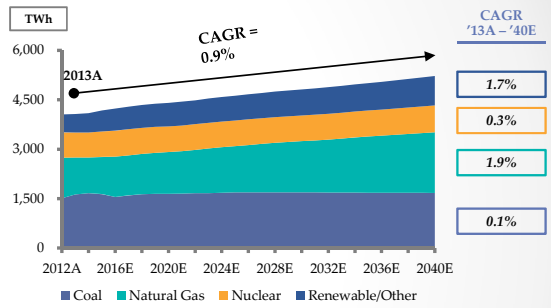
# What are the key drivers behind the decline in thermal coal demand in the U.S.?

- Environmental regulation and the emergence of cheap and plentiful natural gas in the U.S. are driving the retirement of coal-fired generation capacity, which is materially impacting the demand outlook for the U.S. thermal coal industry

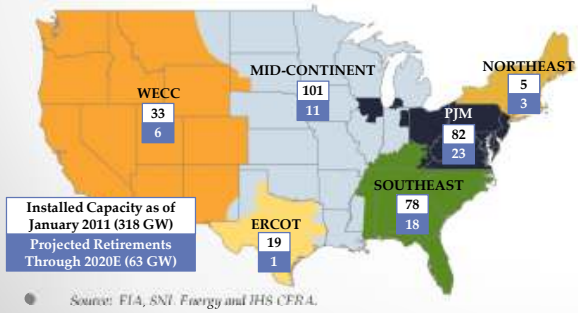
## COMMENTARY

- In the U.S., total and coal-fired electricity generation are expected to remain relatively flat from 2013 – 2040, increasing at CAGRs of 0.9% and 0.1%, respectively
  - Though coal is expected to remain a primary source of electricity generation for the foreseeable future, it is forecasted to lose share (~800 bps) to natural gas through 2040
- U.S. power producers plan to retire ~41 GW of coal capacity to natural gas between 2015 and 2020
  - Significant incremental retirements beyond the announced closures are expected
- Most U.S. coal retirements are expected to be concentrated in the PJM, Mid-Continent and Southeast regions
  - ERCOT is not predicted to experience coal plant retirements in the near term, as local coal types (lignite), as well as PRB, remain economical and gas conversions can't be justified from a cost standpoint

## U.S. ELECTRICITY GENERATION BY SOURCE

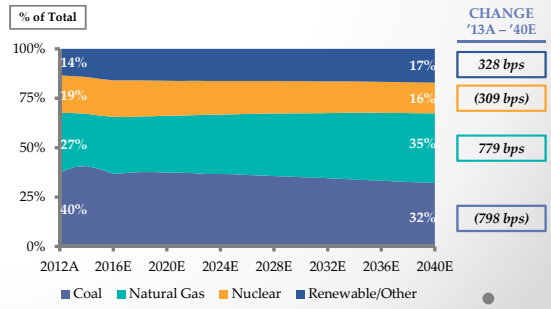



## COAL CAPACITY RETIREMENTS THROUGH 2020E




Source: EIA, SNL Energy and IHS CERA.

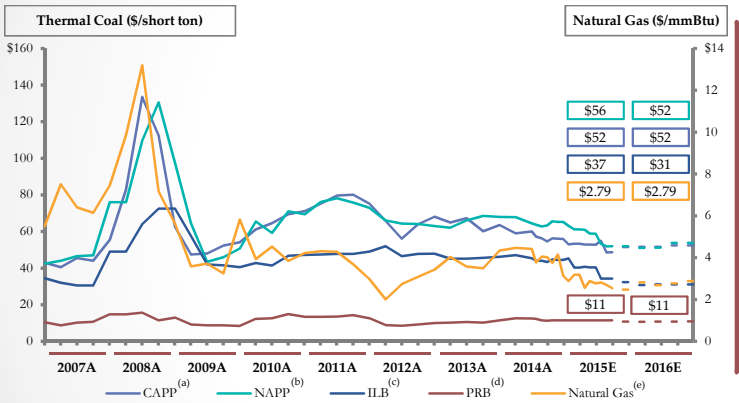
## SHARE OF U.S. ELECTRICITY GENERATION



# What are the pricing trends for U.S. thermal coal?

- While U.S. thermal coal prices appear to be approaching the "bottom," price growth is expected to be limited over the near- to medium-term

