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Testimony of George W. Bilicic
Lazard Frères & Co. LLC
Vice Chairman of Investment Banking
Global Head of Power, Energy & Infrastructure
Head of Midwest Investment Banking

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Committee on Natural Resources
Subcommittee on Energy and Mineral Resources
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Good morning and thank you Chairman Gosar, Ranking Member Lowenthal and members of the Subcommittee for the opportunity to speak with you about the Navajo Generating Station ("NGS") and, relatedly, Peabody Energy's ("Peabody") Kayenta Mine ("Kayenta"), which supplies coal to NGS.

I am a Vice Chairman of Investment Banking at Lazard Frères & Co. LLC ("Lazard") and currently head the firm's Midwest investment banking business and global efforts in power, energy & infrastructure. I have been with Lazard for more than fifteen years. With origins dating to 1848, Lazard is one of the world's preeminent financial advisory and asset management firms, operating from 43 cities around the globe. Over the past ten years, Lazard has advised on over 170 U.S. power & utility engagements and is currently the leading advisor in power & utility M&A—I have led nearly all of these engagements.

In June 2017, Lazard was retained by Peabody to study and facilitate a transfer of ownership of NGS that would enable the power plant to remain in long-term operation.

Today, I will offer my views regarding the process that Lazard initiated in mid-2017 to find a potential new owner for NGS, the "needs" identified by potential new owners that would help to keep NGS operational over the long-term and the perspectives of potential new owners/investors regarding the ability of NGS to compete with other power generation sources over the long-term.

GEORGE W. BILICIC
Lazard Frères & Co. LLC
300 North LaSalle Street
Chicago, IL 60654

Background on NGS

NGS is a 2,250 megawatt baseload coal-fired power plant located in the LeChee Chapter of the Navajo Nation near Page, Arizona. The power plant is currently owned by a number of utility owners, including the Salt River Project (42.9%), Arizona Public Service Company (14.0%), NV Energy (11.3%) and Tucson Electric Power (7.5%), with the balance of the ownership held by the U.S. Department of the Interior, Bureau of Reclamation (24.3%).

NGS historically has been cost competitive, allowing the plant to operate at a high utilization rate compared to other coal and natural gas plants in the region. We understand that NGS currently meets all federal air quality standards and emission limitations, with more than $650 million spent on environmental equipment over the past ten years.

NGS has been a key infrastructure asset that has assisted in the growth of the economy in Northern Arizona and the Southwestern United States more broadly. Some of the ways in which NGS is woven into the fabric of these economies are as follows:

(i) NGS provides electricity to its various utility owners for service of customer load;

(ii) NGS provides electricity to the Bureau of Reclamation for service of the Central Arizona Project ("CAP"), a vital collection of infrastructure assets that provide water to a large portion of Arizona, including Phoenix and Tucson;

(iii) NGS and Kayenta (the sole source of coal for NGS) are responsible for ~1,000 jobs directly and an additional ~2,000 jobs indirectly, many of which are held by Native Americans; and

(iv) We understand that NGS and Kayenta-related revenues comprise a significant portion of the overall budget of the Navajo Nation and the Hopi Tribe (e.g., lease revenues, royalty revenues, etc.).

In February 2017, the current owners of NGS, led by the plant's operating agent, Salt River Project, indicated that they intended to operate NGS through the end of 2019, with decommissioning of the plant proceeding thereafter. A byproduct of the decommissioning of the plant would be the shut down and reclamation of the Kayenta Mine, which has no other significant use for the coal it produces. Although the current owners plan to exit or shut down the plant in 2019, according to Industry-leading consultants, NGS has an expected useful life through the mid-2040's.

Process to Identify Potential New Owner(s)

In July 2017, Lazard formally launched a sale process for NGS, reaching out to over **45** potential counterparties, consisting of broadly-focused financial investors, power- and energy-focused financial investors, strategic power generation companies, experienced power generation developers and operators, and others who had expressed inbound interest based on the news surrounding the situation.

Of the potential counterparties that Lazard contacted, follow-up calls were scheduled with over **25**, of which **15** expressed interest and signed a non-disclosure agreement with Salt River Project. To the counterparties who executed a non-disclosure agreement, Lazard provided data room access, a confidential information memorandum and a financial model. These counterparties were asked to provide, by the end of September, an initial proposal/term sheet for how they would assume ownership of NGS.

There are a number of positive factors that we understand are driving a strong interest in NGS from potential investors. First, Peabody is actively studying ways in which Kayenta can adjust its mining operations in order to reduce the cost of coal, which would more favorably position NGS vis-à-vis natural gas generation. Additionally, reputable and experienced private equity firms and power plant operators that have expressed interest in NGS believe that the plant could operate more efficiently from a fixed cost basis, further increasing the cost competitiveness of NGS. Finally, a provision in the EPA rule relating to NGS (i.e., 40 CFR Part 49, alternatively known as "Alternative B"), would allow the entire 2,250 megawatts of power generation capacity at NGS to operate over the long-term without the need for certain capital expenditures. This provision is not available to the current owners of NGS.

