

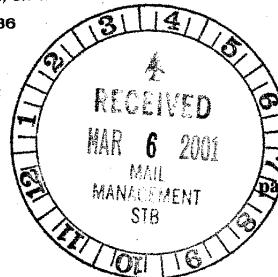
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March 6, 2001

BY HAND DELIVERY

The Hon. Vernon A. Williams
Secretary
Case Control Unit (Finance Docket No. 33407)
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

ENTERED
Office of the Secretary

MAR -7 2001

Part of
Public Record

Re: Docket No. 33407, *Dakota, Minnesota & Eastern
Railroad Corporation Construction into the
Powder River Basin*

Dear Mr. Williams:

In accordance with the Board's decisions served September 27, 2000 and December 14, 2000 in the above-referenced proceeding, enclosed for filing please find an original and ten (10) copies of the Joint Comments on Draft Environmental Impact Statement by Western Coal Traffic League, Dairyland Power Cooperative, Kansas City Power & Light Company, Lower Colorado River Authority, Minnesota Power, Northern States Power Company D/B/A Xcel Energy, and Wisconsin Public Service Corporation (referred to herein as the "Alliance of Western Coal Transportation Consumers"). In addition, a diskette containing this filing is enclosed.

We have enclosed an additional copy of this filing to be date-stamped and returned to the bearer of this letter.

Thank you for your attention to this matter.

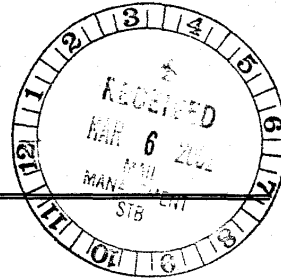
Sincerely,

Peter A. Pfohl
An Attorney for the Alliance of
Western Coal Transportation Consumers

Enclosures

cc: Kevin V. Schieffer (w/ enclosure via overnight mail)

BEFORE THE
SURFACE TRANSPORTATION BOARD



DAKOTA, MINNESOTA & EASTERN
RAILROAD CORPORATION --
CONSTRUCTION INTO THE POWDER
RIVER BASIN

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) Finance Docket No. 33407
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JOINT COMMENTS ON DRAFT ENVIRONMENTAL IMPACT STATEMENT BY
WESTERN COAL TRAFFIC LEAGUE
AND
DAIRYLAND POWER COOPERATIVE
KANSAS CITY POWER & LIGHT COMPANY
LOWER COLORADO RIVER AUTHORITY
MINNESOTA POWER
NORTHERN STATES POWER COMPANY D/B/A XCEL ENERGY
WISCONSIN PUBLIC SERVICE CORPORATION

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OF COUNSEL:

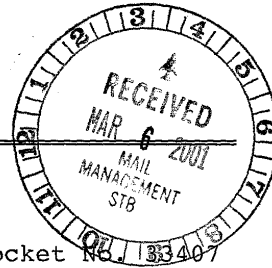
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Dated: March 6, 2001

Attorneys and Practitioners

BEFORE THE
SURFACE TRANSPORTATION BOARD



DAKOTA, MINNESOTA & EASTERN
RAILROAD CORPORATION --
CONSTRUCTION INTO THE POWDER
RIVER BASIN

Finance Docket No. 33407

JOINT COMMENTS ON DRAFT ENVIRONMENTAL IMPACT STATEMENT BY
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NORTHERN STATES POWER COMPANY D/B/A XCEL ENERGY
WISCONSIN PUBLIC SERVICE CORPORATION

These Joint Comments on the Draft Environmental Impact Statement ("EIS") in this proceeding are submitted on behalf of the Western Coal Traffic League ("WCTL") and six individual power producers who purchase and pay for the rail of transportation of Powder River Basin ("PRB") coal for use as an electric generation fuel. These individual providers are Dairyland Power Cooperative, Kansas City Power & Light Company, Lower Colorado River Authority, Minnesota Power, Northern States Power Company d/b/a

Xcel Energy, and Wisconsin Public Service Corporation.¹ Together with WCTL, these parties have participated in this proceeding as the Alliance of Western Coal Transportation Consumers, or "Coal Consumers."

Coal Consumers hereby submit these Comments in accordance with the Surface Transportation Board's procedural schedule governing the consideration of the Draft EIS prepared by the Board's Section of Environmental Analysis ("SEA") in Docket No. 33407. Docket No. 33407 concerns the Application of Dakota, Minnesota & Eastern Railroad Corporation ("DM&E") to construct approximately 281 miles of new rail lines and rebuild approximately 598 miles of its existing rail lines in Wyoming, South Dakota and Minnesota to enable it to reach and serve the important low-sulfur coal fields in the Wyoming Powder River Basin ("PRB") and to facilitate the movement of coal over its system.

¹Kansas City Power & Light Company, Lower Colorado River Authority, Minnesota Power, and Wisconsin Public Service Corporation are also individual members of WCTL. Wisconsin Public Service Corporation is also submitting separate letter comments on the Draft EIS.

I.

IDENTITY AND INTEREST

Coal Consumers are shippers and receivers of coal who collectively purchase and transport by rail well over 100 million tons of coal annually, most of which is from PRB mines. Several of the Coal Consumers constitute a portion of the core market for which DM&E has targeted its PRB coal transportation services. The Coal Consumers strongly support DM&E's Application as a means of promoting railroad competition and system reliability and efficiency, and of remedying persistent capacity and infrastructure problems that have plagued PRB coal movements in recent years.

The Board has divided this proceeding into two phases, a transportation review phase and an environmental review phase. Coal Consumers participated in Phase One of the case, which culminated in the Board's December 10, 1998 decision finding that the project satisfies the transportation-related requirements of governing law. The interest of Coal Consumers in this Phase Two environmental review portion of the proceeding is in helping to ensure that a full and fair review of the project's potential direct, indirect, and cumulative impact on the environment are considered in a timely fashion. In particular, Coal Consumers

are interested in helping to ensure that, in accordance with applicable law, the Board's consideration of potential environmental mitigation is reasonably related to the purpose of the proposal; i.e., to facilitate the movement of coal from the PRB eastward by DM&E to assist Coal Consumers with their desire to obtain competitive, reliable, and efficient coal transportation service.

II.

COMMENTS ON THE DRAFT EIS

- A. The Statutory Framework Governing the Board's Environmental Review Mandates that Any Proposed Mitigation Must Be Consistent with Project Goals

Section 10901 of Title 49, United States Code, governs the issuance of certificates authorizing the construction and extension of rail lines. The statute specifies that "[t]he Board shall issue a certificate . . . unless the Board finds that such activities are inconsistent with the public convenience and necessity." Id. at § 10901(c). On December 10, 2000, the Board held that DM&E's Application satisfies the transportation aspects of 49 U.S.C. §10901 and meets the public convenience and necessity standard; i.e., DM&E is financially fit to undertake the project, there is sufficient public demand or need for the project, and the project will not harm existing rail services.

In its decision, the Board indicated that "[f]ollowing the conclusion of the environmental review process . . . we will issue a further decision assessing the potential environmental impacts of the proposal and the cost of any environmental mitigation we might impose." December 10, 1998 Decision at 51. The Board further indicated that construction activities may not commence until it had issued a final decision.

The Board's (SEA's) March 10, 1999 Notice of Availability of Final Scope of Study for the Environmental Impact Statement (EIS) ("Notice of Final Scope") set forth the scope of the Board's environmental analysis, which generally involves a review of DM&E's proposed Wyoming mainline construction extension into the PRB, its construction of a new mainline bypass at Mankato and rail line connection with I&M Rail Link in southern Minnesota, and certain upgrades of its existing track. Id. at 20. SEA also indicated that it would examine some 16 categories of project impact, including impacts on land use; biological resources; water resources; geology and soils; air quality; noise; energy resources; socioeconomics; safety; transportation systems, cultural and historic resources; recreation; aesthetics;

environmental justice; and cumulative effects. Id. at 20-29.²

The statutory framework governing the EIS review process includes the National Environmental Policy Act ("NEPA"), 42 U.S.C. §§ 4321 et seq.; the regulations issued by the Council on Environmental Quality, 40 C.F.R. Pts. 1500-1508; and the Board's own environmental rules, 49 C.F.R. Pts. 1105 et seq., and other applicable environmental statutes, orders, and guidelines. The EIS process is devised to ensure that major federal actions with the potential for significant environmental impacts are evaluated.³

In evaluating specific alternatives and the imposition of environmental mitigation, SEA and the Board are required to

²The Draft EIS discusses/examines DM&E's proposed PRB routing as set forth in its Application (as modified) and alternatives developed during the public scoping process and afterwards. See Draft EIS, Vol. 1, Chapter 2 and Vol. 4, Chapter 6. In examining possible environmental mitigation, the Draft EIS examines DM&E's proposed routing as well as various alternatives to DM&E's proposal for the new construction, bypass, and rebuild components of project. Id. In the Draft EIS, SEA has set forth its preliminary conclusions or determinations on alternatives in each of the environmental impact areas listed above. In total, SEA has proposed that 98 preliminary environmental mitigation measures be imposed. See Vol. 4, Chapter 7 (listing "SEA's Proposed Environmental Mitigation").