## HISTORICAL & PROJECTED U.S. THERMAL COAL PRICES



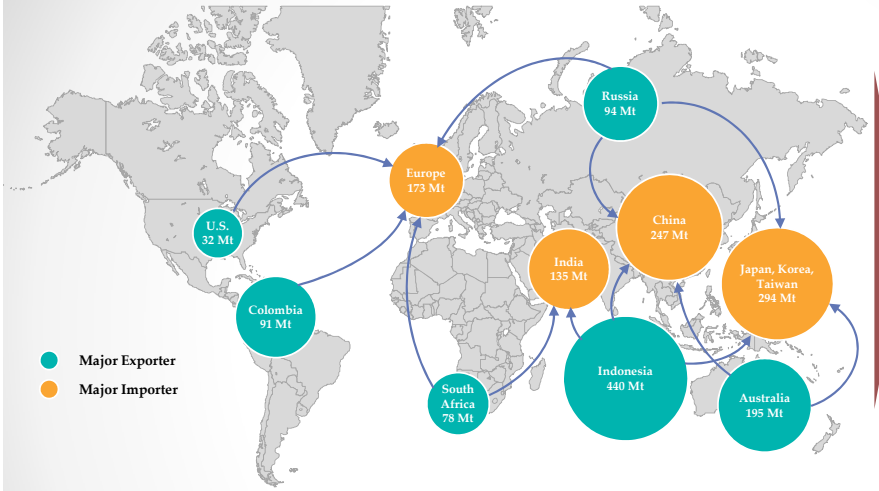

## COMMENTARY

- U.S. thermal coal prices are expected to remain depressed in the near term, but rising natural gas prices could bolster relative economics (*e.g.*, more muted coal-to-gas switching)
  - Near-term price recovery hampered by rail network congestion and mild weather outlook
- CAPP coal cannot competitively dispatch in a sub $5.00/mmBtu natural gas price environment, accelerating declines in production
- NAPP and ILB coal can compete with natural gas at $3.00 – $4.00/mmBtu, and could gain ground as scrubber upgrades allow more plants to burn these higher sulfur types of coal
- PRB coal is cost-competitive even at natural gas prices of $2.75 – $3.00/mmBtu

*Source:* *Bloomberg.*
(a) Big Sandy Barge Low Sulfur ($/ short ton).
(b) Pennsylvania Railcar Seam Coal ($/short ton).
(c) Illinois Basin Mid Sulfur ($/short ton).
(d) Powder River Basin 8,800 Btu Coal ($/short ton).
(e) Henry Hub natural gas spot price and forward curve ($/mmBtu).

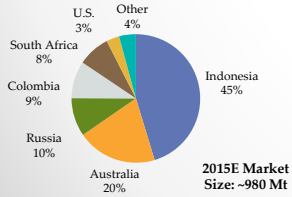
# What is the seaborne thermal coal market?

## GLOBAL SEABORNE THERMAL COAL—MAJOR TRADE FLOWS

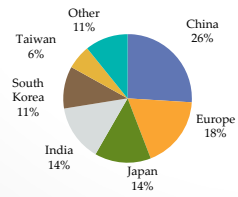



- The seaborne market accounts for ~30% of global thermal coal production
- Exports are dominated by Indonesian and Australian producers due to:
  - Proximity to high-demand regions (*e.g.*, China, Japan, India)
  - Quality of coal
- U.S. producers are typically marginal/ swing suppliers in the seaborne thermal market due to high transportation costs
  - Freight disadvantaged to the Pacific Basin
  - Limited infrastructure capacity restricts exports from the western U.S.
- Recently, Colombia has gained limited traction with coastal power generators due to its freight advantage
- China recently enacted import restrictions on lower quality thermal coal, which could impact certain seaborne producers as well as import tariffs on thermal coal

