

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 1999

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to ____

Commission file number 1-13105

ARCH COAL, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

43-0921172
(I.R.S. Employer Identification No.)

CityPlace One, Suite 300, St. Louis, Missouri 63141
(Address of principal executive offices)(Zip Code)

CityPlace One, Suite 300, St. Louis, Missouri 63141
(Mailing Address)(Zip Code)

Registrant's telephone number, including area code (314) 994-2700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____

At November 12, 1999, there were 38,187,382 shares of registrant's common stock outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ARCH COAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

	September 30, 1999	December 31, 1998
	----- (Unaudited)	-----
Assets		
Current assets		
Cash and cash equivalents	\$ 4,140	\$ 27,414
Trade accounts receivable	170,182	202,871
Other receivables	58,517	24,584
Inventories	76,174	68,455
Prepaid royalties	2,583	13,559
Deferred income taxes	8,694	8,694
Other	10,376	7,757
	-----	-----
Total current assets	330,666	353,334
	-----	-----
Property, plant and equipment, net	1,859,070	1,936,744
	-----	-----
Other assets		
Prepaid royalties	53,397	31,570
Coal supply agreements	159,616	201,965
Deferred income taxes	103,967	83,209
Investment in Canyon Fuel	206,508	272,149
Other	35,050	39,249
	-----	-----
Total other assets	558,538	628,142
	-----	-----
Total assets	\$ 2,748,274	\$ 2,918,220
	=====	=====
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 120,923	\$ 129,528
Accrued expenses	131,887	142,630
Current portion of long-term debt	61,000	61,000
	-----	-----
Total current liabilities	313,810	333,158
	-----	-----
Long-term debt	1,181,209	1,309,087
Accrued postretirement benefits other than pension	344,347	343,553
Accrued reclamation and mine closure	148,177	150,636
Accrued workers' compensation	107,555	105,333
Accrued pension cost	18,338	18,524
Other noncurrent liabilities	40,568	39,713
	-----	-----
Total liabilities	2,154,004	2,300,004
	-----	-----
Stockholders' equity		
Common stock	397	397
Paid-in capital	473,335	473,116
Retained earnings	139,277	150,423
Treasury stock, at cost	(18,739)	(5,720)
	-----	-----
Total stockholders' equity	594,270	618,216
	-----	-----
Total liabilities and stockholders' equity	\$ 2,748,274	\$ 2,918,220
	=====	=====

See notes to condensed consolidated financial statements.

ARCH COAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended September 30		Nine Months Ended September 30	
	1999	1998	1999	1998
Revenues				
Coal sales	\$ 368,195	\$ 393,296	\$1,153,877	\$1,034,474
Income from equity investment	3,960	2,719	7,542	5,135
Other revenues	10,081	28,108	33,235	50,504
	-----	-----	-----	-----
	382,236	424,123	1,194,654	1,090,113
	-----	-----	-----	-----
Costs and expenses				
Cost of coal sales	343,731	366,922	1,071,187	943,438
Selling, general and administrative expenses	10,811	12,104	33,188	28,848
Amortization of coal supply agreements	9,315	11,062	28,894	24,726
Other expenses	5,777	10,126	14,060	19,384
	-----	-----	-----	-----
	369,634	400,214	1,147,329	1,016,396
	-----	-----	-----	-----
Income from operations	12,602	23,909	47,325	73,717
Interest expense, net:				
Interest expense	(21,739)	(24,600)	(68,445)	(38,770)
Interest income	317	135	979	316
	-----	-----	-----	-----
	(21,422)	(24,465)	(67,466)	(38,454)
	-----	-----	-----	-----
Income (loss) before income taxes, extraordinary item and cumulative effect of accounting change	(8,820)	(556)	(20,141)	35,263
Provision (benefit) for income taxes	(7,000)	(1,100)	(18,400)	3,900
	-----	-----	-----	-----
Income (loss) before extraordinary item and cumulative effect of accounting change	(1,820)	544	(1,741)	31,363
Extraordinary item from the extinguishment of debt, net of taxes	-	-	-	(1,488)
Cumulative effect of accounting change, net of taxes	-	-	3,813	-
	-----	-----	-----	-----
Net income (loss)	\$ (1,820)	\$ 544	\$ 2,072	\$ 29,875
	=====	=====	=====	=====
Basic and diluted earnings (loss) per common share				
Income (loss) before extraordinary item and cumulative effect of accounting change	\$ (0.05)	\$ 0.01	\$ (0.05)	\$ 0.79
Extraordinary item from the extinguishment of debt, net of taxes	-	-	-	(0.04)
Cumulative effect of accounting change, net of taxes	-	-	0.10	-
	-----	-----	-----	-----
Basic and diluted earnings(loss) per common share	\$ (0.05)	\$ 0.01	\$ 0.05	\$ 0.75
	=====	=====	=====	=====
Weighted average shares outstanding	38,187	39,693	38,463	39,673
	=====	=====	=====	=====
Dividends declared per share	\$ 0.115	\$ 0.230	\$ 0.345	\$ 0.460
	=====	=====	=====	=====

See notes to condensed consolidated financial statements.

