City of Oakland
City Council Public Hearing
September 21, 2015

Executive Summary of testimony by Tom Sanzillo

Coal is a risky investment for Oakland and will not yield the export activity predicted by the developer.

Domestic coal demand is declining, and many coal companies are in dire financial straits. Several U.S. coal companies have filed recently for bankruptcy.

Thermal coal markets are in a state of collapse. The broad consensus among investment houses globally is against investment in coal mines, ports or the coal trade.

Foreign coal demand is also declining, especially in China and India, and coal prices are at historic lows.

Bowie Resource Partners, the mining company behind the Utah-sponsored coal portion of this project, has an eroding domestic market share and would make a weak partner for a port deal.

Coal is not currently part of the commodity mix that has built the Port of Oakland, and it does not need to be part of the Army Base Terminal project. In fact, a commitment to coal will work to undermine the financial viability of the project. The promised benefits of coal exports through the terminal are unlikely to materialize (that includes the 2,300 permanent jobs identified by the operator.

Accepting the proposed investment from the State of Utah will create risks for the public financing for the larger Army Base development. The Utah financing may not meet its own program’s rules and obligations. The Utah investment in itself is a red flag; it suggests that private financiers are avoiding major coal investments. The failure of the coal portion of the project would ultimately require a public bailout. The risks associated with the proposal are not worth it.
What is your name and background?

My name is Thomas Sanzillo and I am Finance Director for the Institute for Energy Economics and Financial Analysis (IEEFA). I have served in this capacity since May 2012, but have been involved in fossil-fuel finance matters since September 2007. At IEEFA, I research, prepare, and supervise studies, memos and testimony and speak publicly on a range of fossil-fuel issues. Topics on which I have authored, co-authored or provided related research include: U.S. domestic coal markets and plant finances, U.S. coal-producer and mine finance and financial regulation, federal coal leasing in the Powder River Basin (PRB), federal coal subsidies, federal/state mine reclamation, coal ports and coal exports, utility finance, and public power financials (including those of municipal power systems, rural cooperatives and state power agencies). My work has involved energy and coal issues in at least 25 states. I have testified before three Public Service Commissions (Minnesota, Wisconsin and Colorado) and submitted affidavits in three coal-related federal proceedings as well as before an administrative proceeding at the Export-Import Bank.

My work also includes analysis of global economic trends, coal markets and the global seaborne thermal coal trading market. I have co-authored a number of international coal-market studies related to India and Australia (with our office in Sydney) and to the Norwegian pension fund, and provided oversight, research and direction on a global analysis of coal markets with Carbon Tracker Institute. In addition I have published a number of reports related to coal export matters on the U.S. West Coast and Gulf of Mexico.

Prior to my work with IEEFA, I served for 17 years (1990-2007) in various senior management positions in New York City and New York State government finance. My last position was First Deputy Comptroller for New York State (and I served for a short period as the State Comptroller due to an early resignation). The New York State Comptroller serves as the sole trustee of a $156 billion, globally invested public pension fund, and as chief accountant, procurement officer, and chief auditor for state finances and agencies and local governments. Duties include reviewing and approving most public debt.1 Of particular relevance to this proceeding are the several dozen audits, reviews and reports that I authored or supervised during those years on economic development incentives, public authority finance and governance and job creation.

Who are you representing?

I represent the Institute for Energy Economics and Financial Analysis, which has been invited by the Sierra Cub to present testimony.

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What is the scope of your testimony?

I have been asked to:

1. Provide basic background on the status of U.S. and global coal markets as they pertain to the potential for exports out of the Oakland Army Base Redevelopment project.
2. Provide comment on the financial risks of the introduction of coal into the commodity mix for the Oakland Army Base Redevelopment project.

What is the main point of your testimony?

The Oakland Army Base\(^2\) developer is taking a major financial risk by relying on coal to provide 49 percent of the commodity mix for expansion of the terminal. This reliance on coal will jeopardize what should otherwise be a successful project. A worldwide consensus of investment banks and powerful financial indicators points to the fact that global coal markets are in a state of collapse and there is little likelihood of a turnaround in the foreseeable future. The project has a high likelihood of default.

Bowie Resources, the coal company associated with this project, is a weak financial partner. In addition to being subject to the pressures of the global market downturn, the company is under extreme pressure in its domestic coal business, as coal plants currently buying coal from its mines have announced retirements. IEEFA’s careful review of the company’s proposal finds it unrealistic and very likely to fail.

The State of Utah’s pledge of financial assistance to the Oakland Army Base project is a red flag that warns of financial distress and underscores the lack of private financial investment in the coal industry today. Even the parent company of Bowie Resources, Trafigura, a large international firm with a $36 billion asset base, is unwilling to risk additional capital for this highly speculative export project.

Utah’s financial participation in this deal presents risks both to the State of Utah and the City of Oakland. From the Utah side, the deal is unprecedented in size. Whether Bowie Resources can commit to a 30-year deal is highly questionable. In addition, a series of program-integrity questions have been raised, and the transaction, if approved, would require the waiver of significant existing program rules.

From the City of Oakland’s point of view, the ultimate likelihood of being unable to move coal through the port will simply mean the City and the Oakland Army Base will fail to meet their revenue targets. With so many public dollars committed already to this project, the failure of the coal portion of the enterprise would require additional public commitments to fix a problem that is avoidable.

\(^2\) The Oakland Army Base Redevelopment is owned in part by the City of Oakland and in part by the Port of Oakland. The coal proposal is for the city side of the project. The Army Base project is now known as Oakland Global. The Oakland Army Base or Army Base Redevelopment will be used to refer to this project.
What is the current commodity mix at the Port Oakland, and is the Port growing?

The Port of Oakland has grown into a strong diversified-commodity business despite a challenging and complex array of labor and global cross pressures.3

The Port of Oakland is the fifth largest container port in the U.S. In 2014, nearly 2.4 million intermodal containers (TEUs) passed through the port. Since 2000, container-shipping exports out of the Port of Oakland have increased 26 percent, though levels have been approximately constant since 2008. The value of goods passing through the port totals $40 billion annually.