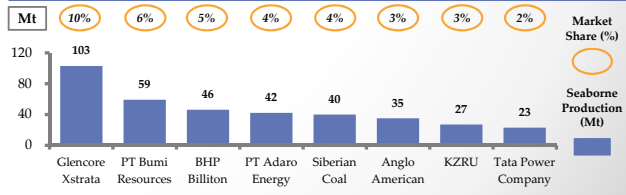
## EXPORTS BY COUNTRY




## IMPORTS BY COUNTRY



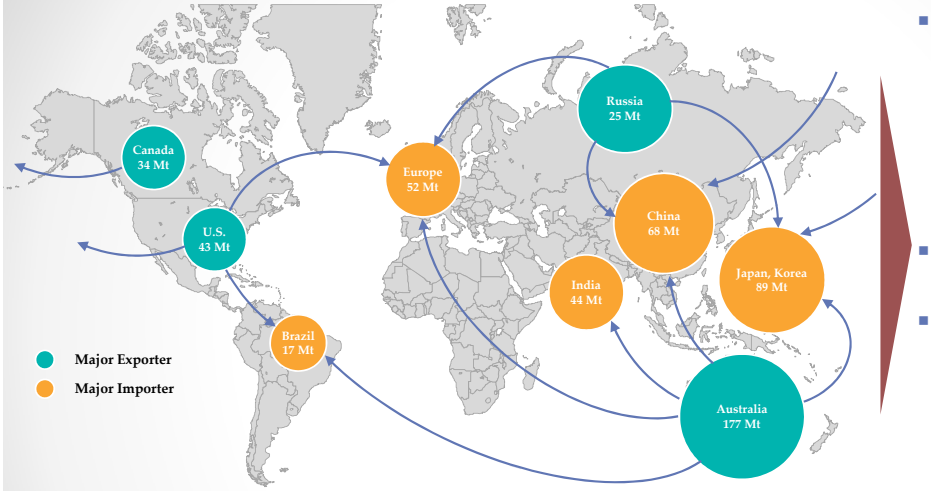

## TOP 8 SEABORNE THERMAL COAL PRODUCERS




*Source: Wall Street research, EIA and AME.*
Note: Import, export and production values represent 2015E estimates.

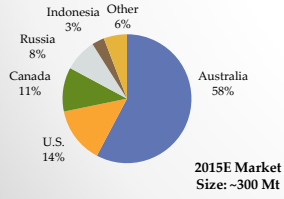
# What is the seaborne met coal market?

## GLOBAL SEABORNE MET COAL—MAJOR TRADE FLOWS

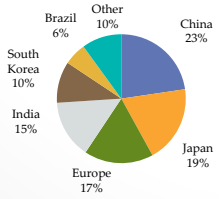



- Pacific Basin dynamics ultimately drive the seaborne met coal market
  - China, which consumes and produces more than half of the world's met coal, became a net importer of met coal in 2009
  - Australian producers dominate the export market due to advantageous cost position, high quality met coal and proximity to Asian steel mills
- With a smaller footprint, and generally higher cost structure, U.S. producers are price takers in the seaborne market
- Most of the largest export met coal producers are large diversified miners (*e.g.*, BHP Billiton, Teck Resources, Anglo American, Glencore Xstrata)
  - Coal-focused U.S. companies (*e.g.*, Peabody Energy, Alpha Natural Resources) are also among the top seaborne met coal producers

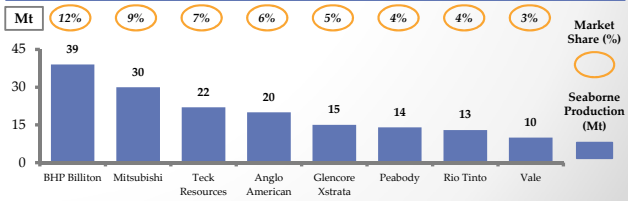
## EXPORTS BY COUNTRY




## IMPORTS BY COUNTRY




## TOP 8 SEABORNE MET COAL PRODUCERS

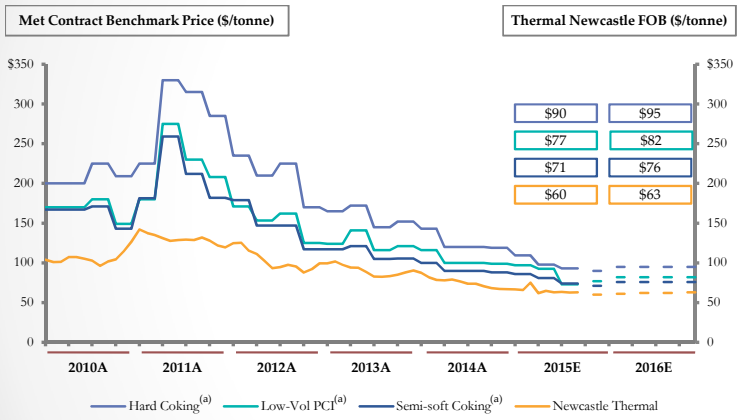



*Source: Wall Street research, EIA and AME.*
Note: Import, export and production values represent 2015E estimates.

# What are the pricing trends for seaborne thermal and met coal?

- As a result of Chinese demand growth contraction, among other factors, seaborne met and thermal coal prices are expected to remain pressured over the near to medium term