³The EIS is a device that is designed to identify impacts, analyze impacts, and consider alternatives to proposed actions that might have significant environmental impacts. See 40 C.F.R. § 1502.1.

consider them in the context of furthering the overall goals of the DM&E project. The Board explicitly referenced this limitation on its authority in its March 10, 1999 Notice of Final Scope. In its Notice of Final Scope, the Board determined that it would not consider a number of proffered alternatives to the DM&E project proffered by certain parties (including the possible utilization of alternative energy sources by electric utilities to produce electricity) that "do not advance the applicant's goals of efficiently transporting coal and upgrading its current rail system." Notice of Final Scope, at 5 n. 3. As elucidated by the Board:

Under NEPA, an applicant's goals are important in defining the range of feasible alternatives. NEPA does not require discussion of an alternative that is not reasonably related to the purpose of the proposal considered by the agencies. Citizens Against Burlington, Inc. v. Busey, 938 F.2d 190 (D.C. Cir. 1991). Here, the proposed project is intended to facilitate the delivery of coal from the Powder River Basin of Wyoming eastward by DM&E.

Id.

Finally, since NEPA's requirements are largely procedural in nature, the statute does not require agencies to prescribe conditions to address all potential environmental impacts -- especially where other important factors, e.g.,

project viability, might be compromised:

[I]t is now well settled that NEPA itself does not mandate particular results, but simply prescribes the necessary process. See *Strycker's Bay Neighborhood Council, Inc. v. Karlen*, 444 U.S. 223, 227-228, 100 S.Ct. 497, 499-500, 62 L.Ed.2d 433 (1980)(per curiam); *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 558, 98 S.Ct. 1197, 1219, 55 L.Ed.2d 460 (1978). If adverse environmental effects of the proposed action are adequately identified and evaluated, the agency is not constrained by NEPA from deciding that other values outweigh the environmental costs.

Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 350 (1989); accord Finance Docket No. 33388, CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company -- Control and Operating Leases/Agreements -- Conrail Inc. and Consolidated Rail Corporation, (Decision No. 89 served July 23, 1998) at 149-50 n. 227.

B. SEA Must Consider the Purpose and Need for the DM&E Project in Fashioning Appropriate Environmental Mitigation

In the Draft EIS, SEA largely concurs with the evidence and comments of the Coal Consumers set forth in the transportation review phase of this proceeding on the purpose and need for the project. Namely, the project offers the possibility of:

(1) providing for new, competitive, and efficient rail service for PRB shippers; (2) addressing residual western rail service problems and recurring service lapses; and (3) helping to combat capacity constraints facing UP and BNSF on their routes out of the PRB. As concluded by the Board in its December 10, 1998 Decision approving the transportation aspects of the Application: "DM&E should bring a lower cost structure (including shorter mileage), faster and more reliable service, and additional capacity." Id. at 45.

The Draft EIS verifies that:

[t]he overall need for the proposed project is to develop viable, safe, and competitive rail service that provides a reliable fuel source to the Midwestern utility industry . . . [which] must meet the increased demands for more energy production and respond to a changing regulatory environment requiring cheaper, cleaner energy.

Draft EIS, Vol. 1, at 1-6. The Draft EIS also recognizes that "[f]or the past five years, and despite continued capital spending, existing PRB coal carriers have consistently failed to . . . meet their obligations to deliver coal [to electric utilities]." Id. at 1-18. The Draft EIS confirms that the project will further the national energy policies supporting lower cost sources of energy and assist utilities in meeting

federal Clean Air Act emission requirements by promoting the utilization of PRB low-sulfur (and thus more environmentally-friendly) coal as an electric generating fuel.

The Draft EIS relies on certain governmental and industry sources for its findings on the needs for the DM&E project. In furtherance of those findings, other, more recent reports and industry developments provide additional support in terms of the needs and goals of the project. In particular, according to the Energy Information Administration's ("EIA") recently issued December 2000 Annual Energy Outlook 2001 (DOE/EIA-0383(2001)), western coal projection is expected to grow to 819 million tons by the year 2020. Id. at 92. According to EIA, rising natural gas costs and nuclear generating facility retirements will add to this growth as such factors "are projected to cause increasing demand for coal-fired baseload capacity." Id. at 95; accord National Mining Association Releases Coal Industry Forecast; Record Levels Seen for U.S. Coal Consumption, NMA Release, Jan. 16, 2001. (See excerpted portions of Annual Energy Outlook 2001 attached hereto as Exhibit 1.)

These reports on growing demand are underscored by recent announcements by several midwestern and western utilities of plans for the construction of new coal-fired generation units

in the next few years. See A Hot Play on King Coal, BusinessWeek Online, Feb. 27, 2001; Coal to Fire Most of Wisconsin Energy's Power Growth, Reuters, February 23, 2001; Coal Shares Spark on Plans for New Coal-Fired Plants, Reuters, Feb. 2, 2001; Unisource Energy and Bechtel Power Announce Plans to Develop 760 Megawatts of Coal-Fired Generation, Unisource Energy Corporation Release, Feb. 1, 2001. These new generating facilities will produce thousands of megawatts of new power capacity that will rely on low-sulfur western coals. (See articles and announcement attached hereto as Exhibit 2).⁴

Additionally, recent high demand for PRB coal apparently has sounded the service crisis alarm bells once again as the incumbent PRB rail carriers (UP and BNSF) are once again experiencing difficulties in moving their trains through their constrained PRB coal corridors. See Concern Over PRB Capacity Crunch Rises, Coal Transportation Report, Feb. 26, 2001, at 1 (article attached hereto as Exhibit 3). These recent service problems, unfortunately, do not appear to be isolated incidents.

⁴The ongoing electricity crisis in California and neighboring states underscores the need for the development of new generation sources that do not rely on expensive natural gas as a fuel. Thus the Coal Consumers expect the demand for PRB coal to grow faster in the future than it has in the last two-three years.

See e.g. Finance Docket No. 33726, Western Coal Traffic League v. Union Pacific Railroad Company, Decision served Nov. 27, 2000, at 7 ("periods of congestion and service disruptions of varying and often significant degrees, often stemming from multiple and unavoidable causes, are simply not uncommon in railroading").

The existing capacity crunch being faced by UP and BNSF -- combined with the likelihood of increased demand for PRB coal as a source of generation fuel -- is all the more reason for the need for additional system capacity in the West to enhance the future reliability of PRB coal transportation service, and to reduce or eliminate recurring rail service disruptions. Finally, the recent escalation of natural gas prices, and the continuing electric utility problems in California, further underscore the importance of the DM&E project in expanding the options open to utilities seeking to secure reliable and affordable fuel and transportation sources to satisfy the nation's growing demand for electricity.

C. Rectifying Flaws in the Draft EIS and the
Board's Environmental Review Process

1. SEA has Failed to Fully Consider the Fragile
State of the DM&E and the Harm to Environment
Should the DM&E Project Fail

In its findings in the December 10, 1998 decision approving the transportation aspects of the DM&E Application, the Board found that DM&E's construction proposal will result in making DM&E a more viable and stable western rail carrier. Conversely, the Board found that, absent the successful implementation of its PRB extension project, DM&E would not be able to invest in improvements to improve service for its existing customers, and ultimately, likely would be forced to terminate its operations. The Board concluded:

We agree that DM&E's infrastructure hampers its ability to serve its existing customers. A railroad with annual revenues in the \$50 to \$60 million range cannot generate sufficient funds to rehabilitate its lines, because normal maintenance expense for over 1,000 miles of track, much of it mainline, runs into million of dollars per year. Replacing track, ties and ballast that are deteriorating costs millions more. Thus, there appears to be the very real likelihood that, absent the funds generated by this project, DM&E would cease to exist as a viable railroad.