The chart below shows the diversity of commodities exported from the Port of Oakland. In 2014, the largest exports by tonnage were wood pulp, edible fruits and nuts, and meat. The port’s success is tied to its commitment to commodity diversification.

Table I: Container Exports From Port of Oakland

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Coal is not currently exported from Oakland. Adding coal to the commodity mix for the new Oakland Army Base Redevelopment project will undermine the project’s financial strength.

Why is coal being added to the commodity mix at this time?

The thesis of the expansion project developer, California Capital Investment Group (CCIG), and operator Terminal Logistics Solutions LLC (TLS), is that the Army Base Redevelopment project’s financial structure will be strengthened as a whole if any commodity, coal included, can be shipped through the port. Under normal circumstances, and from a strictly financial view, there might be a case to add coal to this mix. However, these are not normal circumstances, and there is no financial case to be made for coal exports through the Oakland Army Base.

The coal company involved in the deal, Bowie Resources, seeks to export coal as part of a last-chance bailout strategy for an industry that is in a state of permanent, structural decline.

The U.S. coal industry is rapidly losing market share for electricity generation within the U.S. During the 1990s and early 2000s the U.S. coal industry claimed a 50 percent market share and produced 1 billion tons of coal per year for electricity. In 2015, coal will supply 34 percent of

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5 The last time coal’s share of the electricity market exceeded 50% was in 2003. See: http://www.eia.gov/electricity/monthly/current_year/december2013.pdf, Table 1.1 Net Generation by Energy Source
market share and the coal industry is projected to produce 800 million tons of coal.\(^6\) A recent report by UBS projects that by 2030 coal’s share of the electricity-generation market will shrink to 18 percent.\(^7\)

Competition from natural gas, renewables and energy-efficiency programs have eroded coal’s claim to being the least-cost option for electricity in the U.S. Growing public concern, evidenced by increased regulatory enforcement and other forms of public opposition, have prevented new coal plants from being built. The coal industry has dropped plans to build 180 new coal-fired plants over the past 15 years and is now hobbled by retiring, aging coal plants. Forty-two U.S. coal producers have declared bankruptcy since 2012.\(^8\) The leading U.S. coal producers—Arch Coal, Peabody Energy, and Alpha Natural Resources—have all lost in excess of 90 percent of their share value over the past five years, a time in which the Dow Jones Industrial Average has risen by 53 percent. This means that while the U.S. economy is growing, the coal industry is not. Recently, Kevin Crutchfeld, the CEO of Alpha Natural Resources, put it this way: “Even as the United States has enjoyed modest annual gross domestic product growth during the past five years, demand for coal along with coal prices have fallen sharply over the past four years, reaching a 10-year low during the summer of 2015.”\(^9\)

During the late 2010s, as the industry began to recognize that its market share in the U.S. was in decline, it embarked on a strategy that was akin to an “export or die” scenario. Buoyed by growing coal demand and high prices in Asia (circa 2008-2011), coal producers in western state invested in new ventures to increase imports off the West Coast, and numerous coal ports were proposed.\(^10\) In the ensuing months and years, however, global coal demand and prices have collapsed, compounding the problems of U.S. domestic coal producers. Many U.S. coal producers, including Bowie Resources,\(^11\) the producer that seeks shipping capacity through the Oakland Army Base, are continuing to press a falling exports agenda.

What was once seen by the U.S. coal industry as a panacea for its financial future has now become another set of failures and liabilities in the form of broken port deals, sunk costs, canceled ports and growing public opposition.

The financial health of the Oakland Army Base Redevelopment project rests in part on the diversity of commodity shipments from growing industries. The Port of Oakland does well with this strategy, and it does well without coal in its portfolio. There is no reason for the Army Base Redevelopment to include coal as part of its business strategy.

The City of Oakland can look to what is happening in other locations on the West Coast where coal export terminals have been proposed in the past. Some of these coal export terminals have been shelved due to a weak market for coal (see below). Some have been scuttled in favor of other viable development choices. Washington State, for example, in cancelling several proposed coal export terminals, has made clear that it can find economic partners whose future is stronger and less risky than that of the coal industry. The State of Washington AFL-CIO has recently pointed out that the Washington economy is robust and has created

\(^6\) Amanda Luhavalja, *Residential power sales slip 1.7% during 1st half of year*, SNL, September 9, 2015

\(^7\) Julien Dumoulin-Smith, UBS Analyst, *Pondering the Future Fuel Mix* (revised), U.S. Electric Utilities and IPP’s. Global Research, UBS, September 14, 2015

\(^8\) Taylor Kuykendall, *Roster of U.S. Coal companies turning to bankruptcy continues to swell*, SNL, June 4, 2015.


economic-development choices.\textsuperscript{12} Washington has many port-proposal choices from many industries. Since coal is a financial laggard and its future is clouded by climate and environmental risks, organized labor has shied away from coal proposals, noting that coal is a weak partner both financially and environmentally.

Transport Logistics Services (TLS), the designated terminal operator says the terminal, once up and running, will support 2,335 permanent jobs.\textsuperscript{13} Permanent jobs require a steady stream of product moving through the terminal, product that generates revenue to pay employees. It is unlikely the coal demand from Asia will materialize. Intermittent employment is more likely, reflecting at best the irregular deal flow that some coal producers have established in Asian markets. Washington labor organizations are more supportive of projects from industries other than coal because they prefer partnerships with industries that produce regular deal flow, steady work and regular payrolls.

How can you be so certain that the coal industry’s current financial problems are permanent? Don’t most industries go through cyclical downturns and then come back?

Independent investment analysts overwhelmingly project severe retrenchment in the global thermal coal market. These perspectives have been well known for several years. Four major investment firms (Bernstein Research, Citibank, Goldman Sachs, and J.P Morgan) released perspectives in June, July, September and October 2013, respectively that provide qualitative support for the argument that the export market for U.S. coal is under severe stress and is likely to remain so for the foreseeable future.

Both the research and the investment actions taken by these institutions reflect the consensus that the international coal market is oversupplied and that global coal producers will continue to face unsustainably low prices and tight margins. Bernstein Research pointed to the structural nature of the changes, stating that the trend is not likely to reverse itself. Citibank concluded that the end of the coal “supercycle” is here. Goldman Sachs said capital shifts from larger mining concerns suggest a significant move away from coal. J.P. Morgan concluded it is no longer economical to export coal at present.