## HISTORICAL & PROJECTED SEABORNE COAL PRICES



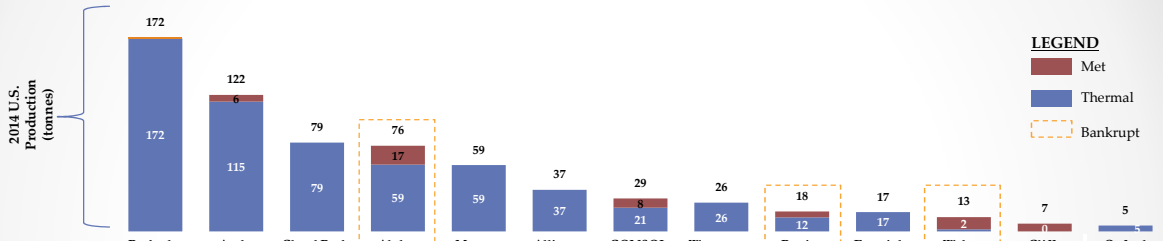

## COMMENTARY

- Seaborne met coal is in a prolonged pricing trough, with expectations for a drawn-out recovery
  - Prices have steadily fallen since 2011 due to a slowdown in Chinese demand and a ramp-up in Australian production
  - Q4'15 benchmark price for high quality met coal settled at $89 per tonne, a six year low; spot prices currently as low as ~$82 per tonne
  - Producer discipline is expected to drive modest recovery beginning in 2016
  - Weakening Australian dollar is further putting pressure on seaborne prices as the price of met coal on an Australian dollar basis has increased over the last three quarters
- Seaborne thermal coal is also in a prolonged pricing trough, with no expectations for a near-term rebound given substantial excess capacity in the industry
  - Participation by U.S. coal producers in the seaborne market, however, is limited

*Source: Wall Street research.*
(a) Quarterly Australia-Japan met coal benchmark contract prices.

# Who are the major U.S. coal producers?

- The U.S. coal market is heavily concentrated, with the top five companies accounting for a significant portion of total production




| Company: | Peabody | Arch | Cloud Peak | Alpha | Murray Energy | Alliance Resource | CONSOL | Westmore-land | Patriot | Foresight Energy[a] | Walter | Cliffs Natural | Oxford Resource |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Status: | Public | Public | Public | Public | Private | Public | Public | Public | Private | Public | Public | Public | Acquired |
| 2014 Production (tonnes): | 172 | 122 | 79 | 76 | 59 | 37 | 29 | 26 | 18 | 17 | 13 | 7 | 5 |
| FY'14A Revenue: | $6,734 | $2,937 | $1,324 | $4,287 | NA | $2,301 | $3,473 | $1,116 | nm | $1,109 | $1,407 | $4,624 | $322 |
| FY'14A EBITDA: | $764 | $280 | $177 | $172 | NA | $819 | $814 | $102 | nm | $382 | $13 | $512 | $36 |
| % Margin | 11% | 10% | 13% | 4% | NA | 36% | 23% | 9% | nm | 34% | 1% | 11% | 11% |
| Coal Reserves (tonnes): | 5,977 | 4,594 | 1,018 | 3,586 | 2,722 | 1,334 | 2,938 | 428 | 1,768 | 2,805 | 386 | 68 | 47 |
| Coals Reserves (short tons): | 6,588 | 5,064 | 1,122 | 3,953 | 3,000 | 1,470 | 3,238 | 472 | 1,949 | 3,092 | 425 | 75 | 52 |
| # of Mines (Active) | 26 | 16 | 4 | 60 | 13 | 13 | 5 | 6 | 10 | 5 | 5 | 3 | 6 |
| **2014 Regional Production:** | | | | | | | | | | | | | |
| PRB | 62% | 84% | 100% | 44% | -- | -- | -- | 81% | -- | -- | -- | -- | -- |
| CAPP | -- | 7% | -- | 40% | ✓ | 4% | 19% | -- | 74% | -- | 73%[b] | 62% | -- |
| NAPP | -- | 3% | -- | 16% | ✓ | 20% | 81% | -- | 26% | -- | -- | -- | 100% |
| ILB | 11% | -- | -- | -- | ✓ | 76% | -- | -- | -- | 100% | -- | -- | -- |
| Southwest | 10% | -- | -- | -- | -- | -- | -- | 19% | -- | -- | -- | -- | -- |
| Other | 17% | 7% | -- | -- | -- | -- | -- | -- | -- | -- | 27% | 38% | -- |
| **2014 U.S. Sales Mix (tonnes):** | | | | | | | | | | | | | |
| Thermal | 100% | 95% | 100% | 78% | 100% | 100% | 72% | 100% | 70% | 100% | 14% | -- | 100% |
| Met | -- | 5% | -- | 22% | -- | -- | 28% | -- | 30% | -- | 86% | 100% | -- |

