



**United States Energy Association  
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Coal in the New Year – Rebalancing Market and Policies  
Hal Quinn, President & CEO, National Mining Association**

Thank you, Barry for the invitation to join my other energy sector colleagues in the USEA's Annual State of the Energy Industry Forum. Given recent market trends, it looks as if you've checked us in to the energy sick bay.

The headlines tell it all: The fever of global oversupply has now spread with alarming speed across many commodity sectors. Clearly some painful measures will be forthcoming to rebalance the markets.

What does it say about the New Year's outlook for fossil energy when it appears that the good news ... or at least the best news in 2015 ... may likely come from Washington?

But such is the state we find ourselves—squeezed by the twin challenges of a global energy glut and costly regulatory policies—leaving the 114<sup>th</sup> Congress ... together with the courts in our nation's capital ... as the brightest lights for fossil fuels in 2015. Before I explain the opportunities we have here in Washington, let me turn to the market ... the policy challenges we face ... and why we see possibilities for a more balanced policy framework.

### **Market Conditions**

Few of us can count on any sudden improvement in 2015. With the global economy on less than firm footing and more than enough capacity still on line, most analysts believe energy markets are likely to remain challenging throughout the year. We know our markets run in cycles and today we're all hoping we are approaching the bottom of this one.

This has put pressure on all our operations and our employees. We've been to this rodeo before and we'll ride this one out too.

Bull riders have a saying: "You don't get ready, you just get on." That fairly describes the approach we all may be taking in 2015.

But if coal is not riding high, neither are we despondent. This year coal will hold its own in the domestic power generation market and continue its growth globally as it furnishes 40 percent of the electricity worldwide. That's a forecast most would welcome under present circumstances.

Those who're preoccupied with domestic headlines on energy issues may miss the bigger picture. In *The Wall Street Journal* last summer Daniel Yergin offered his view of what our energy future will likely look like 20 years from now. In his words, the energy world will be "bigger—but not too different." With fossil fuels supplying 82 percent of world energy today, Dr. Yergin forecast that their share will only be slightly lower twenty years from now as the world uses 35-40 percent more energy.

Confirmation came last month when the International Energy Agency (IEA) reminded one and all that with demand exceeding 9 billion tons per year out to 2020, "coal is still the backbone of electricity generation worldwide." Over the next twenty-five years, fossil fuels will supply two-thirds of the incremental electricity generation with coal accounting for 40 percent of the growth. The only development that could interrupt this steady march would be a step-change drop in energy demand—a prospect I view as neither likely nor desirable when considering the economic aspirations of emerging nations. Rising living standards and faster growth in these countries are fueling the demand for all energy, especially coal.

And coal has inherent advantages that make it especially suitable for fueling global prosperity: ease of scale for base load power; low cost; and, abundance in terms of both the breadth and depth of the global resource base. These last two attributes account for why coal has relatively fewer geopolitical issues that threaten the supply chain. That may be a more important advantage in coming years than most of us realize today.

Here at home we're already seeing a painful restructuring as part of a rebalancing market. Demand is shifting to lower-cost mines in the Illinois and the Powder River coal basins. Despite a cold winter drawing down utility stockpiles, opportunities for higher shipments did not materialize last year due to the underperformance of our railroad partners. A number of power plants idled or ran at lower capacity out of concern that they would be left with insufficient stockpiles this winter. Rail performance is improving after a major increase in capital spending, but stockpiles remain about 40 million tons short of the five-year average.

Looking out to the medium term, the next two years will be challenging as we see most of the coal plant retirements take hold as a result of EPA's utility mercury and air toxic standards (MATS) rule. Nonetheless, despite these retirements, the utilization rates at the remaining plants will increase to fill the gap. Total demand should remain close to 1 billion tons annually. Electric utility demand will remain below its recent 2008 peak but stay above its 2012 low. Softer global demand, overcapacity and a strengthening dollar have kept some US shipments out of the money in the seaborne market. Over the next several years, U.S. coal exports will stay off the 2012 high of 129 million tons. But with shipments close to 90 million tons a year going overseas, the US coal exports remain 55 percent higher than the average annual rate from 2000-2009.