These trends will most likely continue as China’s need for coal imports diminishes. Each of these analyses uses as a backdrop the dramatic rise of Chinese thermal imports over the past decade—and the recent slowdown in this trend. The worldwide market for seaborne coal was approximately 858 million tons in 2013.\textsuperscript{14} When China buys less coal on the global market it drives down worldwide demand and price. Chinese import market peaked in 2013 at 330

\textsuperscript{13} http://tlsoakland.com/faq/
million tons per annum (mtpa). In 2014, China’s coal imports declined to 289 mtpa. As discussed below, China is expected to reduce imports further in 2015 to 200 mtpa.

Bernstein Research concluded in the spring of 2013:

Globally, Chinese demand for coal has been the primary driver or the backstop behind every new investment in coal mining over the last decade; the “global coal market” ended with the collapse in price in 2012: regional miners will see almost zero demand in China from 2015.

Once Chinese coal demand starts to fall there is no robust growth for seaborne thermal coal anywhere; developed market demand is weak due to gas, environmental concerns or industrial activity; that leaves just one large structural growth market for seaborne coal: India.

The Bernstein analysis concluded that global thermal coal market will never recover.

Similarly, Goldman Sachs in 2013 cast a profile of a weak and declining market in thermal coal:

Earning a return on incremental investment in thermal coal mining and infrastructure capacity is becoming increasingly difficult. In the short term, a sharp deceleration in seaborne demand (we expect average annual growth to decline to 1% in 2013-17 from 7% in 2007-12) has moved the market into oversupply and caused a downward shift in the cost curve; we downgrade our price forecasts to US$83/t in 2014 and US$85/t in 2015 (down 13% and 11% respectively) and maintain a relatively flat outlook for the rest of our forecast period to 2017.

Mines are long-lived assets with a long payback period, and investment decisions today are sensitive not just to prices and margins today, but also to projections going well into the next decade. We believe that thermal coal’s current position atop the fuel mix for global power generation will be gradually eroded by the following structural trends: 1) environmental regulations that discourage coal-fired generation, 2) strong competition from gas and renewable energy and 3) improvements in energy efficiency. The prospect of weaker demand growth (we believe seaborne demand could peak in 2020) and seaborne prices near marginal production costs suggest that most thermal coal growth projects will struggle to earn a positive return for their owners; in our view, this is reflected in the way diversified mining companies are reallocating their capital towards more attractive sectors

Goldman Sachs’ price downgrade in 2013 was followed by actual price declines far greater than estimated. Goldman anticipated a price of $83 per ton in 2014. The average price for 2014

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15 Kalayano Teodoro, Global shipping index falls to record low as China cuts coal imports, February 11, 2015.
16 Bernstein Research, Asian Coal and Power: less, Less, Less…The Beginning of the End of Coal, Cover Page, June 2013. (Bernstein)
17 Bernstein, Executive Summary
was $70 per ton.\(^{19}\) (A recent compilation of futures-market contracts for Newcastle Coal places the range of prices from 2015 to 2021 in the mid $50-per-ton range.)\(^{20}\) In January 2014, Goldman Sachs sold its stake in a coal port greenfield project in Bellingham, Washington, a joint venture with SSA Marine Terminals (40+ million ton per year capacity).\(^{21}\)

In October 2013, J.P. Morgan analysts questioned the ability of U.S. coal producers to access the global thermal coal market:

> While the outlook for ILB [Illinois Basin] coal appears stronger than other basins, the region is not immune from the challenged coal market.” Further, “Export markets have been crucial in balancing supply-demand in the US; however, depressed international prices appear to have closed the door on new export contracts and could create domestic oversupply.\(^{22}\)

In 2014, J.P. Morgan forecast a decline of U.S. thermal coal exports through 2016 from 49 mtpa to 36 mtpa.

> It’s not economic to export US coal at present, and while some sales are continuing, probably driven by take or pay commitments, we doubt new sales will be signed outside longstanding relationships.

> U.S. coal exports are falling more quickly now, but with other countries apparently concluding it’s easier to drop costs rather than production, seaborne prices are reaching new lows.\(^{23}\)

In September 2013 Citibank\(^{24}\) said changes in Chinese GDP, pollution and energy policy, internal country improvements, and the rising influence of renewables and other energy sources meant that coal producers looking to enter the export market were going to find it very difficult to succeed.

Because the range of forecasts for Chinese coal demand is wide, we believe investors should price in higher probabilities of lower coal demand. Optimistic long-dated coal prices may be unsupported. Although lower prices may spur demand growth elsewhere, the demand slowdown in China should more than offset such gains, in our view. Coal-exporting countries that have been counting on strong future coal demand could be most at risk. The end of the coal supercycle should weigh on both the mining and equipment sectors. But sectors that excel at renewable integration, distributed generation, transmission could benefit the most.

In October 2014, several major U.S. investment banks announced they would not provide financing to support a large coal mining and export infrastructure in Australia, one of the largest

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\(^{21}\) [http://www.reuters.com/article/2014/01/08/goldman-port-sale-idUSL2N0KI00U20140108](http://www.reuters.com/article/2014/01/08/goldman-port-sale-idUSL2N0KI00U20140108)


proposed mining initiatives in the world (100 million tons per year).\textsuperscript{25} These announcements were followed by similar ones from European and Australian. This is a sign of weakness in the global coal markets—the same markets targeted by the developers of the Oakland Army Base coal project.\textsuperscript{26}