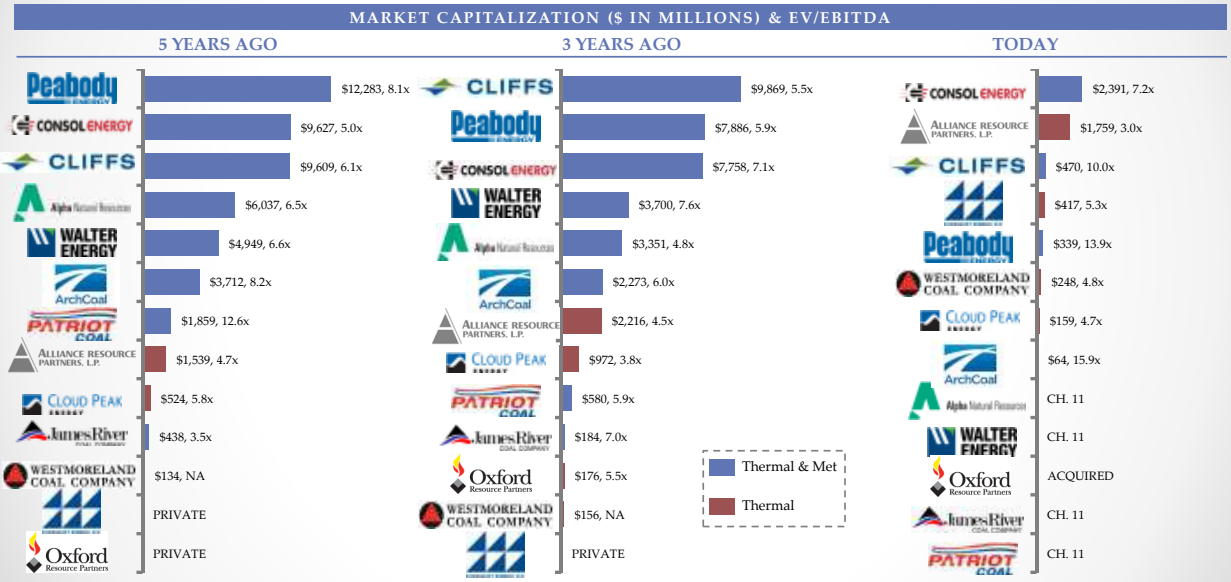
*Source: EIA, Company filings, Wall Street research.*

(a) Murray Energy acquired a majority interest in Foresight in April 2015.

(b) Includes production at Alabama mines.

# What is the financial condition of the major U.S. coal producers?

- The market capitalizations of the major U.S. coal producers have declined substantially over the past five years. Three of the larger U.S. coal producers (Alpha, Patriot and Walter) filed for bankruptcy in 2015




| 5 Year Benchmarks (% change) | |
|---|---|
| S&P | 95% |
| Market Cap Peers Wtd. Index | (22%) |
| Thermal Coal Price (CAPP) (a) | 10% |
| Met. Coal Price (b) | (7%) |

| 3 Year Benchmarks (% change) | |
|---|---|
| S&P | 63% |
| Market Cap Peers Wtd. Index | (56%) |
| Thermal Coal Price (CAPP) (a) | (29%) |
| Met. Coal Price (b) | (62%) |

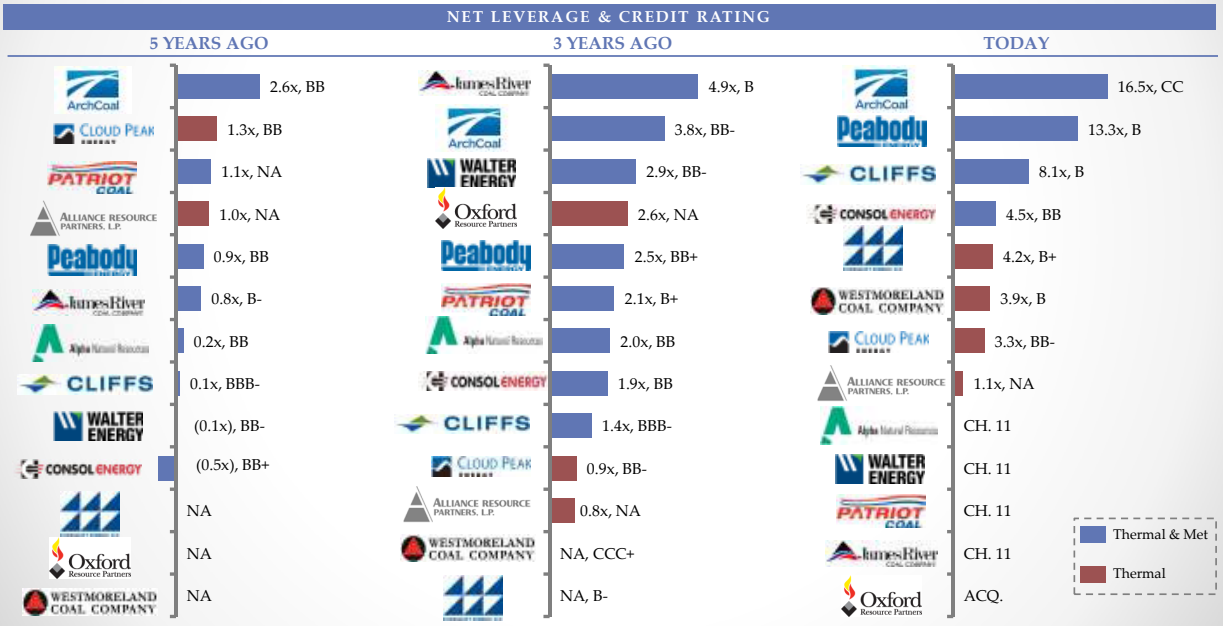
*Source: Company listings, S&P, FactSet, Bloomberg.*