December 10, 1998 Decision at 45.

SEA's Draft EIS concurs in the Board's findings. See Draft EIS, Vol. 1, at 1-3 ("DM&E currently does not have the revenue base to provide the capital necessary to accomplish the system-wide rehabilitation required to provide safe, reliable, and efficient service to its existing shippers.") If the DM&E Application is approved, the SEA has found that DM&E would be able to rebuild its system and offer improved, more efficient, and safer service. The Draft EIS concludes:

This new revenue base would provide DM&E the capital necessary to rebuild its existing system. This rebuild would provide DM&E's existing shippers with improved service, increased safety, greater efficiency, and the potential to expand markets nationwide.

Id.

As noted, supra, DM&E's viability as a railroad is at stake with this transaction. Absent approval, and the funds generated by this project, the Board has concluded that DM&E will likely fail. There is no alternative rail service provider in DM&E's 700 mile service territory in South Dakota and Minnesota to serve DM&E's existing customers. Accordingly, the approximately 60,000 carloads of wheat, bentonite clay, cement, wood, and other products DM&E currently moves annually would likely need to move by truck if the DM&E were to fail. Even a

rough estimate of the environmental impacts caused by the DM&E's failure shows significant adverse results.

Assuming four trucks are necessary to substitute for every train carload,⁵ some 240,000 additional trucks would need to operate on local roads annually (or 658 additional trucks per day) in Minnesota, South Dakota, and beyond to make up for the loss in DM&E service. Such a major diversion would result in serious environmental impacts from an air quality, safety, and energy consumption perspective. See e.g. Finance Docket No. 33388, CSX Corporation, et al. - Control and Operating Leases/Agreements - Conrail Inc., et al (Decision No. 89 served July 20, 1998), at 133-34 (concluding that "trucks on average require at least three times the amount of fuel as trains to move the same amount of freight the same distance").

The Draft EIS apparently has not considered the adverse environmental impacts that an alternative "no action," (or the imposition of individual mitigation measures or cumulative "action alternatives" that may be operationally and/or financially unviable to undertake) would have on the DM&E and its

⁵See Docket No. AB-497 (Sub-No. 2X), Minnesota Northern Railroad, Inc. -- Abandonment Exemption -- Between Redland Junction and Fertile, in Polk County, MN (Decision served Nov. 14, 1997).

customers should its proposed PRB access project fail. Likewise, the Draft EIS does not consider the amount of truck-to-rail diversions that will result from the DM&E's ability, if the proposed construction/rehabilitation project goes forward, to serve additional (primarily non-coal) customers that would otherwise move their freight by truck.⁶ Coal Consumers submit that the Final EIS should examine these important impacts.

2. SEA has failed to Assess the Costs of Proposed Mitigation on the Viability of the Project

A review of the Draft EIS reveals that SEA also has largely failed to assess the individual and cumulative costs of the imposition of its proposed environmental mitigation on the overall viability of the project.⁷ In preparing the Final EIS, and in evaluating the possible imposition of individual environmental mitigation measures such as restrictions on traffic

⁶An important aspect of the environmental review conducted in Finance Docket No. 33388, involving approval of the Conrail control transaction, was the "substantial environmental benefits" that the Board found would occur through the transaction's diversion of traffic from highways to rail lines. In particular, the Board and SEA cited significant fuel savings, improved air quality, and safety benefits resulting from such truck-to-rail diversions. See e.g. Decision No. 89 served July 20, 1998 at 133-34. Coal Consumers are unaware that any similar analysis has been conducted with respect to DM&E's Application.

⁷See listing of the SEA's 98 recommended preliminary environmental mitigation measures at Vol. 4, Chapter 7 of the Draft EIS.

flows and construction of expensive by-passes, the Final EIS should recognize that the imposition of such mitigation (both individually and collectively) can have significant adverse effects on the operating capacity, efficiency, and net benefits of the transaction and, ultimately, DM&E's ability to complete the project.⁸

As detailed above, in evaluating specific alternatives and the imposition of environmental mitigation SEA must consider them in the context of advancing the overall goals of the DM&E project. See Notice of Final Scope at 5 n. 3. The avowed purposes of the DM&E project -- to provide a new alternative to move PRB coal eastward and make DM&E a viable rail carrier -- will be compromised should the Board impose individual or cumulative mitigation that would make the project economically or

⁸This is not to say that the SEA or the Board ultimately should affirm or deny DM&E the authority to construct based on the number or extent of mitigation measures that may be imposed. The issue of economic viability of the proposed construction should be left to the marketplace. It is not the responsibility of the Board to protect individual investors from themselves or to second guess a private sector initiative -- even it questions the operating or economic viability of any construction proposal with the imposition of certain environmental mitigation measures. As verified by the Board in the Tongue River decision: "as with any business transaction, the financial market itself, of course, will ultimately determine if the project is economically viable." Finance Docket No. 30186 (Sub-No. 2) Tongue River Railroad Co. -- Rail Construction and Operation -- Ashland to Decker, Montana, 1996 WL 648614, *13 (Decision served Nov. 8, 1996).

operationally infeasible. As discussed above, such actions could cause the failure of the railroad and thus its ability to serve its existing customers. The Final EIS should ensure that any mitigation imposed is both economically and operationally feasible in furthering the DM&E's proposed PRB coal operations and its continued viability as an important rail carrier serving the upper Midwest.

3. Further Delay Will Exacerbate
DM&E's Fragile Position

Along with the DM&E, Coal Consumers in the early part of this proceeding urged the Board to adopt an expeditious procedural schedule for consideration of both the transportation and environmental review aspects of the case. Coal consumers urged adoption of such a schedule to afford both DM&E and interested parties more certainty as to the time frame governing the Board's overall consideration of the Application. The Board's failure to adopt a firm schedule for consideration of the environmental review phase of this proceeding, unfortunately, has produced unmistakable harm to the viability of the project, both from the perspective of planning and the ability of the railroad to obtain vitally-needed private investment.

On April 20, 1999, the Board issued a decision in this proceeding affording parties additional time to file comments on certain bypass proposals. In its decision, the Board recognized that in fulfilling its mandate under NEPA, "we are aware that we cannot let the environmental review process indefinitely delay the Board's final decision on this matter." Id. at 1. The Board further concluded: "we must balance our responsibility to analyze a reasonable range of alternatives with the need to move the environmental review process forward without undue delay." Id. at 2. Accord STB's December 14, 2000 served Decision, at 2 ("[i]t is important to move the environmental review process in this and every case forward without undue delay").

At the end of this month, it will be three years since the SEA issued its initial Notice of Intent to Prepare an EIS. This processing time is well over three times as long as the schedule DM&E originally requested for the environmental review portion of this proceeding. The financial and managerial burdens on a small railroad such as the DM&E, with recognized limited cash flow and capital, in terms of pursuing and financing its construction project -- while at the same time continuing to provide service to its existing customers -- obviously cannot continue indefinitely.

The time SEA already has taken to process the environmental portion of this case is far too long. Unfortunately, it appears that the Board has not heeded its own admonition that it will not permit undue delays in the orderly processing of the environmental review phase of this proceeding.

There is probably no better way to kill the DM&E project than by subjecting this proceeding to additional and unnecessary delays. SEA and the Board surely can do better to move this proceeding fairly and efficiently toward a conclusion.

III.

CONCLUSION

In evaluating potential and appropriate environmental mitigation through the EIS process, the Board is required to ensure that such mitigation is reasonably related to the purpose of the DM&E project: to assist shippers with their desire to obtain competitive, reliable, and efficient coal transportation service, and to ensure the continued viability of DM&E itself. In particular, SEA must be mindful that the imposition of individual or cumulative environmental mitigation measures that are operationally and/or financially unviable, or subjecting this proceeding to further unnecessary delay, will result in the

Board's failing its mandate under NEPA to ensure that the imposition of environmental alternatives is reasonably related to the purpose of the proposal.