**What are the current trends in China and India and how are U.S. coal producers faring in that respect?**

As described above, the market for imported coal in China—and the global coal market generally—cooled, and global prices have continued to hit new bottoms.\textsuperscript{27} Most financial-analyst projections have evolved into a clear consensus: as China reduces its import needs, existing Pacific Rim coal producers (Australia, South Africa, Indonesia and Russia) have sufficient capacity to meet the needs of the remaining import countries, including India. U.S. coal producers will fill a niche market but one not much larger than what exists today. Carbon Tracker Institute and the Institute for Energy Economics and Financial Analysis\textsuperscript{28,29} reached the same conclusion in an extensively researched report in September 2014. Wood Mackenzie (WM), a coal-industry consultant that Bowie Resources uses, has altered its once-optimistic position on the export potential of PRB coal and from western states. The company published a broad analysis of domestic and global coal markets and export potential out of the U.S. in March 2012, when it said U.S. exports would increase to 500 mtpa by 2030.\textsuperscript{30} In February 2015, however, WM\textsuperscript{31} reversed its outlook on Asian demand for U.S. coal exports, citing a number of factors at play in China, including a slowing Chinese economy, a growing divergence between commodity price and market growth versus GDP growth, a change in economic priorities and new policy directions due to air pollution. WM saw short- and medium-term problems in particular for U.S. coal producers\textsuperscript{32} looking to export. WM projected that the global thermal market will stay in a condition of oversupply through 2021, plus or minus how many new mine projects are actually delayed.\textsuperscript{33}

Actual import trends in China are bearing out these predictions. In 2013, China imported 329 million tons of coal. In 2014, that number dropped to 290 million tons. Through July 2015, China is

\textsuperscript{27} http://www.theguardian.com/environment/2014/oct/22/chinas-coal-use-falls-for-first-time-this-century-analysis-suggests
\textsuperscript{31} http://energiasia.com/blog/china-energy-demand-decoupled-significantly-gdp-says-wood-mackenzie-economist/
\textsuperscript{32} http://www.woodmac.com/public/media-centre/12526159
\textsuperscript{33} Rohan Somwanshi, Analyst: Sporadic coal mine closures to not enough to rebalance oversupplied market, SNL, February 17, 2015. (Somwanshi-SNL-Global)
on course to import 200 million tons per year. A very recent analysis, published in September 2015 by UBS, sees China as a future exporter of coal.

Many coal producers, particularly in the U.S., are looking to India as a potential new customer for coal markets. Many large international coal investors, however, are quite skeptical of any successful foreign investment in India or long-term import strategies. Although the Government of India is still importing significant amounts of coal—upward of 200 mtpa—it has announced a policy aimed at decreasing its imports to zero in the coming years. U.S. coal producers exported 1.1 million tons of thermal coal to India (largely from Northern Appalachian mines) in 2014.

If China and India are successful in cutting only half of their import demand, they would collectively reduce worldwide coal demand by 260 mtpa, or almost one third of current demand. The current global oversupply under such circumstances would continue as major supplier countries—Australia, South Africa, Indonesia, Russia, Colombia and perhaps China—all will be competing for much smaller markets in Japan, Korea, Malaysia and Vietnam.

In 2012, U.S. coal producers exported 125 million tons of coal, a recent peak. On September 9, 2015, the United States Energy Information Administration estimated that U.S. coal exports in 2015 would total 79.5 million tons and that in 2016 the figure would decline further to 72.3 million tons.

**How are prices responding to these general declines in demand and what indication does that give to U.S. coal producers?**

The import trends described above are having a deep impact on the price of coal traded on the global markets, leading to a worldwide price collapse. The market price for global thermal coal—the price that would apply to coal that would be shipped through the port of Oakland to unspecified Asian ports—has plummeted. The UBS September 2015 price chart, below, shows that prices on the global spot market for Newcastle coal have dropped from a high of $140 per ton in 2011 to $30 per ton in August 2015. (Newcastle coal is typically the benchmark used for the global price of coal and refers to coal mined in Australia. The other coal types identified on the chart are Kalimantan from Indonesia and Richards Bay from South Africa.)

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36 UBS September 2015.
37 [http://www.peabodyenergy.com/content/508/peabody-in-india](http://www.peabodyenergy.com/content/508/peabody-in-india)
38 [http://in.reuters.com/article/2013/05/09/energy-india-coal-investment-idINKB6N0L626B2015050202](http://in.reuters.com/article/2013/05/09/energy-india-coal-investment-idINKB6N0L626B2015050202)
45 SNL, September 9, 2015.
46 [http://www.reuters.com/article/2015/02/02/energy-india-coal-investment-idINKB6N0L626B2015050202](http://www.reuters.com/article/2015/02/02/energy-india-coal-investment-idINKB6N0L626B2015050202)
Africa.) The second chart from UBS—spot and term contract prices from ‘Newcastle coal only’—shows that the basic contract price for coal has similarly collapsed.

Table III: September 2015 UBS Price Reporting Global Thermal Coal Trade

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<th>Thermal coal prices: 4½ year down-cycle &amp; counting</th>
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<tr>
<td>Thermal coal prices - spot</td>
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<td>Thermal coal prices - spot &amp; term contract</td>
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Peabody Energy and Arch Coal in late 2010 and early 2011, respectively, provided their investors with analyses of the Chinese coal markets, using price points in the $90 per ton range. That is, each company was informing its investors that it required $90 per ton on the global market to profit from U.S. coal shipped through West Coast ports. At the time, Arch and Peabody appeared confident that this price target was achievable as a permanent long-term goal (In 2012 China imported over 300 million tons of coal, up from 200 million tons in 2011, and coal producers worldwide were predicting longer-term growth from this source). Each company was also predicting net back profit margins (the amount of profit received by the U.S. coal producer from the $90 per ton international market price of coal minus transport and

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45 Peter Gartrell and John Miller, Peabody projections show lucrative Chinese market for PRB coal
46 Platts Coal Trader December 6, 2010
47 Peter Gartrell, Arch CEO sees $20 range for PRB coal to Asia, Platts Coal Trader 1/31/11
48 http://www.eia.gov/cfapps/ipdbproject/IEDIndex3.cfm?tid=1&pid=1&aid=3
logistics costs) of $20 per ton. More recently Cloud Peak Energy stated it would require a market price of between $80 and $90 per ton.\(^4^9\)

Most of the proposals for new coal export terminals on the West Coast were made when prices were high—in early 2008, and then again when prices spiked in 2011. As shown in Table III, these spikes were short lived. During the 25-year period covered in the charts, only three or four years were actually periods in which the global price exceeded $80 per ton. These volatile and ultimately weak long-term prices (along with public opposition in Oregon and Washington and the fact that the communities have other choices from more stable business partners) go a long way toward explaining why U.S. coal producers have never established a strong, permanent, long-term set of relationships with coal-burning consumers in Asia.