ARCH COAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Nine Months Ended September 30	
	1999	1998
Operating activities		
Net income	\$ 2,072	\$ 29,875
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	179,942	142,223
Prepaid royalties expensed	12,107	15,180
Net gain on disposition of assets	(5,020)	(29,847)
Income from equity investment	(7,542)	(5,135)
Distributions from equity investment	72,843	16,250
Cumulative effect of accounting change	(3,813)	-
Changes in:		
Receivables	(1,882)	(10,085)
Inventories	(7,719)	4,439
Accounts payable and accrued expenses	(18,202)	39,226
Income taxes	(27,513)	(5,405)
Accrued postretirement benefits other than pension	794	9,173
Accrued reclamation and mine closure	(2,459)	(2,035)
Accrued workers' compensation	2,222	1,293
Other	134	(22,984)
Cash provided by operating activities	195,964	182,168
Investing activities		
Cash paid for acquisitions	-	(1,090,000)
Additions to property, plant and equipment	(76,078)	(65,326)
Proceeds from dispositions of property, plant and equipment	19,627	26,349
Proceeds from coal supply agreements	14,067	-
Additions to prepaid royalties	(22,958)	(55,481)
Cash used in investing activities	(65,342)	(1,184,458)
Financing activities		
Net proceeds from revolver and lines of credit	23,266	56,190
Proceeds from (payments on) term loans	(151,144)	973,436
Payments on senior notes	-	(42,860)
Proceeds from sale and leaseback of equipment	-	45,442
Dividends paid	(13,218)	(13,688)
Proceeds from sale of common stock	1	691
Proceeds from sale of treasury stock	2,548	-
Purchases of treasury stock	(15,349)	(928)
Cash provided by (used in) financing activities	(153,896)	1,018,283
Increase (decrease) in cash and cash equivalents	(23,274)	15,993
Cash and cash equivalents, beginning of period	27,414	9,177
Cash and cash equivalents, end of period	\$ 4,140	\$ 25,170

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 1999
(UNAUDITED)

Note A - General

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and Securities and Exchange Commission regulations, but are subject to any year-end adjustments which may be necessary. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Results of operations for the periods ended September 30, 1999 are not necessarily indicative of results to be expected for the year ending December 31, 1999. Arch Coal, Inc. (the "Company") operates one reportable segment: the production of steam and metallurgical coal from surface and deep mines throughout the United States for sale to utility, industrial and export markets. The Company's mines are primarily located in the central Appalachian and western regions of the United States. All subsidiaries (except as noted below) are wholly owned. Significant intercompany transactions and accounts have been eliminated in consolidation.

The Company's 65% ownership of Canyon Fuel Company, LLC ("Canyon Fuel") is accounted for on the equity method in the Condensed Consolidated Financial Statements as a result of certain super-majority voting rights in the joint venture agreement. Income from Canyon Fuel is reflected in the Condensed Consolidated Statements of Operations as income from equity investment (see additional discussion in "Investment in Canyon Fuel" in Note C).

Note B - Change in Accounting Method

Plant and equipment have principally been depreciated on the straight-line method over the estimated useful lives of the assets, which range from three to twenty years. Effective January 1, 1999, depreciation on the Company's preparation plants and loadouts was computed using the units-of-production method which is based upon units produced, subject to a minimum level of depreciation. These assets are usage-based assets and their economic lives are typically based and measured on coal throughput. The Company believes the units-of-production method is preferable to the method previously used because the new method recognizes that depreciation of this equipment is related substantially to physical wear due to usage and also to the passage of time. This method, therefore, more appropriately matches production costs over the lives of the preparation plants and loadouts with coal sales revenue and results in a more accurate allocation of the cost of the physical assets to the periods in which the assets are consumed. The cumulative effect of applying the new method for years prior to 1999 is an increase to income of \$3.8 million net-of-tax (\$6.3 million pre-tax) reported as a cumulative effect of accounting change in the Condensed Consolidated Statement of Operations for the nine months ended September 30, 1999. In addition, the net income of the Company, excluding the cumulative effect of accounting change, for the three months and nine months ended September 30, 1999 is \$.3 million higher and \$.2 million lower, respectively, or \$.01 per share higher and \$.01 per share lower, respectively, than it would have been if the Company had continued to follow the straight-line method of depreciation of equipment for preparation plants and loadouts.