Coal Consumers urge SEA and the Board to evaluate the environmental impacts of the DM&E's Application in a manner that helps assure future competitive and reliable coal transportation service and adequate rail transportation capacity in moving PRB coal to market. The nation's interest in the full use of its largest low-sulfur coal reserves as fuel for the generation of electricity remains at stake and should be carefully considered when evaluating alternatives through the EIS process.

Respectfully submitted,

ALLIANCE OF WESTERN COAL
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Dated: March 6, 2001

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Annual Energy Outlook 2001

With Projections to 2020

December 2000

Energy Information Administration
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U.S. Department of Energy
Washington, DC 20585

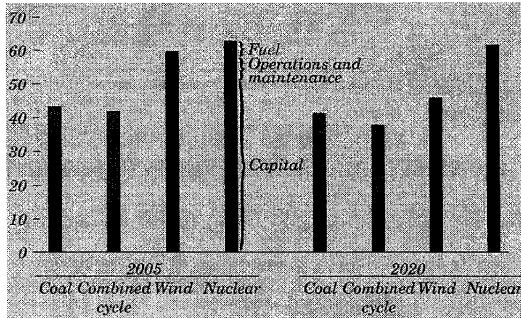
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Electricity Generation

Least Expensive Technology Options Are Likely Choices for New Capacity

Figure 76. Projected electricity generation costs, 2005 and 2020 (1999 mills per kilowatthour)



Technology choices for new generating capacity are made to minimize cost while meeting local and Federal emissions constraints. The choice of technology for capacity additions is based on the least expensive option available (Figure 76). The reference case assumes a capital recovery period of 20 years. In addition, the cost of capital is based on competitive market rates, to account for the competitive risk of siting new units.

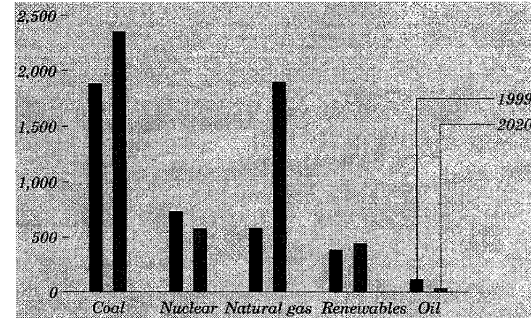
In the AEO2001 projections, the costs and performance characteristics for new plants are expected to improve over time, at rates that depend on the current stage of development for each technology. For the newest technologies, capital costs are initially adjusted upward to reflect the optimism inherent in early estimates of project costs. As project developers gain experience, the costs are assumed to decline. The decline continues at a slower rate as more units are built. The performance (efficiency) of new plants is also assumed to improve, with heat rates declining by 4 to 14 percent between 1999 and 2010, depending on the technology (Table 13).

Table 13. Costs of producing electricity from new plants, 2005 and 2020

Item	2005		2020	
	Advanced coal	Advanced combined cycle	Advanced coal	Advanced combined cycle
1999 mills per kilowatthour				
Capital	31.08	11.87	30.44	10.60
O&M	4.28	1.90	4.28	1.90
Fuel	7.84	27.86	6.49	25.18
Total	43.20	41.63	41.22	37.68
Btu per kilowatthour				
Heat rate	9,253	6,639	9,087	6,350

Gas- and Coal-Fired Generation Grows as Nuclear Plants Are Retired

Figure 77. Projected electricity generation by fuel, 1999 and 2020 (billion kilowatthours)



As they have since early in this century, coal-fired power plants are expected to remain the key source of electricity through 2020 (Figure 77). In 1999, coal accounted for 1,880 billion kilowatthours or 51 percent of total generation. Although coal-fired generation is projected to increase to 2,350 billion kilowatthours in 2020, increasing gas-fired generation is expected to reduce coal's share to 44 percent. Concerns about the environmental impacts of coal plants, their relatively long construction lead times, and the availability of economical natural gas make it unlikely that many new coal plants will be built before about 2005. Nevertheless, slow growth in other generating capacity, the huge investment in existing plants, and increasing utilization of those plants are expected to keep coal in its dominant position. By 2020, it is projected that 11 gigawatts of coal-fired capacity will be retrofitted with scrubbers to meet the requirements of the Clean Air Act Amendments of 1990 (CAAA90).

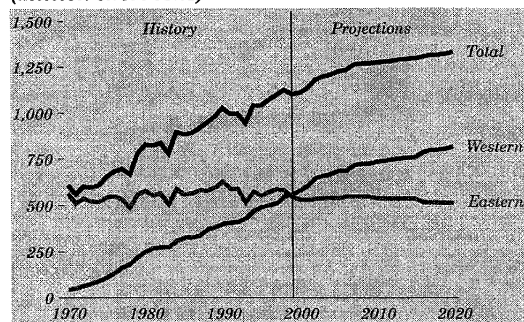
The large investment in existing plants is expected to make nuclear power a growing source of electricity at least through 2000. With substantial recent improvements in the performance of nuclear power plants, nuclear generation is projected to increase until 2000, then decline as older units are retired.

In percentage terms, gas-fired generation is projected to show the largest increase, from 16 percent of the 1999 total to 36 percent in 2020. As a result, by 2004, natural gas is expected to overtake nuclear power as the Nation's second-largest source of electricity. Generation from oil-fired plants is projected to remain fairly small throughout the forecast.

Coal Production and Prices

Emissions Caps Lead to More Use of Low-Sulfur Coal From Western Mines

Figure 113. Coal production by region, 1970-2020 (million short tons)



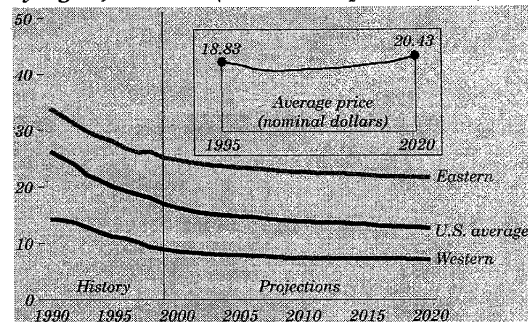
Continued improvements in mine productivity (which have averaged 6.7 percent per year since 1979) are projected to cause falling real minemouth prices throughout the forecast. Higher electricity demand and lower prices, in turn, are projected to yield increasing coal demand, but the demand is subject to an overall sulfur emissions cap from CAAA90, which encourages progressively greater reliance on the lowest sulfur coals (from Wyoming, Montana, Colorado, and Utah).

The use of western coals can result in up to 85 percent lower sulfur dioxide emissions than the use of many types of higher sulfur eastern coal. As coal demand grows in the forecast, however, new coal-fired generating capacity is required to use the best available control technology: scrubbers or advanced coal technologies that can reduce sulfur emissions by 90 percent or more. Thus, even as the demand for low-sulfur coal is projected to grow, there are still expected to be market opportunities for low-cost higher sulfur coal throughout the forecast.

From 1999 to 2020, high- and medium-sulfur coal production is projected to decline from 616 to 592 million tons (0.2 percent per year), and low-sulfur coal production is projected to rise from 490 to 740 million tons (2.0 percent per year). As a result of the competition between low-sulfur coal and post-combustion sulfur removal, western coal production is expected to continue its historical growth, reaching 819 million tons in 2020 (Figure 113), but its annual growth rate is projected to fall from the 9.3 percent achieved between 1970 and 1999 to 1.8 percent in the forecast period.