**Are there any reliable longer term price indicators that support your case?**

Yes. The import trends for China and India suggest a continued slowdown in the global thermal seaborne coal trade. As noted above, both countries have internal reasons for adopting policies that reduce or eliminate the level of imported coal into their countries. The Newcastle forward future prices are in the high $50 per ton range through December 2021. This weak pricing is causing the cancellation of projects and pullback of capital spending from coal companies around the world.\(^5^0\)

**Table IV: Newcastle Benchmark Thermal Coal Futures Coal Prices**\(^5^1\)

The coal industry has acknowledged that markets are oversupplied in every region of the world with an active coal market: the CEO of Alpha Natural Resources, a major player in the global

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\(^{50}\) UBS-September 2015, p. 8.

metallurgical market (and a thermal coal exporter), has acknowledged that coal markets are in more than a cyclical downturn.\textsuperscript{52} Glencore, a global mining concern, has announced cuts in production, staff and dividends\textsuperscript{53} in the wake of persistent low prices.\textsuperscript{54} BHP has issued investor warnings about long-term oversupply issues.\textsuperscript{55} Teck Resources in Canada has cut back plans for new mines in the wake of weak markets.\textsuperscript{56} Indonesian coal producers are looking at new strategies to address the drop in prices and shrinking markets.\textsuperscript{57} And South African companies are reporting cutbacks due to oversupply in the markets.\textsuperscript{58}

Are these structural trends harming Bowie Resources plans to ship coal through the Oakland Army Base Redevelopment?

Yes. Although Bowie Resources continues to search for more throughput capacity, the company does so as market indicators are showing less demand for coal off the U.S. West Coast.

Bowie Resources recently filed an Initial Public Offering (IPO)\textsuperscript{59} with the United States Securities and Exchange Commission (SEC). Ironically, the IPO itself contains information that undermines the case for the Oakland Army Base Coal Port. The IPO document says Bowie Resources currently has 5.7 million tons\textsuperscript{60} of throughput capacity at the Port of Stockton (Bowie Resources owns three mines in Utah—Sufco, Skyline and Dugout, which, according to published reports,\textsuperscript{61} would be the source of the coal that would flow through the Port of Oakland). The document\textsuperscript{62} also cites statements by Bowie Resources' coal-industry consultant Wood Mackenzie projecting a maximum export demand in 2035 for Utah coal of only 4.7 million tons per year.

In its SEC filing, Bowie claims its sponsor (Trafigura) will ship only 1 million tons of coal through California ports in 2015.\textsuperscript{63} For Bowie to fulfill even its current throughput agreements at the Port of Stockton, it would need to increase export tonnage by almost sixfold from current, actual export levels. Officials at the Port of Stockton are reporting that they expect revenues to lag over the next year due to declining coal export activity.\textsuperscript{54}

Bowie Resources' plans are highly speculative and its numbers are not consistent with current or projected market demand for coal. The addition of 4.2 million tons per year in coal exports from

\textsuperscript{52}http://trib.com/opinion/columns/crutchfield-alpha-is-restructuring-for-the-future/article_a47d5d8b-d599-5a78-a7af-22ad44173cbbc.html
\textsuperscript{53}http://www.wsj.com/articles/glencore-scraps-final-dividend-raises-cash-to-cut-debt-1441607323
\textsuperscript{54}http://www.marketwatch.com/story/glencore-may-cut-coal-output-more-to-combat-glut-2015-06-04
\textsuperscript{58}http://www.heraldlive.co.za/coal-oversupply-cuts-back-profits/
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\textsuperscript{64}http://www.recordnet.com/article/20150629/NEWS/150629684
Bowie through the Oakland Army Base would require an almost tenfold increase in export demand for Bowie’s coal products from current actual levels.

This magnitude of increase is not supported by the estimates being made by the United States Energy Information Administration. According to EIA, total U.S. coal exports to Asia are expected to rise from 8 million tons in 2015 to 19.9 million tons in 2035. This would mean an increase of less than 1 million new tons per year to meet the demand. This means also that Bowie Resources is estimating that its product alone would capture 80 percent of the market in new Asian coal demand exported through West Coast ports. Bowie is predicting apparently that virtually all of its existing and future competitors will fail. These competitors include other companies that also plan to export coal from Utah—like Rhino Energy (with explicit plans to export Utah coal), and Murray Energy (with a global platform)—along with Powder River Basin coal producers that include the Signal Peak mine (owned by the Gunvor Group, an international competitor of Trafigura, with a track record of sales from its Montana mines), similarly-situated Cloud Peak Energy, and Peabody Energy, Arch Coal and Westmoreland Coal.

Government officials and others examining Bowie Resources’ proposals clearly need to undertake additional due diligence to determine where Bowie Resources has contracts to sell this coal. The market is too weak to skip this essential diligence step.

Does Bowie Resources face the same pressure to export as above?

Yes. The domestic market for coal from Utah is fragile. In December 2014, Seth Schwartz, president of Energy Ventures Associates, a widely regarded coal consultant, testified at the Idaho Public Utility Commission and provided a detailed view of the Utah coal market.

Mr. Schwartz makes several important points:

- First, Utah coal production has been on the decline, dropping from 26 million tons in 2006 to 16.6 million tons by 2013.