By the end of September, we had received **5** initial proposals to keep NGS alive. These proposals were from well-respected financial investors with strong track records in the power generation sector. These **5** counterparties were placed on hold until further progress around NGS plant costs (i.e., Peabody coal pricing) and revenue (i.e., load, tenure, price) was made.

Given the significant complexities surrounding NGS, we believed that selecting a credible and experienced potential investor to perform detailed diligence and engage with key stakeholders would result in the highest probability of success. Therefore, in late-January 2018, based on these qualifications and our assessment, Peabody selected, from the pool of interested counterparties, a reputable and experienced investor and that investor's power plant operating company (the "Potential Investor"), to perform detailed due diligence of NGS.

In mid-February 2018, Lazard arranged an in-person meeting between Peabody and the Potential Investor to discuss key developments that have been made with respect to NGS, its level of interest in pursuing NGS and potential next steps. The Potential Investor reiterated that it was very interested in pursuing NGS and believes the plant can be made economic in the current price environment for power.

Over the course of the past two months, the Potential Investor, with Lazard's help, has performed a significant amount of work in finding a solution for NGS that would allow the power plant to supply power at market competitive prices. This has involved several due diligence visits, including a site visit of NGS and Kayenta, a meeting with key representatives of the Navajo Nation and Hopi Tribe, and a meeting with each of the current utility owners, among other efforts. We are pleased to report that, to date, the ownership transition process remains on track, within the timeframe set forth by Salt River Project.

Although our recent efforts have focused on working closely with the Potential Investor, there are additional prospects for NGS and Kayenta to remain open, including: (i) re-engaging the remaining counterparties who submitted an initial proposal, and others, who are currently on the "sidelines," awaiting direction from Lazard on next steps and (ii) for Peabody to vertically integrate NGS and the mine.

<u>Selected "Needs" of Potential New Owners</u>

Based upon the initial proposals received in late-September 2017 and recent conversations with the Potential Investor, there are four key areas on which a potential new owner would need to perform in-depth due diligence relating to NGS's ability to operate post-2019. Any one of these key diligence issues could jeopardize the viability of NGS to operate post-2019 if not fulfilled. They are as follows:

(i) <u>Revenue Certainty/Power Purchase Agreements</u>—Potential new owners have been focused on the key terms of a potential offtake/power purchase agreement contract with the current owners/other counterparties. Further visibility and, more importantly, willingness from the current owners to contract power from NGS at market competitive prices will be required. Based on preliminary discussions between the current owners and the Potential Investor, it appears that the current owners are willing to purchase power from NGS, albeit at lower volumes than historically procured and for a shorter tenure (i.e., 3 – 5 years) than what potential new owners believe to be ideal. This represents the area of most uncertainty; however, NGS has the support of the Arizona Corporation Commission (Arizona's public utility commission) and the U.S. Department of the Interior. There are several actions the Arizona Corporation Commission and the U.S. Department of the Interior can take, or have taken, to assist potential new owners with revenue certainty, including establishing a diverse portfolio standard in Arizona (which would require utilities within its jurisdiction to source a certain portion of their power from coal-fired power generation facilities) and compelling CAP to source power from NGS (due to their current debt obligation of over $1 billion to the federal government for the construction of CAP infrastructure, including NGS).

(ii) <u>Coal Supply Agreement</u>—The cost of coal is the single largest variable cost at NGS; thus the price at which coal can be supplied to NGS is a necessary component to understanding the future competitiveness of the facility and the price at which new owners would be willing to supply power. Peabody has performed a tremendous amount of work on this topic, including revisiting their mining plan and helping to develop different ways to structure a potential coal supply agreement.

(iii) <u>Lease Agreement with Navajo Nation</u>—A potential new owner will need to execute a fair, long-term lease agreement with the Navajo Nation that will allow NGS to compete effectively against gas-fired and renewables power generation. The Navajo Nation has shown a willingness to be flexible on the terms of a lease agreement, including flexibility with respect to the structure of the lease (e.g., fixed payments vs. profit sharing).

(iv) Fixed Cost Management—Based on benchmarking analyses conducted by a third-party consultant, Lazard and the Potential Investor, comparable coal-fired power plants are operated safely and efficiently at a significantly lower expense. Bringing NGS in line with comparable facilities could save over $100 million annually.

Conclusion

Based on Lazard's interactions with experienced and reputable counterparties and the Potential Investor, and assuming the key "needs" highlighted above are fulfilled, NGS could be in a position to supply power at prices lower than current market rates and compete against newly-built natural gas-fired power generation facilities, allowing NGS and Kayenta to operate post-2019. Lazard understands the importance of NGS and Kayenta to the communities they serve, the regional economy and the vitality of the Navajo Nation and Hopi Tribe.

I am happy to answer any questions that you may have.