Minemouth Coal Prices Continue To Fall in the Projections

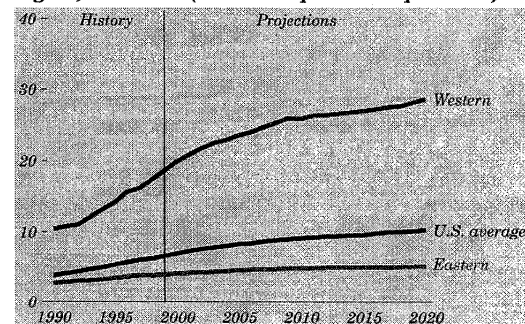
Figure 114. Average minemouth price of coal by region, 1990-2020 (1999 dollars per short ton)



Minemouth coal prices declined by \$5.80 per ton (in 1999 dollars) between 1970 and 1999, and they are projected to decline by 1.4 percent per year, or \$4.28 per ton, between 1999 and 2020 (Figure 114). The price of coal delivered to electricity generators, which declined by approximately 95 cents per ton between 1970 and 1999, is projected to fall to \$19.45 per ton in 2020—a 1.1-percent annual decline.

The mines of the Northern Great Plains, with thick seams and low overburden ratios, have had higher labor productivity than other coalfields, and their advantage is expected to be maintained throughout the forecast. Average U.S. labor productivity (Figure 115) is projected to follow the trend for eastern mines most closely, because eastern mining is more labor-intensive than western mining.

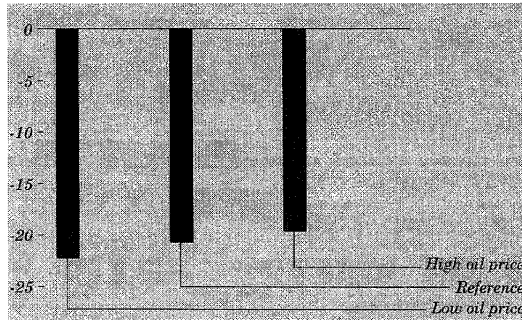
Figure 115. Coal mining labor productivity by region, 1990-2020 (short tons per miner per hour)



Coal Transportation Costs

Transportation Costs Are a Key Factor for Coal Markets

Figure 118. Projected change in coal transportation costs in three cases, 1999-2020 (percent)

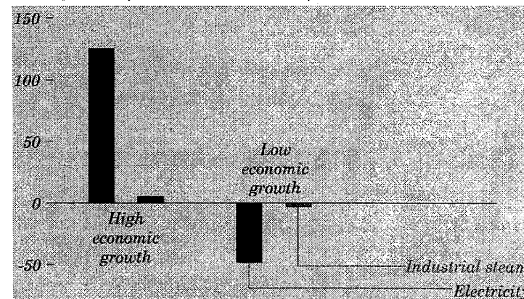


The competition between coal and other fuels, and among coalfields, is influenced by coal transportation costs. Changes in fuel costs affect transportation costs (Figure 118), but transportation fuel efficiency also grows with other productivity improvements in the forecast. As a result, in the reference case, average coal transportation rates are projected to decline by 1.1 percent per year between 1999 and 2020. Historically, the most rapid declines in coal transportation costs have occurred on routes originating in coalfields that have had the greatest declines in real minemouth prices. Railroads are likely to reinvest profits from increasing coal traffic to reduce transportation costs and, thus, expand the market for such coal. Therefore, coalfields that are most successful at improving productivity and lowering minemouth prices are likely to obtain the lowest transportation rates and, consequently, the largest markets at competitive delivered prices.

Assuming that mines in the Powder River Basin will complete needed expansions of their train-loading capacities, western coal is expected to be able to meet the increase in demand expected with the advent of Phase 2 of CAAA90, which became effective on January 1, 2000. The transition will require more low-sulfur coal than was projected in *AEO2000*, because scrubber retrofits are expected to be made at a slower pace in *AEO2001*. Any coal transportation problems associated with the increased shift to low-sulfur coal are expected to be temporary.

Higher Economic Growth Would Favor Coal for Electricity Generation

Figure 119. Projected variation from reference case projections of coal demand in two economic growth cases, 2020 (million short tons)



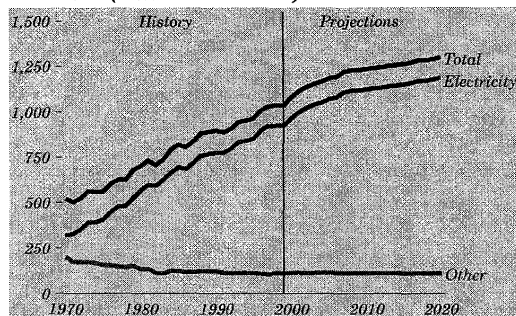
A strong correlation between economic growth and electricity use accounts for the variation in coal demand projections across the economic growth cases (Figure 119), with domestic coal consumption in 2020 projected to range from 1,245 to 1,426 million tons in the low and high economic growth cases, respectively. Of the difference, coal use for electricity generation is projected to make up 173 million tons. The difference in total projected coal production between the two economic growth cases is 182 million tons, of which 148 million tons (81 percent) is projected to be western production. Although western coal must travel up to 2,000 miles to reach some of its markets, it is expected to remain competitively priced in all regions except the Northeast when its transportation costs are added to its low minemouth price and low sulfur allowance cost.

Changes in world oil prices affect the costs of energy (both diesel fuel and electricity) for coal mining. In the low and high oil price cases, the average prices of coal delivered to electricity generators are projected to be 0.8 percent lower and 0.2 percent higher, respectively, in 2020 than projected in the reference case. The low world oil price case projects 79 million tons less coal use in 2020 than the high world oil price case. Low oil prices encourage electricity generation from oil, whereas high oil prices encourage coal consumption. The higher projection for coal consumption in the high oil price case is attributable to the electricity generation sector, which is projected to account for virtually all of the increase.

Coal Consumption

Coal Consumption for Electricity Continues To Rise in the Forecast

Figure 120. Electricity and other coal consumption, 1970-2020 (million short tons)



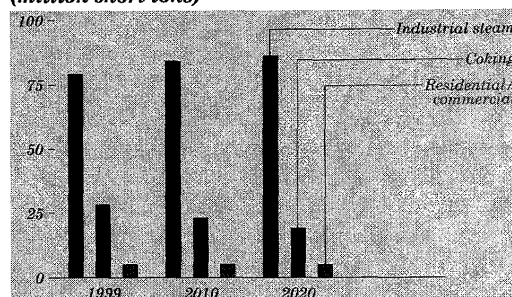
Domestic coal demand is projected to increase by 262 million tons in the reference case forecast, from 1,035 million tons in 1999 to 1,297 million tons in 2020 (Figure 120), because of projected growth in coal use for electricity generation. Coal demand in other domestic end-use sectors is projected to decline.

Coal consumption for electricity generation (excluding cogeneration) is projected to increase from 923 million tons in 1999 to 1,186 million tons in 2020 as the utilization of existing coal-fired generation capacity increases and, in later years, new capacity is added. The average utilization rate is projected to increase from 68 percent in 1999 to 83 percent in 2020. Because coal consumption (in tons) per kilowatt-hour generated is higher for subbituminous and lignite than for bituminous coals, the shift to western coal is projected to increase the tonnage per kilowatt-hour of generation in the midwestern and southeastern regions. In the East, generators are expected to shift to lower sulfur Appalachian bituminous coals that contain more energy (Btu) per ton.

Although coal is projected to maintain its fuel cost advantage over both oil and natural gas, gas-fired generation is expected to be the most economical choice for construction of new power generation units in most situations, when capital, operating, and fuel costs are considered. Between 2005 and 2020, rising natural gas costs and nuclear retirements are projected to cause increasing demand for coal-fired baseload capacity.

Industrial Steam Coal Use Rises, But Demand for Coking Coal Declines

Figure 121. Projected coal consumption in the industrial and buildings sectors, 2010 and 2020 (million short tons)



In the non-electricity sectors, a projected increase of 7 million tons in industrial steam coal consumption between 1999 and 2020 (0.5-percent annual growth) is expected to be offset by a decrease of 9 million tons in coking coal consumption (Figure 121). Increasing consumption of industrial steam coal is projected to result primarily from greater use of existing coal-fired boilers in energy-intensive industries.