- Second, this decline in part came from the elimination of coal demand from coal plants in the East, and a number of the key coal plants that are currently using Utah coal have announced plans for retirement:

  The demand for Utah coal will decline at other local power plants because most of these plants have announced dates when they will close. The Reid Gardner power plant will close units 1-3 at the end of 2014 and the remaining unit at the end of 2017. PacifiCorp will close the Carbon power plant in 2015. NV Energy’s most recent Integrated Resource Plan, filed in 2013, reflects retirement dates for the

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65 [http://www.eia.gov/beta/aeo/#/?id=96-AEO2015&cases=ref2015](http://www.eia.gov/beta/aeo/#/?id=96-AEO2015&cases=ref2015)
66 [http://www.sec.gov/Archives/edgar/data/1490630/000110465911059426/a11-28829_1ex99d1.htm](http://www.sec.gov/Archives/edgar/data/1490630/000110465911059426/a11-28829_1ex99d1.htm), p.21
68 [http://www.puc.idaho.gov/fileroom/cases/elec/PAC/PACE1410/company/20141215SCHWARTZ%20DIRECT.PDF](http://www.puc.idaho.gov/fileroom/cases/elec/PAC/PACE1410/company/20141215SCHWARTZ%20DIRECT.PDF), Mr. Schwartz’s discussion of the Utah coal market starts on Page 19 of the testimony.
North Valmy units in 2021 and 2025. All of the plants in California have announced they will stop burning coal by the end of 2015. Finally, IPP has announced it will stop burning coal after its contracts with the California participants expire in 2027. At that point PacifiCorp is likely to be the only consumer of Utah coal in power plants, along with the industrial customers and the export market.

- Third, the Utah market is oversupplied. Although the remaining coal plants using Utah coal require 7.3 million tons of coal, the remaining mines in the near term will produce between 13 and 15 million tons.70

In February 2015, Robert Murray, the CEO of Murray Energy, a coal producer with significant holdings in the Illinois Basin and Northern Appalachia and with a presence in the Uinta Basin including Utah, stated that market conditions in the Uinta Basin were a “virtual disaster.”71 While Murray pointed to over regulation as the larger cause of coal’s downturn, his view of market realities should not be overlooked.

**PUBLIC FINANCE RISKS OF MOVING COAL THROUGH THE OAKLAND ARMY BASE**

**What is the scope of the bulk terminal project and how is it financed?**

The proposed development budget for the Outer Harbor Intermodal Terminal (OHIT) covers remediation of the Army Base, improved rail access, a recycling facility and a bulk cargo marine terminal. The financing relies upon a series of commitments by the State of California, the City and Port of Oakland, the State of Utah and the developer. The public finance portion, which is coming largely from the federal government and California state and local governments, constitutes the largest portion of the budget. Introducing coal into the commodity mix will be the weak financial link in the overall package and will expose public and private funds to various financial, legal and political risks.

The overall budget for the OHIT project is set at $499.2 million. The budget calls for $327.3 million in various public funds from the City of Oakland, the Port, the State of California (through TCIF (the Trade Corridor Improvement Fund)), and the federal government (through TIGER, the Transportation Investment Generating Economic Recovery grant program). The budget also lists $171.9 million in unspecified private funds. The line item for the City Trade and Logistic Facilities includes the costs for the terminal build-out and is listed at $99.4 million from private funds (a portion of the $171.9 million).

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Table V: OHIT Development Budget

<table>
<thead>
<tr>
<th>Description</th>
<th>Total Cost</th>
<th>Port</th>
<th>City</th>
<th>Private</th>
<th>TIGER</th>
<th>TCIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remediation</td>
<td>$11,400</td>
<td>$5,700</td>
<td>$5,700</td>
<td>$-</td>
<td>$-</td>
<td>$-</td>
</tr>
<tr>
<td>Rail Access Improvements and Manifest Yard</td>
<td>$74,600</td>
<td>$5,000</td>
<td>$3,800</td>
<td>$-</td>
<td>$-</td>
<td>$65,800</td>
</tr>
<tr>
<td>City Site Prep and Backbone Infrastructure</td>
<td>$247,241</td>
<td>$-</td>
<td>$45,000</td>
<td>$25,900</td>
<td>$-</td>
<td>$176,341</td>
</tr>
<tr>
<td>Recycling Facilities</td>
<td>$46,600</td>
<td>$-</td>
<td>$-</td>
<td>$46,600</td>
<td>$-</td>
<td>$-</td>
</tr>
<tr>
<td>City Trade &amp; Logistics Facilities</td>
<td>$99,400</td>
<td>$-</td>
<td>$-</td>
<td>$99,400</td>
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<td>$-</td>
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<tr>
<td>Unit Train Support Yard</td>
<td>$20,000</td>
<td>$5,000</td>
<td>$-</td>
<td>$-</td>
<td>$15,000</td>
<td>$-</td>
</tr>
<tr>
<td>TOTAL (costs in thousands)</td>
<td>$499,241</td>
<td>$15,700</td>
<td>$54,500</td>
<td>$171,900</td>
<td>$15,000</td>
<td>$242,141</td>
</tr>
</tbody>
</table>

The OHIT Baseline Agreement describes the bulk cargo marine terminal as follows:

On the City’s West Gateway site, berth 7 would be converted to a modern bulk cargo marine terminal for movement of commodities such as iron ore, corn and other products brought in to the terminal by rail. 80,000 DWT Panamax vessels would be filled with cargo brought in by rail, unloaded on site and moved by conveyor into the ship’s cargo holds. The terminal would also accommodate project cargo such as windmills, steel coils and oversized goods. The proposed improvements include new rail tracks from the Unit Train Support Yard to this marine terminal, as would improvements to the wharf structure including new piles and protection of existing piles, construction of new purpose-built cargo handling facilities such as a bulk railcar unloading pit, bulk material storage building, ship loader, and conveyor belts between the unloading pit, storage building and ship loader.

In addition to the money that would be provided by public sources in California, the State of Utah in April 2015 conditionally approved an application for a $53 million, 30-year loan at 2 percent interest to support “Terminal Logistics, Oakland Bulk and Oversized Terminal at the Oakland Global Trade and Logistics Port.” The joint application is by four Utah counties: Sevier, Carbon, Emery and Sanpete. The application and the supporting materials cited these budget numbers:

The cost of the Bulk Terminal Facility will be $275 million, $25 million of which will come from the funds shown here. CCIG will finish the design of the Terminal, and will construct the terminal. The Terminal should be complete and in operation by mid-2017. The Counties have proposed that they fund $50 million of the terminal cost in return for throughput allocation at the terminal along with an annual return on their principal investment. The remaining $200 million required to complete the terminal will come from

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third-party lenders, likely one or more North American pension funds. The Project group is working toward a financial close in June of this year.\textsuperscript{75}

