

---

---

Written by Alex Halperin, June 2006.

## Coal Hard Cash for Peabody?

**The world's largest private coal producer has an innovative plan to move into the power business, but environmental groups are up in arms**

The U.S. is on the cusp of a coal boom. While record oil prices have fired up interest in renewable energy sources, that other fossil fuel still generates more than half of the U.S.'s electricity, and domestic reserves are expected to last 200 years or more. The Energy Dept.'s National Energy Technology Laboratory (NETL) projects that up to 140 new coal-fired power plants could come on stream by 2025.

Surging coal use could spell good news for big miner groups like Arch Coal (ACI ) and Consol Energy (CNX). But probably no company stands to gain more than Peabody Energy (BTU ). The St. Louis-based company is the world's largest private-sector coal producer, with revenues of \$4.64 billion in 2005. Its profits have shot up from just \$16 million in 2001 to \$423 million last year, as the price of coal has surged.

Peabody may turn out to be an industry leader in other ways, too. The company has hit on a formula that could allow it to continue thriving, despite the threat of increased regulation.

**GREEN OPPOSITION.** After more than a century of mining and selling coal, Peabody is branching out. Its coal already generates about 10% of the electricity produced in the U.S. Now, the company is getting ready to move into the power business itself. It currently has proposals out for two massive new plants located close to its own reserves in the Illinois coal basin: Prairie State in Illinois and Thoroughbred in Kentucky. Each would generate enough electricity for up to 1.5 million homes.

On the face of it, this move down the supply chain could be a potentially risky one. Coal has galvanized environmental groups in the U.S., who have become more vociferous in their opposition to coal-fired power plants. Although less polluting than in the past, these plants still exhale millions of tons of carbon dioxide. Groups such as the Sierra Club are lobbying for the introduction of controls on this so-called greenhouse gas, perhaps in the form of a carbon dioxide trading program, which could substantially raise costs for operators of coal-fired plants.

In its 2005 annual report, Peabody acknowledges that "should carbon dioxide and other regulations grow stricter," this "could result in fuel switching by the generators if they determined it to be economically preferable to do so."

**SHIFTING THE RISK.** Yet Peabody may have figured out a way to unload some of these potential risks, while at the same time ensuring that demand for its key product remains robust for decades to come. Here's how: To help finance construction of the Prairie State and Thoroughbred plants, Peabody is selling ownership stakes in the plants to power cooperatives and municipal power agencies. As part of the deal, buyers would receive 30-year supply coal contracts with Peabody.

So far, Peabody says it has received letters of intent to purchase 47% of Prairie State. One taker is Wolverine Power Cooperative. Executive Vice-President Craig Borr says Wolverine will purchase a 200 megawatt stake in the project for between \$300 million and \$350 million, subject to the Wolverine board's approval. The prospect of being able to lock in an inexpensive, long-term energy supply immune to price volatility is naturally attractive to outfits like Wolverine. "We think that it will be economical as compared to market costs," says Bob Harbour, CEO of Soyland Power Cooperative, which also hopes to buy a small part of Prairie State.

It's a good deal for Peabody, too. By scaling back its own stake in the new power plants, the coal miner is effectively immunizing itself against the possibility of an adverse change in the regulatory environment. In other words, if environmental groups succeed in winning stricter controls on greenhouse-gas emissions, it will be power cooperatives like Wolverine and Soyland -- and their customers -- that have to pick up their share of the tab. Peabody also plans to pursue a similar approach with Thoroughbred.

**HEATING UP.** Indeed, opposition to Prairie State and Thoroughbred has already mobilized. The Sierra Club and other green groups are fighting air permits received by both plants. A decision on Prairie State is expected soon from the EPA's Environmental Appeals Board. Meanwhile, Thoroughbred is tied up in a state appeals process.

Bruce Nilles, director of the Sierra Club's Midwest Clean Air Campaign, says new coal plants like those Peabody wants to build are "the single biggest threat to fighting global warming in the U.S." Nilles interprets the coal industry's strategy as "Let's get as many of these things permitted and built [as we can] before 2009," when the Bush Administration leaves office. While the NETL's estimated 140 future plants is not a definitive list, the 2001 report projected only 75.

Under the Clean Air Act and related laws, coal plants must already reduce their emissions of pollutants such as nitrogen oxides and sulfur dioxide, which cause acid rain and smog. Peabody says Prairie State would employ advanced technologies like sulfur dioxide scrubbers and catalytic reduction to minimize emissions. But even by the company's own estimates, if the plant ran every day, it would release more than 11 million tons of carbon dioxide annually, though these emissions are not subject to federal regulation. That's roughly equivalent to the annual output of more than 1.8 million cars in normal use, according to EPA spokesman John Millett.

**CREDIT SCHEME.** Vic Svec, Peabody's vice-president of public & investor relations, acknowledges that reducing carbon dioxide emissions "has very recently emerged as a priority by society." However, his company believes that the technology to curb carbon emissions has still not advanced to the point where it can be deployed economically.

Efforts to regulate carbon dioxide are still in their infancy. In February, Senators Pete Domenici (R-N.M.) and Jeff Bingaman (D-N.M.), the chairman and ranking member of the Energy & Natural Resources committee, released a paper discussing "market based" methods to limit emissions. Among the options explored is a cap and trade program, where large producers of greenhouse gasses would be allocated a permissible amount of emissions. Entities releasing less than their allocated amount could sell credits, at market rates, to those exceeding their quota. Such a system is already in place in Europe, while the U.S. uses a sulfur-dioxide trading program.

Calculating how much a carbon-credits scheme would cost a mega-plant like Prairie State is pure speculation. If carbon-dioxide credits were trading at a conservative \$7 per ton and the plant was capped at 10 million tons per year, the owners would have to buy about \$8.4 million worth of credits annually. If the cap was 5 million tons, the owners would need \$43.4 million worth of credits.

Such back-of-the-envelope calculations are unlikely to dissuade Peabody's potential partners. Raj Rao is president of the local government-owned Indiana Municipal Power Agency (IMPA), which plans to finance its purchase of a stake in Prairie State by issuing bonds. Rao thinks the plant is a good fit for the region, carrying the prospect of new jobs and firing up the local economy. Even if IMPA's customers end up paying for carbon credits "it's still cheaper than nuclear," he says.

[Halperin](#) is a reporter for [BusinessWeek.com](#)

*Edited by Cristina Lindblad*