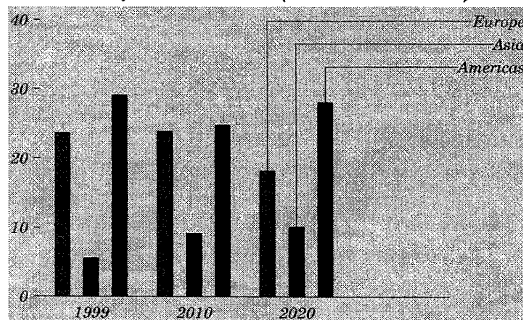
The projected decline in domestic consumption of coking coal results from the expected displacement of raw steel production from integrated steel mills (which use coal coke for energy and as a material input) by increased production from minimills (which use electric arc furnaces that require no coal coke) and by increased imports of semi-finished steels. The amount of coke required per ton of pig iron produced is also declining, as process efficiency improves and injection of pulverized steam coal is used increasingly in blast furnaces. Domestic consumption of coking coal is projected to fall by 1.9 percent per year through 2020, but domestic production of coking coal is expected to be stabilized, in part, by sustained levels of export demand.

Although total energy consumption in the combined residential and commercial sectors is projected to grow by 1.3 percent per year, most of the growth is expected to be captured by electricity and natural gas. Coal consumption in the residential and commercial sectors is projected to remain constant, accounting for less than 1 percent of total U.S. coal demand in the forecast.

Coal Exports

U.S. Coal Exports to Europe and Asia Are Projected To Remain Stable

Figure 122. Projected U.S. coal exports by destination, 2010 and 2020 (million short tons)



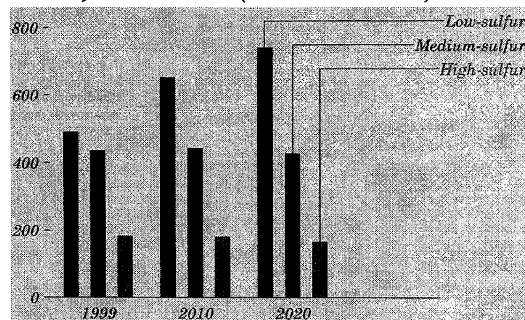
U.S. coal exports declined sharply between 1998 and 1999, from 78 million tons to 58 million tons, but are projected to remain relatively stable over the forecast horizon, settling at 56 million tons by 2020 (Figure 122). Australian and South African coal export prices dropped substantially in 1999, displacing U.S. coal exports to Europe and Asia. Price cuts by Australia, the world's leading coal exporter, were attributed to both strong productivity growth and a favorable exchange rate against the U.S. dollar.

The U.S. share of total world coal trade is projected to decline from 11 percent in 1999 to 8 percent by 2020 as international competition intensifies and demand for coal imports in Europe and the Americas grows more slowly or declines. From 1999 to 2020, U.S. steam coal exports are projected to decline slightly, from 26 million tons to 22 million tons, despite substantial projected growth in world steam coal trade. Steam coal exports from Australia, South Africa, China, and Indonesia are expected to increase in response to growing import demand in Asian countries, and increasing exports from South Africa are expected to displace some U.S. exports to Europe.

U.S. coking coal exports are projected to increase slightly, from 32 million tons in 1999 to 34 million tons in 2020. A small increase in the world trade in coking coal is expected, primarily in Asia. Australia is expected to capture an increasing share of the international market for coking coal because of its proximity to Asian importers and its ample reserves of coking coal.

Low-Sulfur Coal Continues To Gain Share in the Generation Market

Figure 123. Projected coal production by sulfur content, 2010 and 2020 (million short tons)



Phase 1 of CAAA90 required 261 coal-fired generating units to reduce sulfur dioxide emissions to about 2.5 pounds per million Btu of fuel. Phase 2, which took effect on January 1, 2000, tightens the annual emissions limits imposed on these large, higher emitting plants and also sets restrictions on smaller, cleaner plants fired with coal, oil, and gas. The program affects existing utility units serving generators over 25 megawatts capacity and all new utility units [94].

With relatively modest capital investments many generators can blend very low sulfur subbituminous and bituminous coal in Phase 1 affected boilers. Such fuel switching often generates sulfur dioxide allowances beyond those needed for Phase 1 compliance, and the excess allowances generated during Phase 1 were banked for use in Phase 2 or sold to other generators. (The proceeds of such sales can be seen as further reducing fuel costs for the seller.) In the forecast, fuel switching for regulatory compliance and for cost savings is projected to reduce the composite sulfur content of all coal produced (Figure 123). The main sources of low-sulfur coal are the Central Appalachian, Powder River Basin, and Rocky Mountain regions, as well as coal imports.

Coal users may incur additional costs in the future if environmental problems associated with nitrogen oxides, particulate emissions, and possibly carbon dioxide emissions from coal combustion are monetized and added to the costs of coal combustion.

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A Hot Play on King Coal

This old fossil fuel generates most of America's power, demand for it is growing -- and stock prices are sizzling

You may not have a coal-burning furnace in your basement, but odds are better than 2-to-1 that when you flick on a light or turn on your computer, the electricity comes from burning coal.

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With all the media attention given to tight supplies of clean-burning natural gas, it's often overlooked that more than 51% of the electricity generated in the U.S. comes from coal, a fossil fuel often dismissed as a pollutant. Nuclear power, at 20%, is a distant second. Natural gas comes in third, with 16%. The rest comes largely from hydroelectricity and petroleum.

"Coal is still the power backbone of this country," says Peter Ward, an analyst at Lehman Brothers. Indeed, the U.S. often is called the Saudi Arabia of coal because of its abundant supplies.

LOWER INVENTORIES. Coal dominates electricity generation in the U.S. chiefly because of its cost. Unlike volatile petroleum and natural-gas prices, coal prices have remained cheap and steady until recently. But several factors have converged to push coal prices -- and coal stocks -- to record highs. Supplies are tight, thanks to an unusually cold winter and soaring natural-gas prices in 2000. Also, years of oversupply, scaled-back production, and lower prices have led to lower inventories.

But now demand is outpacing supply, much to the delight of U.S. coal producers, who have been watching their stocks sizzle. "This is a turning point for an industry that has faced declining prices and oversupply for the last two decades," wrote Wayne Atwell, a metals and mining analyst for Morgan Stanley Dean Witter, in a recent research note.

For example, Arch Coal Inc. (ACI), based in St. Louis, posted a 52-week high of \$22.70 on Feb. 16 -- not a bad recovery for a stock that had sunk to a 52-week low of \$4.75 on April 12, 2000. Both Lehman's Ward and MSDW's Atwell rate it a buy. Part of Arch's appeal is the low sulfur content in its coal, which meets the federal Clean Air Act's Phase II requirements, which went into effect a year ago.

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LONG-TERM VARIABLES. Other coal plays are on a hot streak, too. Alliance Resource Partners (ARLP), based in Tulsa, recorded a 52-week high of \$19.75 on Feb. 20, and is still hovering around \$19. Wilmington (Del.)-based Consol Energy Inc. (CNX) posted a yearly high of \$31.76 on Feb. 1. It has since retreated a bit to trade around \$28. Still, that's a big jump from its April, 2000, price of around \$10. And Massey Energy Co. (MEE), based in Richmond, Va., is trading at \$18, nearly double where it was at a year ago, although way off its 52-week peak of \$42.87 on Dec. 5, 2000.

While Wall Street analysts are confident coal prices will continue to show strength during the first quarter, its longer-term prospects depend on several variables, including the weather and environmental concerns that could prevent operation of certain mountaintop mines.

Progress in developing cleaner coal technologies obviates some of the environmental issues. Scrubbers, often limestone, are used to react with and remove sulfur dioxide at a third of what it cost in the 1970s. Various devices also are being used to reduce nitrogen oxide and eliminate nearly all particulates that coal plants emit.

CARBON ROCKS. Longer term, the industry is researching technologies to reduce the emission of greenhouse gases, chiefly carbon dioxide, at affordable prices. One potential -- and costly idea -- would have plants funneling carbon dioxide to the bottom of the ocean, where it can be harmlessly released. Elsewhere, the carbon dioxide could be isolated and exposed to other materials to produce minerals or rocks.

Many energy companies, such as AES Corp. (AES) in Arlington, Va., which had nearly \$6.7 billion in sales last year, are considering adding coal generation. "More people are talking about building coal-fired power plants than was the case two or three years ago," says Tom Sarkus, a senior technical analyst for the Energy Dept.'s National Energy Technology Lab in Pittsburgh.