The pro-forma amounts below reflect the retroactive application of units-of-production depreciation on preparation plants and loadouts:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	----- 1999	----- 1998	----- 1999	----- 1998
	(in thousands, except per share data)			
Net income (loss) as reported	\$ (1,820)	\$ 544	\$ 2,072	\$ 29,875
Net income (loss) adjusted for the cumulative effect of accounting change and its retroactive application	\$ (1,829)	\$ 427	\$(1,741)	\$ 29,391
Basic and diluted earnings(loss) per common share as reported	\$ (0.05)	\$ 0.01	\$ 0.05	\$ 0.75
Basic and diluted earnings(loss) per common share adjusted for the cumulative effect of accounting change and its retroactive application	\$ (0.05)	\$ 0.01	\$ (0.05)	\$ 0.74

Note C - Investment in Canyon Fuel

The following table presents unaudited summarized financial information for Canyon Fuel which, as part of the Company's June 1, 1998 acquisition of Atlantic Richfield Company's ("ARCO") coal operations (the "Arch Western transaction"), is accounted for on the equity method:

	Three Months Ended September 30,		Nine Months Ended September 30,	Four Month Ended September 30,
	----- 1999	----- 1998	----- 1999	----- 1998
	(in thousands)			
Revenues	\$ 73,078	\$ 65,570	\$ 196,672	\$ 86,153
Total costs and expenses	68,701	66,152	188,530	83,398
Net income (loss)	\$ 4,377	\$ (582)	\$ 8,142	\$ 2,755
	=====	=====	=====	=====
The Company's income from its equity investment in Canyon Fuel	\$ 3,960	\$ 2,719	\$ 7,542	\$ 5,135
	=====	=====	=====	=====

The Company's income from its equity investment in Canyon Fuel represents 65% of Canyon Fuel's net income after adjusting for the effect of its investment in Canyon Fuel. The Company's investment in Canyon Fuel reflects purchase adjustments primarily related to sales contracts, mineral reserves and other property, plant and equipment.

Note D - Inventories

Inventories are comprised of the following:

	September 30, 1999	December 31, 1998
	-----	-----
	(in thousands)	
Coal	\$ 39,338	\$ 25,789
Repair parts and supplies	36,836	42,666
	-----	-----
	\$ 76,174	\$ 68,455
	=====	=====

Note E - Debt

Debt consists of the following:

	September 30, 1999	December 31, 1998
	-----	-----
	(in thousands)	
Indebtedness to banks under lines of credit	\$ 51,150	\$ 12,884
Indebtedness to banks under revolving credit agreement, expiring May 31, 2003	375,000	390,000
Variable rate term loan payable quarterly from July 1, 2001 through May 31, 2003	135,000	285,000
Variable rate term loan payable May 31, 2003	675,000	675,000
Other	6,059	7,203
	-----	-----
	1,242,209	1,370,087
Less current portion	61,000	61,000
	-----	-----
Long-term debt	\$1,181,209	\$1,309,087
	=====	=====

In connection with the Arch Western transaction, the Company entered into two new five-year credit facilities: a \$675 million non-amortizing term loan to Arch Western Resources, LLC ("Arch Western"), the entity owning the coal reserves and operating assets acquired in the Arch Western transaction, and a \$900 million credit facility to the Company, including a \$300 million fully amortizing term loan and a \$600 million revolver. Borrowings under the Company's new credit facilities were used to finance the acquisition of ARCO's Colorado and Utah coal operations, to pay related fees and expenses, to refinance existing corporate debt and for general corporate purposes. Borrowings under the Arch Western credit facility were used to fund a portion of a \$700 million cash distribution by Arch Western to ARCO, which distribution occurred simultaneously with ARCO's contribution of its Wyoming coal operations and certain other assets to Arch Western. The \$675 million term loan is secured by Arch Western's membership interests in its subsidiaries. The Arch Western credit facility is not guaranteed by the Company. The rate of interest on the borrowings under the agreements is, at the Company's option, the PNC Bank base rate or a rate based on LIBOR. At September 30, 1999, the Company's debt is approximately 68% of capital employed.

On August 23, 1999, the Company prepaid \$105 million or seven installments on the \$300 million fully amortizing term loan. The prepayments were funded by additional borrowings under the \$600 million revolver. The next quarterly installment for \$15 million is payable July 1, 2001.

Terms of the Company's credit facilities and leases contain financial and other restrictive covenants that limit the ability of the Company to, among other things, pay dividends, effect acquisitions or dispositions and borrow additional funds and require the Company to, among other things, maintain various financial ratios and comply with various other financial covenants. Failure by the Company to comply with such covenants could result in an event of default which, if not cured or waived, could have a material adverse effect on the Company.

The Company enters into interest-rate swap agreements to modify the interest-rate characteristics of the Company's outstanding debt. At September 30, 1999, the Company had interest-rate swap agreements having a total notional value of \$862.5 million. These swap agreements were used to convert variable-rate debt to fixed-rate debt. Under these swap agreements, the Company pays a weighted-average fixed-rate of 5.47% (before the credit spread over LIBOR) and is receiving a weighted-average variable-rate based upon 30-day and 90-day LIBOR. The remaining term of the swaps at September 30, 1999 ranged from 35 to 59 months.

Note F - Treasury Stock

On September 29, 1998, the Company's Board of Directors authorized the Company to repurchase up to 2 million shares of Company common stock. The timing of the purchases and the number of shares to be purchased are dependent on market conditions. As of September 30, 1999, the Company had acquired 1,704,000 shares under the repurchase program at the average price of \$12.32 per share.