(a) Big Sandy Barge Low Sulfur ($/short ton), Bloomberg.

(b) Seaborne Hard Coking Coal Contract Price – Monthly ($/tonne), Bloomberg.

# What is the financial condition of the major U.S. coal producers? (cont'd)

- Coal companies have significantly increased their leverage in recent years following a spate of mergers and acquisitions (Alpha, Arch, Consol, Peabody, Walter), as well as declining profitability




*Source: Company listings, S&P, FactSet.*

# How does the current environment impact DIP and exit financing for coal companies?

- As a general matter, financing for coal companies, both healthy and distressed, is challenging in the current environment
  - Many capital providers to coal companies have recently been burned given the deteriorating business environment
  - Certain financial institutions have a stated policy of reducing their exposure to coal companies due to pressure from environmental activists
- DIP and exit financing for coal companies is even more scarce given the recent history of DIPs being close to being impaired (*i.e.*, James River, Patriot I), as well as subsequent bankruptcies of reorganized coal companies (*i.e.*, Patriot II)

**RECENT COAL INDUSTRY DEBTOR IN POSSESSION FINANCING FACILITIES ($ IN MILLIONS)**

| Company | Filing Date | DIP Size (mm) | DIP Tranches | Pricing By Tranche | Pricing Wtd. Avg. | Upfront Fees % | Upfront Fees $ (mm) | Commentary |
|---|---|---|---|---|---|---|---|---|
| Alpha Natural Resources | 8/3/15 | $592 | TL: $300 [a]<br>RCF: $200<br>2nd Out LCF: $192 | TL: L(100)+900 bps<br>RCF: TBD<br>LCF: L+400 bps | 7.7% | 5.0% | $15.7 | Roll-up/New Money from 1L & 2L Lenders |
| PATRIOT COAL | 5/12/15 | $100 | TL: $100 | 12.00% | 12.0% | 2.0% | $2.0 | New Money from 1L & 2L Lenders |
| Xinergy | 4/6/15 | $40 | TL: $40 | 10.00% Cash/4.00% PIK | 14.0% | 2.5% | $1.0 | Roll-up/New Money from 1L Lenders |
| James River Coal Company | 4/7/14 | $110 | TL: $110 | L(100)+850 bps | 9.5% | 5.9% | $6.5 | New Money from 3rd Party Lenders |
| PATRIOT COAL | 7/9/12 | $802 | RCF: $125<br>TL: $375<br>Roll-Up LCF: $302 | RCF: L(150)+325 bps<br>TL: L(150)+775 bps<br>LCF: L(150)+775 bps | 8.5% | 4.2% | $33.5 [b] | Roll-up/New Money from 3rd Party Lenders |
| Mean | | | | | 10.3% | 3.9% | $11.8 | |
| Median | | | | | 9.5% | 4.2% | $6.5 | |

*Source: Court Filings.*
(a) Includes $100 million Bonding Accommodation.
(b) Represents aggregate fees paid in connection with DIP financing.

# What are the major labor issues facing coal producers?

- Labor Costs
  - 1974 Multi-Employer Pension Plan
    - Liabilities to remaining companies increase as others shed future responsibilities
  - Coal Act
    - Passed in 1992
    - Designed to (i) address underfunding of UMWA health plans and (ii) stabilize funding for health care of coal retirees generally
    - Created two funds: 1992 Fund and Combined Fund
    - 1992 Fund used to protect (i) employees without coverage and (ii) "orphaned" retirees (those subject to employee funded plans no longer in existence)
    - Combined Fund absorbed then existing UMWA health benefit funds
    - Creates significant funding obligations for coal operators
      - Both funds financed through premiums assessed against operators on a per-beneficiary basis
      - requirement to fund individual employer retiree health plans (IEPs)
      - Certain operators maintaining an IEP also must post-collateral to the 1992 Fund (security in case operator terminates IEP and 1992 Fund must absorb "orphaned" employees)