The figures provided by the Oakland Army Base published in the 2012 development budget (Table V) and posted on its website currently are at variance with the presentation made to the State of Utah in April 2015. It appears that the Oakland Army Base numbers state that the terminal will cost $99.4 million while the State of Utah places the cost for the terminal at $275 million. The published minutes of the meeting and the application itself in Utah do not describe the specific use of the dollars or the specific commodities to be shipped through the port. However, published reports and emails provided in response to a Sierra Club Utah Government Records Access and Management Act (GRAMA)\textsuperscript{76} indicate that the project is designed\textsuperscript{77} to ship coal mined in Utah through the port to overseas users. Once finished, the coal portion of the project would have a throughput capacity of 4-5 million tons of coal\textsuperscript{78} per year, out of a total project shipping capacity of over 9 million tons. The published minutes and public records do not provide details regarding the actual legal structure of the transaction, including how the funds would be transferred from the State of Utah or its counties to the Oakland Army Base, City of Oakland, Port of Oakland, the developer (CCIG) or any other party. Apparently the State of Utah funds would be deemed “private dollars” to back a portion of the overall project budget in Oakland.

What are the risks to the public entities involved with the financing of this project?

Some of these risks are already known and acknowledged; all are fundamental in nature.

First, as described in detail above, the economic fundamentals related to the coal portion of this project (the general industry and specific mining, sale and company financials) are exceedingly weak. The coal portion of this project is expected to produce at least half of the total tonnage shipped through the newly expanded cargo bulk terminal. Therefore, the project has a very high likelihood of default and failure. When the coal shipments fail to materialize, the investments made by the State of Utah, California government entities, the Port and other private and public sources will be at risk (or will be diverted to other uses at the port, meaning the public entities will not be receiving promised services for the expenditures made).

This project is heavily financed with public-sector dollars (even some of the so-called “private” amount of $99.4 million appear to be backed, for now, by $53 million in public funds from the State of Utah and its counties). In the event of financial failure, additional public funds will be

\textsuperscript{75} CIB Presentation April 2, 2015 -- MASOB, Request for Carbon, Sevier, Sonepete and Emery Counties for $53,000,000.00 for Throughput Allocations in a Multi-Commodity Bulk Terminal at the site of the Former Oakland Army Base. There is no crosswalk explanation that reconciles the $275 million figure in the Utah data with the line item in the Port development budget of $99.4 million.

\textsuperscript{76} Amanda B. McPeck, Information Disclosure Officer, General Counsel, State of Utah, Department of Public Workforce Services to David Abell, Sierra Club, Environmental Law Program, August 12, 2015. (McPeck-FOIA)


needed to pay for whatever costs are associated with the assignment, transfer or other requirements to bring in new business.

Failed coal-shipping agreements are commonplace in the industry today. Cloud Peak Energy, a company with a track record of exporting Montana coal, has failed to meet its export targets in 2015 and is expected to miss them again in 2016 as weak pricing persists.\(^\text{79}\) Ambre Energy failed\(^\text{80}\) and was unable to complete its export plans through Washington State and sold its interests to a private equity investor. Arch Coal dropped out of a multi-year deal with Ridley Terminal in Canada,\(^\text{81}\) which serves U.S. and Canadian coal producers and is facing financial stress in 2015.\(^\text{82}\) Historically, west coast coal ports have seen some high profile failures in the past.\(^\text{83}\)

Second, the private-sector portion of the project may pose risks to the public dollars involved. It is unclear which pension funds or other institutional funders have made commitments for the project (presumably these funds or funders constitute the “private dollars” listed in the budget), or what the requirements for those investments may be. The disclosure to the State of Utah calls for a closing on the remaining $200 million by June 2015. This deadline appears to have slipped.

It is also useful to examine the one recent example of indirect pension fund investment in Northwest coal ports. In that case, Goldman Sachs GS Infrastructure Partners participated in the proposed Gateway Pacific Port in Bellingham, Washington, but then pulled its investment. (Goldman manages pension fund assets.) It is similarly unclear how any future pension fund would participate and how the ownership interests and funds would be integrated into the larger development budget shown in Table V above.\(^\text{84}\)

Third, this allocation of public funds in Utah side raises a series of risks. Utah officials have expressed several reservations regarding the $53 million loan, including unspecified legal concerns, the large size of the allocation, the need for greater specificity on use of funds, the Attorney General’s sign-off, and contingent dollar commitments.\(^\text{85}\) Materials provided by the State of Utah to the Sierra Club in a public records request response dated August 12, 2015, contain the following statement: “Please note that while the CIB [Permanent Community Impact Fund Board] has set aside money for the potential use of this project, no funding of this project by CIB has occurred. The project is still under legal review.”\(^\text{86}\)

The Community Impact Fund has specific rules requiring that the facility that is funded be used for intended purposes. A change of use must receive permission from the Fund:

A recipient of PCIFB grant funds may not, for a period of ten years from the approval of funding by the Board, change or alter the use, intended use, ownership or scope of a project without the prior approval of the Board. A recipient of PCIFB loan funds may not,  

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\(^\text{82}\) [http://daily.sightline.org/2015/06/05/ridleys-coal-exports-a-terminal-illness/](http://daily.sightline.org/2015/06/05/ridleys-coal-exports-a-terminal-illness/)


\(^\text{84}\) A check of the Port of Oakland’s website page on September 15, 2015 showed there were no updates regarding the budget or new financial commitments on the City Trade and Logistics Facilities page

[http://www.portoakland.com/maritime/oab_funding.aspx](http://www.portoakland.com/maritime/oab_funding.aspx)


\(^\text{86}\) McPeck-FOIA
for the term of the loan, change or alter the use, intended use, ownership or scope of a project without the prior approval of the Board.87

In a typical multi-purpose port project, if one commodity falters and others prove more lucrative, a shift can take place to the more profitable commodity. However, despite the steps that have been taken in this case to make this project appear to be a multi-commodity project, its primary purpose is to support coal mining and transport. When the coal deals fail to materialize, there may be little recourse short of retooing the facility. It remains to be seen what entities will be responsible for ultimate liabilities.