On February 25, 1999, the Company's Board of Directors authorized the Company to amend its Automatic Dividend Reinvestment Plan to provide, among other things, that dividends may be reinvested in the Company's common stock by purchasing authorized but unissued shares (including treasury shares) directly from the Company, as well as by purchasing shares in the open market. On May 4, 1999, the Company filed a Form S-3 with the Securities and Exchange Commission to register 2 million shares of the Company's common stock for issuance under the amended Plan. As reflected in the Prospectus filed therewith, the amended Plan provides that the Company determines whether the Plan's administrator should reinvest dividends in shares purchased in the open market or in shares acquired directly from the Company. The Company authorized and directed its Plan administrator to reinvest the June 15, 1999 and September 15, 1999 dividends in the Company's treasury stock. On June 15, 1999, the Company paid a dividend of approximately \$4.4 million of which, approximately \$2.5 million was reinvested in 188,647 shares of treasury stock. On September 15, 1999, the Company paid a dividend of approximately \$4.4 million, of which \$13,000 was reinvested in 859 shares of treasury stock. In accordance with the terms of the amended Plan, the treasury stock was reissued by the Company at the average of the high and low per share sales price as reported by the New York Stock Exchange on June 15, 1999 and September 15, 1999, which was \$13.438 and \$15.188 per share, respectively. The Company accounts for the issuance of the treasury stock using the average cost method.

Note G - Contingencies

The Company is a party to numerous claims and lawsuits with respect to various matters. The Company provides for costs related to contingencies, including environmental matters, when a loss is probable and the amount is reasonably determinable. The Company estimates that its probable aggregate loss as a result of such claims as of September 30, 1999 is \$3.8 million (included in other noncurrent liabilities) and believes that probable insurance recoveries of \$.1 million (included in other assets) related to these claims will be realized. The Company estimates that its reasonably possible aggregate losses from all material litigation that is currently pending could be as much as \$.5 million (before taxes) in excess of the probable loss previously recognized. After conferring with counsel, it is the opinion of management that the ultimate resolution of these claims, to the extent not previously provided for, will not have a material adverse effect on the consolidated financial position, results of operations or liquidity of the Company.

Note H - Changes in Estimates and Other Non-Recurring Revenues and Expenses

The Company's operating results for the nine months ended September 30, 1999 reflect a charge of \$6.5 million related to the planned temporary shut down of its Dal-Tex mine in Logan County, West Virginia on July 23, 1999. The charge consists principally of severance costs, obligations for non-cancelable lease payments and a change in the reclamation liability due to the temporary shut down. The shut down was due to a delay in obtaining mining permits resulting from legal action in the U.S. District Court for the Southern District of West Virginia (for a discussion of the legal action, see the "Contingencies - Legal Contingencies - Dal-Tex Litigation" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report). The Company has also entered into settlements with various suppliers that resulted in increased income of \$4.5 million for the nine months ended September 30, 1999.

The Company's operating results for the three and nine months ended September 30, 1998 reflect pre-tax gains on the sale of surplus land totaling \$1.2 million and \$11.1 million, respectively. The Company's operating results for the three and nine months ended September 30, 1998 also include the sale of inactive coal properties in eastern Kentucky, which resulted in a pre-tax gain of \$18.5 million (\$11.3 million after-tax).

Note I - Sale and Leaseback

On January 29, 1998, the Company sold mining equipment for approximately \$74.2 million and leased back the equipment under an operating lease with a term of three years. This included the sale and leaseback of equipment purchased under an existing operating lease that expired on the same day. The proceeds of the sale were used to purchase the equipment under the expired lease for \$28.3 million, to pay related transaction fees of \$.4 million and to pay down debt. At the end of the lease term, the Company has the option to renew the lease for two additional one-year periods or purchase the equipment. Alternatively, the equipment may be sold to a third party. In the event of such a sale, the Company will be required to make a payment to the lessor in the event, and to the extent, that the sale proceeds are less than \$32.2 million. The gain on the sale and leaseback of \$10.7 million was deferred and is being amortized over the base term of the lease as a reduction of lease expense. Effective April 1, 1999, as a result of the pending temporary shut-down of the Dal-Tex operation, the Company purchased several pieces of equipment under lease that were included in this transaction for \$14.4 million and transferred them to the Company's western operations. A pro rata portion of the deferred gain, \$3.1 million, was utilized against the purchase value of the assets. Future non-cancelable rental payments remaining under this lease are expected to be approximately \$2.3 million for the remainder of 1999 and \$8.3 million and \$.6 million in 2000 and 2001, respectively.