# What are the major labor issues facing coal producers? (cont.)

- Black Lung Act
  - Created claims process whereby coal miners may assert disability claims arising from black lung disease
  - Department of Labor conducts investigation
  - If claim substantiated, (i)responsible operator must pay benefit awarded or (ii), if no responsible operator located, trust funds payments from excise tax proceeds paid by operators (thus, another expense to operator, regardless of actual liability to any former employee)
  - Operator must post security or obtain insurance to secure Black Lung obligations

# Addressing Labor Costs in Chapter 11

- Modification of Labor Agreements/Retiree Healthcare Benefits (1113/1114)
  - The debtor must make a formal proposal for modification
  - The proposal must be based on the most complete and reliable information available at the time
  - The proposed modifications must ensure that the debtor, its creditors, and other affected parties are treated fairly and equitably
  - The proposed modifications must be necessary to permit the reorganization of the debtor
  - The debtor must provide relevant information as is necessary for the union or retiree representative to evaluate the proposal
  - The debtor must meet with the union or retiree representative at reasonable times to discuss the proposal
  - The debtor must confer with the union or retiree representative in good faith.
  - The union may not reject the proposal without good cause
  - If the debtor seeks court approval of rejection of a CBA or modification of retiree benefits, the foregoing standards must be met and the balance of the equities must clearly favor granting the request

# Addressing Labor Costs in Chapter 11 (cont.)

- Coal Act
  - May use 1114 as a basis to modify Coal Act obligations (In re Horizon Natural Resources, Co., 316 B.R. 268 (E.D. Ky 2004); but see In re Westmoreland Coal Co., 213 B.R. 1 (Bankr. D. Colo. 1997 (deciding Coal act premiums not entitled to administrative priority under 1114(e) of the Bankruptcy Code, because "retiree benefits" only include voluntary and not statutory benefits))
  - Potential to sell assets free and clear of Coal Act obligations under section 363 of the Bankruptcy Code (In re Leckie Smokeless Coal Co., 99 F.3d 573 (4th Cir. 1996))
  - Note: Courts have found Coal Act liabilities are taxes arising after bankruptcy filing are administrative expenses (Callahan v. UMWA (In re Callahan), 304 B.R. 743 (W.D. Va. 2004); In re LTV Steel Co., 299 B.R. 863 (Bankr. N.D. Ohio 2003))

# Addressing Labor Costs in Chapter 11 (cont.)

- Black Lung
  - In chapter 11, trust fund pays benefits and then seeks reimbursement from debtor
  - Potential statutory lien may exist from failure to pay benefits
  - Potential liability to officers from failure to pay benefits
  - Given priority and potential officer liability, may be difficult to limit payments made on account of Black Lung liability

# What are the major environmental issues facing coal producers?

- Federal and state regulatory authorities impose obligations on the coal mining industry in a wide range of areas
  - Employee health and safety
  - Permitting and licensing requirements
  - Environmental protection
  - Reclamation and restoration of mining properties after mining has been completed
  - Surface subsidence from underground mining and the effect of mining

# What are the major environmental issues facing coal producers?

- Ongoing compliance with environmental regulations during bankruptcy
  - A debtor must continue to comply with its environmental obligations under applicable federal, state and local laws, regulations and permits, as well any obligations under court orders and settlements with regulators or non-governmental organizations
  - In the event a debtor fails to comply with its obligations, penalties assessed will be granted administrative expense status, which must be paid in full in connection with a reorganization
  - May be joint and several liability
- Permit Block Considerations
  - Federal and state agencies can block the issuance or renewal of mining permits (without which a coal company cannot lawfully engage in coal mining) in order to enforce the provisions of its safety, health and environmental laws

# Reclamation Obligations

- Coal companies have the legal obligation to close and restore (or reclaim) land disturbed by mining operations
- States require that companies provide financial assurance to secure these reclamation obligations
- Before a coal company can obtain mining and related permits, they must provide acceptable financial assurance, usually in the form of reclamation bonds, to the relevant state agencies to secure performance of its obligations
- Required amount of reclamation bond is supposed to be sufficient to assure the completion of the reclamation if the work has to be performed by the regulatory authority in the event of a default by the company, which would allow the state agencies issuing the permits to draw on the bonds