Already, demand for coal is increasing. Coal-fired generation was up about 6% in 2000, according to estimates from Hill & Associates, an energy consulting firm in Annapolis, Md. That's partly because the industry is benefiting from higher natural-gas prices. In December, natural-gas futures hit an all-time high of \$9 per 1,000 cubic feet on the New York Mercantile Exchange.

CLEAR ADVANTAGES. Natural-gas futures have since come down to earth a bit to trade in the \$5 range, but the price is still well above the usual \$2 to \$3 range. And prices are likely to stay at high levels for a while because energy analysts estimate it will take two or three years for new drilling to restore inventory levels. Other observers say the days of \$2 and \$3 for natural gas are gone permanently.

Given those facts, coal seems to have a clear advantage. Analysts estimate clean coal that meets tough East Coast environmental standards hit highs of roughly \$1.60 per 1,000 cubic feet in December. The price has since dipped to around \$1.20. By contrast, the price was only about 80 cents a year earlier.

Still, it's not certain coal will gain market share. "Very few people have launched new coal plants in this country," says Richard Bajura, director

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of the National Research Center for Coal & Energy at West Virginia University. Many on Wall Street are skeptical about a big comeback for coal-fired electricity. They cite long construction lead times and emission concerns among other factors.

DIVERSE MIXTURE. "These new coal-fired plants will be on a much more limited scale and scope than the build-out currently under way for natural gas-fired electric capacity," wrote Frederick Schultz, a utilities analyst at Raymond James, in a recent research note. "In other words, our bet is still on the gas crowd."

A sure bet is that power demand will continue to climb. In 1999, Americans consumed about 96.1 quadrillion British thermal units of energy, according to Sarkus. The Energy Dept. projects U.S. energy consumption will grow about 32% by 2020. That's one of the reasons most experts believe in the wisdom of having a diverse mixture of energy fuels rather than relying too much on natural gas. So, one way or another, coal probably has a bright future.

By Heesun Wee in New York
Edited by *Thane Peterson*

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Friday, February 23, 2:02 pm Eastern Time

Coal to fire most of Wisconsin Energy's power growth

Timothy Gardner

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NEW YORK, Feb 23 (Reuters) - Wisconsin Energy Corp (NYSE:WEC - news). (WEC) a power producer that last fall announced the first U.S. plans in five years to build coal-fired electric plants, said Friday it plans another coal plant despite environmentalists' objections over the fuel's release of greenhouse gases.

It will account for the majority of WEC's plans to inject 2,800 megawatts of new power capacity in Wisconsin, the company said.

Plans to build one more 600 megawatt (MW) power plant than projected in its September plans to build two 600 MW gas-burning plants. One megawatt is enough to power on average 1,000 homes.

The remaining 1,000 MW would be natural-gas fired plants.

The company hopes to begin construction on the plants next year and open the new gas-fired unit by 2005, WEC's chairman Richard Abdoo said in a statement.

The eyes of power companies have been opened to coal following the natural gas price spike that has contributed to California's power woes.

Natural gas futures peaked to record highs of above \$10 per mmBtu in December, and last year its average price exceeded that of 1999's. On Friday, natural gas was trading above \$5.00 per mmBtu.

Earlier this month, Unisource Energy Corp. and Bechtel Power Corp. said they were building new coal-powered units in Arizona. Two 380 MW coal fired units at the Springville power plant in northeastern Arizona are due onstream by 2004 and 2005.

Coal releases far more carbon dioxide, a greenhouse global warming gas, than any other fossil fuel. Sierra Club officials said electricity demand should be met by more efficient appliances than by a fuel so outdated it powered the industrial revolution.

Coal proponents say new technologies, including a coal-to-gas process now in use at two government and industry led power plants, can increase the efficiency of burning coal by up to 70 percent.

Coal company shares such as Arch Coal (NYSE:ACI - news) and Consol Energy (NYSE:CNX - news) have spiked on new popularity for coal. Last week the spike even prodded Peabody Group, the largest U.S. coal company, to file an initial public offering (IPO). Analysts said the IPO was likely to grow in size to \$300 million.

C said cleaner technologies could be part of its program. "The coal gasification process is one we are considering, the final determination has not yet been made," a WEC spokesman told Reuters.

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Friday February 2, 2:15 pm Eastern Time

Coal shares spark on plans for new coal-fired plants

NEW YORK, Feb 2 (Reuters) - Shares in coal companies were stoked higher late this week after power companies, wary of high natural gas prices, announced plans to build plants fired by the controversial fossil fuel, analysts said Friday.

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Leading coal company shares surged by as much 15 percent on Thursday after UniSource Energy Corp. (NYSE:UNS - [news](#)) and Bechtel Power Corp said they were building new coal powered units in Arizona, some of the first planned in five years in the United States.

The two 380 megawatt (MW) coal-fired units at the Springerville power plant in northeastern Arizona are due to come onstream by 2004 and 2005.

"We're not going to see a megawatt of new coal-fired power for about four years, but any new plans are very positive for the coal market," said Michael Dudas, analyst with Bear Sterns in New York.

By Friday, coal company share prices on the New York Stock Exchange stabilized but the country's No. 2 coal company Arch Coal Inc. (NYSE:ACI - [news](#)) was trading at \$17.30, nearly four times its year low.

Shares in Consol Energy Inc. (NYSE:CNX - [news](#)), the No. 4 U.S. coal producer and largest exporter of U.S. coal, were trading at \$30.60 per share, more than three times their lows, while the No. 5, Massey Energy (NYSE:MEE - [news](#)), was trading at \$18.10, more than double its year low.

And Lehman Brothers (NYSE:LEH - [news](#)), the investment bank owners of Peabody Coal, the No. 1 U.S. coal company, are considering a stock market flotation of the business, according to industry sources.

Coal now fuels more than half of electricity generated in the U.S., according to the Department of Energy (DOE), but cleaner burning natural gas plants were expected to make gains to the exclusion of coal plants.

That was before gas hit unprecedented prices of more than \$10 per million British Thermal units (mmBtu) this winter. Natgas was trading much lower at \$6.73 per mmBtu on Friday, but is still more than double its price at this time last year.

Coal has long been seen as a risky investment because burning it releases large amounts of greenhouse gas carbon dioxide and acid rain component sulphur dioxide.

But new cleaner burning coal-to-gas technology in development at two experimental U.S. plants that are jointly run by industry and DOE, have boosted the fuel's efficiency.

In addition, a Republican sponsored energy bill in the U.S. Senate includes an offer of up to \$100 million

in tax credits for clean coal technology.

Wisconsin Energy Corp. (NYSE:[WEC](#) - [news](#)) was in the lead to announce plans for the first new coal fired electricity capacity in five years. In September, it said it will build two new 600 MW coal burning plants.

Analysts said there was talk of a 1,000 to 1,500 MW coal-fired plant being planned near the Mississippi River in Arkansas. But neither the power company in question, nor the mayor of planned plant's town, returned phone calls.

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February 1, 2001

FOR IMMEDIATE RELEASE

February 1, 2001

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**UNISOURCE ENERGY AND BECHTEL POWER ANNOUNCE
PLANS
TO DEVELOP 760 MEGAWATTS OF COAL-FIRED
GENERATION**

Tucson, AZ — UniSource Energy Corporation (UNS:NYSE) and Bechtel Power Corporation have signed a memorandum of understanding intended to increase electric generating capacity for Arizona.

The agreement calls for finalizing a development plan for engineering, procurement and construction of two additional coal-fired generation units at Tucson Electric Power Company's (TEP) Springerville Generating Station (SGS) in northeastern Arizona. TEP is a wholly owned subsidiary of UniSource Energy.

Originally designed by Bechtel as a four-unit coal-fired plant, SGS currently consists of two 380-megawatt units that were placed in service in 1985 and 1990. The UniSource Energy-Bechtel project contemplates completion of the original plant design by building two additional 380-megawatt units to be placed in service in 2004 and 2005.

UniSource Energy expects that the two additional units will be fully utilized between the energy needs of its own customers and the power purchase agreements with other Arizona energy providers. Final commitment to proceed with construction is targeted for July of 2001, following a complete analysis of the project permit, engineering and procurement requirements. A Project Labor Agreement for construction of the project has also been negotiated with the Phoenix Building and Construction Trades Council, and ratification by the various labor locals is now under way.