The forecast beyond 2020 is clouded by the pending EPA proposals for regulating carbon dioxide emissions from the power sector. Power plant CO<sub>2</sub> emissions have dropped by

almost 15 percent since 2005, but EPA is pushing for a 30 percent cut over ten years. This is a risky and costly ask placing an additional 45,000 megawatts of coal capacity at risk of closure or reduced operating levels—and many of those plants have sunk \$47 billion into additional emission controls to meet EPA's MATS rules.

## **Regulatory Challenges**

Balancing energy capacity with a rapidly evolving market is never easy. But in the case of coal the adjustment has been made immeasurably more difficult — for operators, for their employees and for thousands of coal communities around the country — by the administration's regulatory policies. In the headlong pursuit of building its climate-credentials, the administration is assigning an environmental agency the task of engineering nothing less than a wholesale transformation of the nation's electric grid.

This is a transformation guided not by market forces but by regulatory commands. Not by congressional consent, but by congressional circumvention. And, certainly not by energy experts. The result is a reckless gamble with a system that has for decades provided American households and businesses with affordable and reliable electricity. To be sure, market forces often persuade utilities to idle capacity, but they can always bring that capacity back on line when conditions warrant. The capacity doesn't go away, the risk is minimized. But when regulations close these units, the capacity is gone for good along with the twin hallmarks of our electric grid—reliability and affordability.

These twin benefits from a diverse electric grid save consumers \$93 billion a year according to IHS Energy. Fuel diversity also cuts the variability of monthly utility bills in half. Last winter served advance notice of the consequences of a less diverse, less reliable and more expensive electricity supply. During the frigid winter conditions that affected much of the eastern half of the country, coal-based generation supplied 92 percent of the increased demand. Much of that coal capacity will be closed thanks to EPA's MATS rule, and next time we might not be able to dodge what AEP's Nick Akins called a proverbial cannon ball. It was the grid's diversity—or optionality—that Southern Company's Tom Fanning credited for saving his customers \$100 million in the first quarter of 2014.

We asked Energy Ventures Analysis (EVA) to assess what would happen if we experienced similar frigid conditions after most of the EPA mercury rule induced retirements take hold in 2015-2016. The results are sobering:

- Wholesale power prices increase 27-55 percent across different regions—no state is spared.
- Businesses and households pay \$35 billion more for natural gas
- A combination of a cold winter followed by a warmer than usual summer costs consumers \$100 billion in higher electricity and natural gas prices.

Those who accepted EPA's estimate that its MATS rule would only force the closure of 5,000 megawatts of power plant capacity expressed surprise that such harsh

consequences came so soon. However, independent experts previously warned that the agency's retirement estimate was off the mark by at least an order of magnitude with 60,000-70,000 megawatts more likely. If you too are skeptical of EPA's latest assurance that its Clean Power Plan (CPP) carries no risk and promises great reward, you need not ask for forgiveness. Your concerns are well founded according to those who actually operate and oversee the grid:

- North American Electric Reliability Corporation: the CPP will be difficult, if not impossible, to implement without compromising the reliability of the nation's electricity supply. EPA underestimates the number of power plants that will be closed and overestimates the amount of new power sources and increased energy efficiency assumed to offset the lost power generation capacity.
- Southwest Power Pool: CPP will result in cascading outages and voltage collapse in six of the eight states it operates the grid.
- American Electric Power: Performance studies across the system reveal widespread voltage degradation, collapse and cascading outages.
- Electric Power Research Institute: CPP uses an overly simplistic analysis of what is actually possible in the real electric power world—the plan lacks adequate transmission reliability evaluations to understand the full reliability, economic and financial impacts.

All of these assessments go to the core of the CPP's web of assumptions—what EPA ironically calls 'building blocks'—each of which standing alone are improbable and together are implausible. Based upon what these experts say, grading the plan leaves it with an "I" for irresponsible.

Some have suggested that these risks can be managed by inserting a so-called "reliability safety valve" in the plan. But safety valves are used in systems that are inherently dangerous. When it comes to something as essential as our electricity supply, prudence would advise an inherently safe design rather than one which, by all accounts, is anticipated to fail.