# Reclamation Bonds

- Self-bonding
  - Certain states allow "self-bonding" if the company meets certain financial criteria; if the company does not qualify or the state does not allow for this, the company will need to obtain surety bonds from a third party
  - Where a company self-bonds, the applicable state regulator may determine that a company no longer qualifies to self-bond and require that the company provide collateral or obtain third party surety bonds to secure the performance of its reclamation obligations
  - The state may be able to enforce these requirements even during chapter 11 pursuant to a "police and regulatory" exception to the automatic stay
  - Alpha - In June 2015, Wyoming informed Alpha that it no longer qualified for self-bonding, and it had 90 days to post $411 million in respect of reclamation obligations; Alpha subsequently filed for bankruptcy on August 3, 2015; Alpha settled its self-bonding dispute with Wyoming by providing a $61 million superpriority claim, but no cash or L/Cs in connection with Alpha's $411 million self-bonding obligations
- Third party sureties
  - Cannot demand more collateral during chapter 11 as a result of the automatic stay
  - In reorganization cases, sureties have generally ridden through bankruptcy unimpaired

# Environmental Challenges to Asset Sales

- Given the permitting and bonding process, reclamation obligations cannot be discharged in a reorganization, and, there are several legal and practical impediments to selling assets free and clear of reclamation obligations
- Thus, a company is arguably precluded from reorganizing around "good" assets and leaving the "bad" assets (*i.e.*, those with reclamation obligations) behind without a creative solution that has regulator and surety approval
    - Negative purchase price – James River Coal/Revelation Energy transaction
    - Alternative purchaser - Patriot/VCLF transaction
    - Liquidating trust – Horizon Natural Resources

# Environmental Regulatory Trends

- The U.S. Clean Power Plan
  - This regulation, which was finalized in August 2015, aims to reduce carbon dioxide emissions from the power sector by 32% from 2005 levels. The regulation would require states to implement it by developing state-specific carbon dioxide emissions reduction plans.
  - Compliance could require implementation of carbon emission reduction technology at existing coal-fired power plants, which could lead to further plant shutdowns and further reduce demand for coal.
- Potential Obstacles to the U.S. Clean Power Plan
  - *In re: Murray Energy Corp. / West Virginia v. EPA*: these lawsuits challenging the proposed version of the rule, which were consolidated in the U.S. Court of Appeals for the D.C. Circuit, were rejected on procedural grounds as being premature by a panel of the D.C. Circuit in June 2015.
    - Among the arguments petitioners raised are (i) the rule is beyond EPA's authority because it seeks to regulate "beyond the fence-line" of power plants; and (ii) the specific statutory language of the Clean Air Act precludes EPA from regulating carbon emissions from power plants because EPA has already regulated "air toxics" emissions from power plants.

# Environmental Regulatory Trends

- Potential Obstacles to the Clean Power Plan (cont.)
  - *In re: Murray Energy Corp. / West Virginia v. EPA* (cont.)
    - While the court did not reach the merits of petitioners' arguments, similar arguments will likely form the basis of challenges to the final rule; these are expected to be filed after publication of the final rule in the Federal Register later this fall.
  - *Emergency Stay Request*: In August 2015, after the final rule was released, 16 states petitioned the D.C. Circuit for an emergency stay of the Clean Power Plan, which was denied by a panel of the D.C. Circuit in September 2015.
  - *Lack of State Cooperation*: A number of states have indicated that they will not develop implementation plans; note EPA has prepared a federal plan that will apply to any state that does not comply.
- U.S. Carbon Pollution Standards for New Power Plants
  - This rule, finalized in August 2015, places carbon emissions limits on new coal-fired power plants; to meet limits, new plants would likely have to be built with costly "carbon capture and sequestration" technology that has had limited commercial success, which significantly lowers the incentives to build new plants.

# Environmental Regulatory Trends

- U.S. Mercury and Air Toxics Standards for Power Plants (MATS)
  - This rule, which is currently in effect, has required coal-fired power plants to install pollution controls to limit the amount of mercury and other air toxics in emissions.
  - It is currently subject to litigation; although a panel of the Court of Appeals for the D.C. Circuit upheld the rule in 2014, in June 2015, the Supreme Court remanded to rule to the rule to the D.C. Circuit for further review of whether EPA adequately took costs into consideration early in the rulemaking process.
- Carbon Emissions Targets in Other Countries
  - China, India and Brazil have recently released carbon emissions reduction targets that have the potential to impact the worldwide market for coal.
- U.S. Clean Water Rule
  - This rule, which clarifies the scope of waters subject to regulation under the Clean Water Act, could impact the coal mining industry (and its utility customers) in various ways (e.g., by requiring wastewater discharge permits for discharges to a broader variety of waters).
  - Various states and coal companies (including Murray Energy) have sued to block this rule, and in October 2015, the U.S. Court of Appeals for the 6th Circuit issued an order temporarily staying implementation of the rule, finding the petitioners (a group of states) demonstrated a substantial possibility of success on the merits.