Note J - Earnings per Share

The following table sets forth the computation of basic and diluted earnings (loss) per common share from continuing operations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1999	1998	1999	1998
(in thousands, except per share data)				
Numerator:				
Income (loss) before extraordinary item and cumulative effect of accounting change	\$ (1,820)	\$ 544	\$ (1,741)	\$ 31,363
Extraordinary item, net of taxes	-	-	-	(1,488)
Cumulative effect of accounting change, net of taxes	-	-	3,813	-
Net income (loss)	<u>\$ (1,820)</u>	<u>\$ 544</u>	<u>\$ 2,072</u>	<u>\$ 29,875</u>
Denominator:				
Weighted average shares - denominator for basic	38,187	39,693	38,463	39,673
Dilutive effect of employee stock options	-	8	-	33
Adjusted weighted averages shares - denominator for diluted	<u>38,187</u>	<u>39,701</u>	<u>38,463</u>	<u>39,706</u>
Basic and diluted earnings (loss) per common share before extraordinary item and cumulative effect of accounting change	<u>\$ (.05)</u>	<u>\$.01</u>	<u>\$ (.05)</u>	<u>\$.79</u>
Basic and diluted earnings(loss) per common share	<u>\$ (.05)</u>	<u>\$.01</u>	<u>\$.05</u>	<u>\$.75</u>

Note K - Subsequent Event

On October 24, 1996, the rock strata overlaying an abandoned underground mine adjacent to the coal-refuse impoundment used by the Lone Mountain preparation plant failed, resulting in an accidental discharge of approximately 6.3 million gallons of water and fine coal slurry into a tributary of the Powell River in Lee County, Virginia. At the request of the Environmental Protection Agency (the "EPA") and the U.S. Fish and Wildlife Service, the United States Attorney for the Western District of Virginia opened a criminal investigation of the 1996 incident. In resolution of this matter, on November 1, 1999, Lone Mountain pleaded guilty to violating two misdemeanor counts of the federal Clean Water Act. It also agreed to pay a fine of \$85,000 and restitution of \$1.5 million, which will be used to improve local water quality through sewage treatment

projects. The fine and restitution have been accrued by the Company as of

September 30, 1999.

The U.S. Department of the Interior notified the Company that it intends to file a civil action under the Clean Water Act and the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") to recover the natural resource damages suffered as a result of the October 24, 1996 discharge. The Interior Department alleges that fresh water mussels listed on the federal Endangered Species List that reside in the Powell River were affected as a consequence of the discharge. The Company and the Interior Department have reached an agreement in principle to settle this matter. The settlement requires a payment of \$2.5 million by the Company. A material portion of the tentative settlement has been accrued by the Company as of September 30, 1999.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This quarterly report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements in the "Outlook" and "Liquidity and Capital Resources" sections below. Words such as "anticipates," "believes," "estimates," "expects," "is likely," "predicts," "may" and variations of such words and similar expressions are intended to identify such forward-looking statements. Although the Company believes that its expectations are based on reasonable assumptions, it cannot assure that the expectations contained in such statements will be achieved. Important factors which could cause actual results to differ materially from those contained in such statements are discussed in the "Contingencies" and "Certain Trends and Uncertainties" sections below.

RESULTS OF OPERATIONS

The Company acquired Atlantic Richfield Company's U.S. coal operations (the "Arch Western operations") effective June 1, 1998 (the "Arch Western transaction"). Results of operations do not include activity of the Arch Western operations prior to the effective date of this transaction. Accordingly, the Company's results of operations for the nine months ended September 30, 1999 and nine months ended September 30, 1998 are not directly comparable.

Quarter Ended September 30, 1999, Compared to Quarter Ended September 30, 1998

The net loss for the quarter ended September 30, 1999 was \$1.8 million, compared to net income of \$.5 million for the quarter ended September 30, 1998, which included a one-time after-tax gain of \$11.3 million related to the sale of certain inactive coal properties in eastern Kentucky.

Total revenues for the quarter ended September 30, 1999 decreased \$41.9 million, or 10%, from the same period of the prior year. The decrease in revenues was caused in part by the temporary idling on July 23, 1999 of the Company's Dal-Tex operation in central Appalachia. The Company, as planned, has temporarily shut down the Dal-Tex operation due to a delay in obtaining mining permits resulting from legal action in the U.S. District Court for the Southern District of West Virginia (for a discussion of the legal action, see the "Contingencies - Legal Contingencies - Dal-Tex Litigation" section below). The Company also experienced reduced brokerage sales resulting from adverse market conditions and reduced sales at the Wylo mine in central Appalachia as a result of winding down operations at the mine due to the depletion of its recoverable reserves. In addition, the quarter ended September 30, 1998 included revenues of \$18.5 million associated with the one-time sale of inactive coal properties in eastern Kentucky. The decrease in revenues was partially offset by increased sales at the Samples mine in central Appalachia and an increase in sales from the Company's western operations. On a per-ton basis, the Company's average selling price decreased by \$2.04 primarily as a result of an increase in the mix of western versus eastern coal sales. Western coal has a significantly lower average sales price than that provided from the Company's eastern coal operations, due in part to lower Btu content of Powder River Basin coal. The decrease in selling price was also affected by adverse conditions in certain western United States and export markets, as well as continuing adverse conditions in eastern coal markets.