Fourth, the use of the Utah funds on this project should be a red-flag warning to Oakland officials that the project is fundamentally weak. The coal industry is working through a massive wave of bankruptcies,88 new business and finance models89 and is searching for ways to take expenses offline. With private investors in short supply, some state governments are looking to step up and absorb direct financial risk for particular coal companies. For example, Wyoming and Montana have proposed new legislation to authorize bonds90 to support construction of coal ports due to the sagging fortunes of coal companies.91 Now, the State of Utah is looking to alter the use of a longstanding state infrastructure program by supporting Bowie Resources in its effort to ship coal through the Oakland Army Base.

The reason for these extraordinary state and local government measures is that traditional private investors have pulled out of coal port financing. Goldman Sachs, the blue-chip investment house that pulled out of the Gateway Pacific port deal in Washington. Goldman’s replacement was a more speculative investor.92 Kinder Morgan, another blue-chip investor, pulled the plug its investment in a Coos Bay deal in Oregon.

In the Oakland case, Trafigura and its private equity subsidiary Galena have invested in Bowie but are relying on public financing to provide the needed capital to fund this speculative coal export project. By contrast, in the case of the Burnside coal port Terminal in Louisiana, Trafigura used its own credit and borrowed several hundred million to finance the project.93 The Utah CIB public financing underwrites one part of the speculative aspects of the Oakland export logistics deal. A pension fund presumably would underwrite some other portion. These are all tactics by Trafigura—a company that had revenues of $127 billion and assets of $37 billion in 201394—to limit its own financial exposure to Bowie should the export scenario fail and to instead leave taxpayers with the financial risk.

Fifth, the Oakland Army Base coal export project, City or the developer may be exposed to additional terms and conditions on the Utah funding, to litigation or political risk. The financial risk to the City is likely to take the form of the need for future concessions to the developer in the event of Fund revocation or an adverse change in the terms and conditions of the transaction.

87 http://www.rules.utah.gov/publicat/code/r990/r990-008.htm#T1
88 Darren Epps, Bankruptcies continue to rock coal companies in ’13, but hope for survivors, SNL, December 5, 2013.
89 Darren Epps, Slumping coal sector MLP structure offers producers attractive outlet, October 31, 2014.
For example, the rules governing the Utah Permanent Community Impact Fund raise the following caveats:

- According to published reports, the applicants for the funds are four Utah counties, operating in a joint project. But are these counties the true applicants or is Bowie Resources the true applicant? This project appears to be geared to assist the company to mine coal at its various facilities and to market it overseas. According to program rules, applicants must demonstrate that the proposed funding is “not merely a device to pass along low interest government financing to the private sector” (R 990-8-2 Eligibility).

- Bowie Resources has access to other forms of private capital to invest in the port project. Both Trafigura and its subsidiary Galena Asset Management invest in companies and projects in the oil, petroleum, minerals and mining sectors across the globe. Bowie Resources and CCIG/TLS have devised a financial scenario where neither Bowie nor Trafigura nor Galena need take much if any investment risks in the Oakland Army Base coal export project. The States of California and Utah (and the four counties) bear the risk for a long-term project with an industry and a specific company that is plagued by short-, medium- and long-term fundamental problems. Although comparative financing scenarios have not been made public it is not too far a stretch to suggest that 2 percent financing for 30 years by the State of Utah is a better deal than Bowie would receive from either Trafigura or Galena. The sole purpose of the funding is to provide a troubled company cheap and flexible financing.

- The program rules generally limit projects to $5 million. Agency minutes indicate that other projects with greater than $5 million have been approved in the past, but those projects were located within the borders of the State and served multiple counties with long term capital assets. None of those conditions seem apparent from the information on the record to date regarding the Oakland Army Base coal project.

- Program rules offer a clear set of financial accountability standards. Certain assumptions about ownership and future uses here would apply only to the model typically used in Utah for in-state projects. In the case of the Oakland Army Base coal export project, some new business arrangements might be necessary and new measures of State accountability adopted.

All applicants must demonstrate that any arrangement with a lessee of the proposed project will constitute a true lease, and not a disguised financing arrangement. The lessee must be required to pay a reasonable market rental for the use of the facility. In addition, the applicant shall have no arrangement with the lessee to sell the facility to the lessee, unless fair market value is received. (R 990-8-3, K Applicant Requirements)

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95 http://www.rules.utah.gov/publicat/code/r990/r990-008.htm#T1
96 The application from the four counties states that the loan will be guaranteed by throughput contracts with unspecified parties. See: Permanent Community Impact Fund Board Application Form, Project Title: Bulk Commodity Marine Terminal located in Oakland, California, Part B, Project Funding, Section 2.5 Type of Funds Requested, Other. In one email on April 8, 2015 sent by Mr. Holt, BMO, Subject: Press to several county representatives, state and banking officials he reminds them that the operation of the facility is not Bowie, but is in fact TLS. “The terminal operator is TLS, not Bowie. Bowie is known for coal. TLS is a bulk operator.” The counties are arguably only a pass through for the financing and appear to be only vaguely aware of the parties to the development team.
The proposal for a new coal export terminal in Oakland, aimed at shipping coal to Asia, comes at a time when global thermal coal markets are in a state of collapse. A broad consensus of the world’s leading investment houses warns strongly against investing in coal mines, coal ports or the global coal trade. The seaborne global coal market is not going to recover. Import demand is down in China, a major driver of world coal markets, and India is headed in the same direction. Prices are at historic lows and likely to remain so for the foreseeable future. Low prices keep U.S. coal producers from competing in the global market. Bowie Resources, a company already suffering from a substantial erosion of its domestic market, is a weak financial partner for a port deal.

Investments of public dollars from California, Utah, and the federal government will be in jeopardy if this project moves forward. In fact, the pledge of assistance from the State of Utah should be a red flag warning to the State of California and to City and Port of Oakland officials because it is a sign of financial weakness in the coal industry. Some Utah officials are questioning it as well.

More important, the underlying economic weakness of the coal industry, and the flaws in its plans to export coal to Asia in particular, pose risks to the Oakland Army Base project, and thus City of Oakland. This project will not produce coal for export at sufficiently robust levels to meet financial targets. From Day One, the coal component of this project will be a financial drain on the City of Oakland as a whole, and will remain so for the foreseeable future. It is not a risk worth taking.