### **What to Watch: Congress, Courts and Governors**

The poet pugilist Mike Tyson once said: "Everyone has a plan until he's hit in the mouth." Coal has absorbed some competitive jabs from natural gas, but coal has always risen to meet the competition. Of deeper concern are unbalanced policies that hit below the belt by wiping out competition and inflicting higher costs on American households and businesses alike. It should not be lost on anyone that the consumer benefit of today's lower oil prices may be eroded by continuing increases in electricity prices.

This year begins a new round—a Congress with different leadership in the Senate and a wider majority in the House, several consequential cases before the courts and a growing wall of states questioning the wisdom of partnering with EPA in its costly power plan venture. These are three venues that could deliver blows requiring EPA to revisit its plans.

The 114th Congress is one reason to think we will see an effective counterweight to executive policies that restrict our nation's energy choices. The House of Representatives was quite active in the last Congress with oversight and legislation on energy. We fully expect the Senate under new leadership to join the House this year in conducting robust oversight and advancing corrective legislation. As Fred Upton, Chairman of the House Energy & Commerce Committee, aptly observed last month about EPA's existing power plant rule, "It seems like the deeper we dig into this proposal, the more problems we uncover."

The Supreme Court has granted NMA's petition that claims it was unreasonable for EPA to refuse to consider regulatory costs in proceeding with the MATS rule. The costs—even by EPA's estimate—are considerable, \$9.6 *billion* annually. In return, the benefits are \$4-6 *million* a year. In other words, EPA believed it unnecessary to consider the wisdom of investing \$960 for a meager return of 6 cents at most. And most of the costs are associated with complying with standards for non-mercury emissions the agency itself found did not pose a threat to public health. Bernstein Research recently estimated that a decision overturning EPA could preserve 37,000 megawatts of coal capacity.

EPA recently announced that it will finalize later this summer all three CO<sub>2</sub> power plant emissions rules—new, modified and existing plants. The dust from the stampede to the court house will be visible and the ensuing litigation protracted. But EPA's plan for existing plants could be short-circuited by a pending case in the D.C. Circuit. Murray Energy and 11 states claim EPA cannot regulate power plants using Clean Air Act § 111(d) new source performance standards because they are already regulated under the §112 for hazardous air pollutants. Many legal observers believed the case was premature and the question presented would need to await litigation over the final CO<sub>2</sub> rule. To their surprise, or disappointment, the court has asked the parties to brief this important question. It is entirely possible the court may decide to dismiss the case as premature. But there are compelling reasons for the court to decide sooner than later the threshold question of EPA's authority to regulate power plant CO<sub>2</sub> emissions in the first instance.

Finally, a growing number of governors are aware that when all is said and done with EPA's carbon regulations, this administration will be gone and they will be left explaining to their citizens why they must live with a risky power plan where the costs are real, but the benefits are not. Two economic studies show the stark choices provided by EPA. One conducted by EVA, assessing the mass-based option, projects the costs at \$407 billion in higher electricity and natural gas prices. The other study performed by NERA, evaluating the rate-based approach, found the cost to be as high as \$479 billion. In short, states can choose between dumb and dumber. There are no low-cost options in the EPA plan.

But are these the only choices for governors if they conclude implementing EPA's plan poses unacceptable risks to their citizens and economy? No less than 15 governors asked EPA last year what happens legally and practically if their states failed to

implement a state plan. So far, no answers are forthcoming. Let's consider—can EPA actually step in and run a state's grid; order some plants to run less, others more; decree the build-out of more renewables, transmission and pipelines; and tell businesses and households their darkest days are ahead because they must use less energy. This may be a dog with more bark than bite.

For these reasons, we are cautiously optimistic that 2015 may provide a counterweight if not a solution to our regulatory challenges. Given the gulf that separates the administration from the fossil fuel industry, however, we are not naïve about the challenge ahead.

Our differences were succinctly captured in a statement by the administration's climate negotiator in Lima last month. He said: "the great imperative is to break the link between growth and fossil fuels." Entirely overlooked in this statement is the enduring link between better living standards and fossil fuels. If we sever this link, we will have gained nothing.

Thank you for your attention. To my energy industry colleagues, here is wishing for a soft landing followed by a big bounce.