Income from operations for the quarter ended September 30, 1999 decreased \$11.3 million from the same period in the

prior year. The prior year period included a one-time pre-tax gain of \$18.5 million (\$11.3 million after-tax) on the sale of inactive coal properties in eastern Kentucky. Excluding the one-time sale, operating results increased \$7.2 million over the prior year. Operating losses at the Dal-Tex operation were lower in the current quarter compared to the same quarter in the prior year as a result of the July 23, 1999 mine idling. The prior year's quarter results were affected by production shortfalls and deterioration of mining conditions as the Dal-Tex operation waited for the ruling on the issuance of the new permit that was necessary for continued operations. This was offset by reduced production at other operations resulting from difficult mining conditions and adverse rail service.

Selling, general and administrative expenses decreased by \$1.3 million over the same period of the prior year primarily as a result of synergies created after the Arch Western transaction and reduced media and legal costs associated with the West Virginia mountaintop mining and Dal-Tex permit issues.

Sales contract amortization decreased \$1.7 million primarily as a result of the buyout of an above-market contract in March 1999.

Interest expense decreased \$2.9 million due to the reduction of debt from the same period of the prior year.

Other expenses decreased \$4.3 million due to reduced costs in the current quarter resulting from the December 1998 sale of a dock facility on the Big Sandy River.

The Company's effective tax rate is sensitive to changes in annual profitability and percentage depletion.

EBITDA (income from operations before the effects of changes in accounting principles and extraordinary items, merger-related costs and unusual items, net interest expense, income taxes, depreciation, depletion and amortization for the Company, its subsidiaries and its ownership percentage in its equity investments) was \$80.9 million for the quarter ended September 30, 1999 compared to \$89.6 million for the same quarter a year ago. The decrease in EBITDA is primarily attributable to the inclusion of the one-time pre-tax gain of \$18.5 million related to the sale of inactive coal properties in eastern Kentucky in September 1998 offset in part by the closure of the Dal-Tex operations which had an operating loss in the same period of the prior year. EBITDA is a widely accepted financial indicator of a company's ability to incur and service debt, but EBITDA should not be considered in isolation or as an alternative to net income, operating income, or cash flows from operations, or as a measure of a company's profitability, liquidity or performance under generally accepted accounting principles. The Company's method of computing EBITDA also may not be the same method used to compute similar measures reported by other companies, or EBITDA may be computed differently by the Company in different contexts (i.e., public reporting versus computations under financing agreements).

Nine Months Ended September 30, 1999 Compared
to Nine Months Ended September 30, 1998

Net income for the nine months ended September 30, 1999 was \$2.1 million, compared to \$29.9 million for the nine months ended September 30, 1998, which included a one-time after-tax gain of \$11.3 million related to the sale of certain inactive coal properties in eastern Kentucky and an after-tax gain of \$6.5 million on the sale of surplus land. Current period results include operating results of the Arch Western operations for the entire nine-month period, whereas the prior period results only include operating results of the Arch Western operations from June 1, 1998, the effective date of the Arch Western transaction.

Total revenues for the nine months ended September 30, 1999 increased \$119.4 million, or 12%, from the prior period primarily as a result of the inclusion of revenues from the Arch Western operations for the entire nine months ended September 30, 1999 compared to the inclusion of revenues from the Arch Western operations from June 1, 1998 in the nine months ended September 30, 1998. Revenues also increased as a result of increasing production and sales at the Samples mine. The increase in revenues was partially offset by a decrease in sales caused by reduced production at the Dal-Tex operation, which was temporarily idled on July 23, 1999, reduced sales at the Wylo mine in central Appalachia as a result of winding down operations at that mine due to the depletion of its recoverable reserves and the closure of the Arch of Illinois surface operation in June 1998 after depleting its recoverable reserves. The nine months ended

September 30, 1998 also include revenues associated with the one-time sale of inactive coal properties in eastern Kentucky, the sale of other inactive coal properties and transloading income from a dock facility on the Big Sandy River that was sold in December 1998. On a per-ton-sold basis, the Company's average selling price decreased by \$5.01 primarily because of the inclusion of lower-priced coal produced at the Arch Western operations. Western coal has a significantly lower average sales price than that provided from the Company's eastern coal operations, due in part to lower Btu content of Powder River Basin coal. The decrease in selling prices were also affected by adverse conditions in the western United States and export markets, as well as continuing adverse conditions in eastern coal markets.