"This project provides an excellent opportunity for the expansion of our existing resources to support the energy and reliability requirements of Arizona's residential, commercial and industrial customers," said James S. Pignatelli, UniSource Energy Chairman, President and CEO. "We are extremely pleased with the high level of interest being shown from both an investment as well as an energy sales perspective. The Springerville plant's outstanding operating record matches up extremely well with Bechtel Corporation's long-standing experience and expertise in the design and construction of coal-fired generation facilities. Our partnership provides a solid

foundation for the successful implementation of this UniSource Energy opportunity."

Bechtel Power's Senior Vice President Eric Grenfell, manager of fossil power for the Americas, said " We have designed and constructed more than 100 baseload coal-fired facilities and 350 fossil-fired units since entering the power market in 1946. We are currently building coal-fired plants in China, Australia, and Mississippi, and recently delivered a coal plant in the Philippines. With increased interest in coal due to expectations of continued high natural gas prices in North America, we expect to see more coal projects such as this one in Springerville."

UniSource Energy has retained the international consulting firm of CH2M Hill to provide technical guidance and licensing support for environmental permits which may be required for the project.

UniSource Energy's subsidiaries include TEP, Arizona's second-largest investor-owned utility; Advanced Energy Technologies, Inc., a developer of renewable energy and distributed generation technologies; ION International, a provider of technology applications for the efficient use of energy; and Southwest Energy Solutions, a regional electric contractor. For more information about UniSource Energy and its subsidiaries please visit www.UniSourceEnergy.com.

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COAL TRANSPORTATION REPORT

Exhibit 3

Volume 20 No. 5

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February 26, 2001

Concern Over PRB Capacity Crunch Rises

With utility demand for coal once again at high levels following an off-year in 2000, an old problem is showing signs of resurfacing in the Wyoming Powder River Basin. As PRB producers consider ramping up production to meet the needs of thirsty utility coal boilers, the problem of maxed-out loading capacity at mines is beginning to constrain ability to meet demand, say sources.

Loadout capacity constraints and associated congestion issues are nothing new. Things came to a head in early 1999 when widespread loading-related congestion at the mines slowed train movements out of the PRB to a crawl (CTR 3/15/00, p.1). The issue reached

boiling point later that year when consulting group CANAC Inc. — contracted by Burlington Northern & Santa Fe and Union Pacific — put out a report recommending that producers foot the bill for 20 additional train landing slots (CTR 9/27/99, p.1).

Under CANAC's projected timetable, construction of the additional staging areas should begin in 2000 when the estimated tonnage demand on the Joint Line was expected to break the 310 million-ton/year barrier.

But little if any additional construction actually occurred — despite

(continued on page 4)

NS To Trim Coal Export Lines?

With Norfolk Southern looking at rationalizing between 3,000-4,000 miles of track from its system, many analysts are banging their heads trying to figure out where and how these lines will be pruned. Recent comments by NS CEO Henry Wolf, however, seem to shine the spotlight on NS's export coal lines.

Speaking at the recent Deutsche Bank Alex. Brown Global Transportation Conference, Wolf noted that over the past few years there had been several changes — both positive and negative — in the markets NS serves, including its coal market.

Now that the railroad has more experience operating its new system, Wolf feels the time is right to plan and adapt to these changing business patterns.

Part of that plan is NS's line rationalization program, which will be accomplished through a variety of programs including line sales or leases to short line operators, joint venture and partnership arrangements, and in some limited cases, line abandonment. Moreover, in areas where there exists excess line capacity, assets can be redeployed to growth markets.

(continued on page 4)

This Issue

News

Concern over PRB capacity crunch rises	1
NS to trim coal export lines?	1
NS merges coal marketing and operations groups	4
Conneaut expects few delays after fire	6
New petcoke plant planned for Port Arthur	6
UP settles dispute with BLE	7

Briefs

CSX vice chairman retires	2
JEA buys Polish coal	2
W.Va. rail line may switch hands	2
Progress Energy structures fuel buying ops	2
Coal is No. 1 out of Duluth	2
Loaded UP coal train derails in Iowa	3
New Hill study shows PRB production growth	3
Savage wins Port Arthur contract	3
January Great Lakes Loadings	7
January Port Loadings	7, 8

NS Export Lines...from page 1

"For example, our export coal network was designed to handle more than 2½ times the current level of demand," said Wolf. "Consequently, our export coal network is under study to determine where capacity can be reduced in light of the reduced demand for our coal in international markets. While this continues to be a core business for us, and we fully expect revenues to improve over 2000 levels, we clearly do not see the need for the capacity we have in place, and we will take the appropriate steps to adjust to this change in the marketplace."

But where and how will NS's coal lines be affected? "Those are good questions, but at this stage we have no answers," said NS spokesperson Susan Terpay. "This is something we're going to be looking at over the next two years, so it's extremely early in the process. We haven't defined any specific lines yet [coal or otherwise]."

"I'd imagine they have to be looking at their export mainline from [West Virginia and Virginia] coal fields to Norfolk, Va.," said one coal industry consultant. "That line may even be triple tracked in some parts because export volume was so high through there at one stage."

NS Merges Coal Marketing And Operations Groups

Norfolk Southern has consolidated its coal ops by merging its coal marketing and coal transportation groups to form the coal business group.

While the marketing and operations groups already worked closely, combining the two groups is expected to benefit NS's overall coal ops.

"Marketing and coal transportation have always worked together, but this formalizes the relationship, and allows us to coordinate with coal customers better," said NS spokesperson Susan Terpay. "It'll help with overall efficiency and the movement of coal trains."

The entire group will report to NS's senior VP of coal marketing, Bill Fox. Terpay said there had been no personnel changes or layoffs as a result of the consolidation. "No, there's been nothing like that. Right now there are no changes."

The move is a result of a business process analysis NS conducted last year. As a result of that process, several teams were formed to study seven areas of the company, trying to find areas for improvement. The recommendation to combine the two coal departments was made by the Car Management team.

"By putting the coal marketing and coal transportation groups together with a common focus, we will provide a much better product to our customers," said Fox in a release. "NS will also benefit by improved internal communications and coal car fleet management synergies."

"This is their basic dilemma – export coal has always been a huge money maker for them. The movement is low-cost because they're running their trains mostly down-hill. Now the export market has always had ebbs and flows, but the ebbs have been very pronounced in recent years and if you look at trend lines, the export trend is downwards. So, the question is, will it come back, or have the underlying fundamentals changed in the export coal market? Can met coal producers maintain their place in the world market? If they can, and the lines aren't too expensive to maintain, you keep them there."

However, the consultant believes NS has already decided some of its excess coal business capacity needs to go. I don't think they expect it to come back to where it once was," said the consultant, who noted that most export analysts agreed. "Given that, do they try to deep-six capacity for that move?"

"The problem is that once you tear up a line, the cost of putting it back is prohibitive, so that's what they have to decide," he continued.

If the cost of maintaining lines along its coal route outweighed the hope that the export market would bounce back in some major way, NS should tear those lines up, thought the consultant. "They'll need to look at doing their coal business differently. I don't know how much of a cost maintaining this excess capacity is, but from the looks of it, it seems major."

✓ PRB Loadout Capacity...from page 1

total PRB production of roughly 323 million tons, according to a recent Hill & Associates Inc. report (see story, page 3). Instead, producers and railroads saw demand and particularly prices for PRB coal fall well below expectations in 2000. The drop in demand was caused by a variety of factors, including high Y2K-related coal stockpiles and mild weather.

In addition to market factors, the need for immediate capital upgrades was eased by significant improvement in scheduling and other efficiencies. Producers, railroads, and, to a lesser extent, utilities, worked closely to try and come up with more efficient systems of communication and coordination.

Burn Baby Burn

But in recent months, cold weather, high natural gas prices and eastern production problems have caused PRB coal demand to soar. And, as demand increases, sources say it won't be long before capacity constraints at PRB mines again begin to affect the speed and efficiency with which coal moves off the joint line.

"Those issues are already coming up again," said one coal industry vet. "There have already been some congestion problems there, though nothing too serious yet. I also think there are significant differences from mine to mine, but that's always going to be the