Income from operations for the nine months ended September 30, 1999 decreased \$26.4 million from the same period in the prior year despite the inclusion of the Arch Western operations for the nine months of 1999 compared to its inclusion as of June 1, 1998 during the nine months ended September 30, 1998. The nine months ended September 30, 1998 included a one-time pre-tax gain of \$18.5 million (\$11.1 million after-tax) on the sale of inactive coal properties in eastern Kentucky and a gain of \$11.1 million on the sale of surplus land. Excluding the one-time sale of inactive coal properties in eastern Kentucky and the sale of surplus land, operating results increased \$3.4 million over the prior year. Operating losses at the Arch of Kentucky operation were lower in the nine months ended September 30, 1999 compared to the same period of the prior year as a result of the operation's January 1998 closure. The prior period's results were impacted by costs associated with the shut down of the operation. The current period's results also include the sale of a dragline at the Arch of Illinois operation resulting in a gain of \$2.5 million, along with settlements with various suppliers that increased income by \$4.5 million. Operating results for the current period were negatively affected by production shortfalls, deterioration of mining conditions and resulting lower income contributions from the Company's Dal-Tex mine complex. The Company, as planned, temporarily shut down the Dal-Tex operation on July 23, 1999. The shut down was due to a delay in obtaining mining permits due to legal action in the U.S. District Court for the Southern District of West Virginia (for a discussion of the legal action, see the "Contingencies - Legal Contingencies - Dal-Tex Litigation" section below). As a result of the shut-down, the Company also recorded a charge of \$6.5 million in the first quarter of 1999 consisting principally of severance costs, obligations for non-cancelable lease payments and a change in the reclamation liability due to the temporary shut down. Operating results in 1999 were also adversely affected by difficult market conditions as described above.

Selling, general and administrative expenses increased \$4.3 million primarily due to the effects of the Arch Western transaction and additional legal and media expenses related to mountaintop removal issues in West Virginia.

As a result of the carrying value of the sales contracts acquired in the Arch Western transaction, amortization of coal supply agreements increased \$4.2 million.

Interest expense increased \$29.7 million due to the increase in debt as a result of the Arch Western transaction.

Other expenses decreased \$5.3 million due to reduced costs in the current nine months resulting from the December 1998 sale of a dock facility on the Big Sandy River.

The Company's effective tax rate is sensitive to changes in annual profitability and percentage depletion.

Effective January 1, 1999, the Company changed its method of depreciation on preparation plants and loadouts from a straight-line basis to a units-of-production basis, which is based upon units produced, subject to a minimum level of depreciation. These assets are usage-based assets and their economic lives are typically based and measured on coal throughput. The Company believes the units-of-production method is preferable to the method previously used because the new method recognizes that depreciation of this equipment is related substantially to physical wear due to usage and also to the passage of time. This method, therefore, more appropriately matches production costs over the lives of the preparation plants and loadouts with coal sales revenue and results in a more accurate allocation of the cost of the physical assets to the periods in which the assets are consumed. The cumulative effect of applying the new method for years prior to 1999 is an increase to income of \$3.8 million net-of-tax (\$6.3 million pre-tax) reported as a cumulative effect of accounting change in the Condensed Consolidated Statement of Operations for the nine months ended September 30, 1999.

EBITDA (income from operations before the effects of changes in accounting principles and extraordinary items, merger-related costs and unusual items, net interest expense, income taxes, depreciation, depletion and amortization for the Company, its subsidiaries and its ownership percentage in its equity investments) was \$255.1 million for the nine months ended September 30, 1999 compared to \$228.2 million for the same period a year ago. The increase in EBITDA is primarily attributable to the additional activity generated from the Arch Western operations offset, in part, by a one-time pre-tax gain of \$18.5 million related to the sale of inactive coal properties in eastern Kentucky in September 1998 and a gain of \$11.3 million on the sale of surplus land in 1998.

OUTLOOK

West Virginia Operations. On October 20, 1999, the U.S. District Court for the Southern District of West Virginia permanently enjoined the West Virginia Division of Environmental Protection (the "West Virginia DEP") from issuing any new permits that authorize the construction of valley fills as part of coal mining operations (for further discussion of the legal action which resulted in this injunction, see the "Contingencies - Legal Contingencies - Dal-Tex Litigation" section below). The West Virginia DEP complied with the injunction by issuing an order banning the issuance of nearly all new permits for valley fills and prohibiting the further advancement of nearly all existing fills. In response to this ban, the Company issued Worker Adjustment and Retraining Notification Act ("WARN Act") notices to all employees at its Hobet 21 and Ruffner mining complexes, both of which need to extend existing valley fills in the near future to continue operating. The Company also announced that its other West Virginia operations may be forced to curtail production in the not-too-distant future.

On October 29, 1999, the district court granted a stay of its injunction, pending the outcome of an appeal of the court's decision filed by the West Virginia DEP with the U.S. Court of Appeals for the Fourth Circuit. In response to the district court's action, the Company withdrew the WARN Act notices.

Assuming there are no further court orders or regulatory changes pending a review of the district court's decision, the Company does not believe that any of its existing mining operations in West Virginia will be materially affected during the six to twelve months that it is expected to take the Fourth Circuit to hear and decide the appeal. If, however, the district court's ruling is not overturned or if a legislative or other solution is not achieved, then the Company's and other coal producer's ability to mine coal in West Virginia in the future would be seriously compromised.

The injunction discussed above was entered as part of the litigation that caused the delay in obtaining mining permits for the Company's Dal-Tex operation (see the "Contingencies - Legal Contingencies - Dal-Tex Litigation" section below). As a result of such delay, the Company idled its Dal-Tex mining operation on July 23, 1999. The Company remains hopeful that it can reopen the Dal-Tex operation after all necessary permits are obtained, which is not expected to occur until mid-2001 at the earliest. Reopening the mine is, however, contingent upon the district court's injunction against the West Virginia DEP being overturned or a legislative or other solution being achieved.

Arch of Illinois. On September 30, 1999, the Company announced that it will idle the remaining operations at the Arch of Illinois mining complex before the end of 1999 due to a lack of demand for the mine's high-sulfur coal. The complex is comprised of the Conant deep mine, the Captain surface mine and a preparation plant. The Captain surface mine was closed during June 1998 after the mine's recoverable coal reserves were depleted. The Company expects reclamation work to be substantially completed at the Captain mine by the end of 2000. The Arch of Illinois complex produced 2 million tons of coal and had \$2.9 million of income from operations for the nine-month period ended September 30, 1999, which included a \$2.5 million gain on the sale of a dragline from that operation. The Company expects to take a charge in the fourth quarter for severance and closure costs. The charge is not expected to have a material impact on the financial results of the quarter.

Lone Mountain, Pardee and Coal-Mac (Kentucky) Operations. On October 11, 1999, the Company announced that it had decided not to sell its Lone Mountain or Pardee mining complexes in central Appalachia, both of which were being considered for possible disposition. Although there was strong interest in these operations, the Company believes that more shareholder value can be created by continuing to operate the mining complexes than by selling them at the prices offered. The Company believes that the operations are efficient with skilled work forces, state-of-the-art infrastructure

and equipment and high-quality coal, and that they will make a positive contribution to cash flow and earnings in the future. The operations, along with the Company's Coal-Mac (Kentucky) operations, had been considered for disposition because of their small size relative to the Company's other eastern mines and because of the Company's aggressive debt reduction goals. The Company continues to explore the potential disposition of the Coal-Mac (Kentucky) operations and expects to make a decision on whether to sell the operations by the end of 1999.

Low-Sulfur Coal Markets. Despite disappointing coal prices and other continuing challenges facing the Company and the coal industry, the Company believes there is reason for optimism in U.S. low-sulfur coal markets in which the Company is well-positioned. With Phase II of the Clean Air Act quickly approaching, the Company has seen some indications that prices for compliance coal are beginning to command a premium in the marketplace, particularly in the Powder River Basin. Compliance coal is coal that meets the requirements of Phase II of the Clean Air Act without the use of expensive scrubbing technology. All of Arch's western coal and approximately half of its eastern production is compliance quality.

The Company's acquisition of the Arch Western operations on June 1, 1998 strongly positioned the Company in the western compliance market. The acquisition also helped solidify the Company's future as other of its operations' reserves deplete, most notably Mingo Logan's Mountaineer Mine, which will deplete its longwall mineable reserves in 2002.

The Company continues to develop its assets at the Arch Western operations including the Black Thunder Mine near Gillette, Wyoming. On March 12, 1999, the Company entered into an agreement to transfer ownership of a portion of the 412-million-ton Thundercloud federal coal lease, which is part of the Company's Black Thunder Mine, to Kennecott Energy Company ("Kennecott Energy"). The reserves, located adjacent to the western border of Kennecott Energy's Jacobs Ranch Mine, are estimated to contain 35 million tons of coal. In exchange for that portion of the lease, the Company received approximately \$12 million along with baseline environmental data with respect to the Thundercloud leasehold. The environmental data will allow the Company to expedite the permitting of the property. In addition, the Black Thunder Mine is currently constructing a fourth dragline that is estimated to be placed in service in the first quarter of 2000.

Other Challenges. The Company experienced poor rail service at its western operations in 1998. Rail service in the west improved during the first nine months of 1999. However, the Company is concerned that rail service may deteriorate as two mines owned by competitors start up production in the Uinta service basin area where the Company's Colorado operations are located. The Company has also experienced production problems at its Black Thunder Mine arising from surface water run-off and groundwater issues. During 1999, the Black Thunder Mine implemented a comprehensive water control and drainage program which began to produce positive results at the end of the second quarter of 1999. The Company believes that the corrective measures implemented through 1999 should minimize water-related difficulties at the operation.

The Company experienced rail service problems at its eastern coal operations in 1999, which the Company believes resulted from the integration of Conrail's operations into the Norfolk Southern and CSX. The Company expects the rail service to its eastern operations to improve. However, such service may continue to hinder performance through the fourth quarter of 1999.

Ashland Inc. Proposal. On June 22, 1999, Ashland Inc. ("Ashland"), which owns approximately 58% of the Company's outstanding shares of common stock, announced that it was exploring strategic alternatives for its investment in the Company. On September 10, 1999, the Company received a proposal from Ashland that contemplates a tax-free spin-off of Ashland's interest in the Company to Ashland's shareholders. On October 5, 1999, the Company confirmed that its Board of Directors had formed an independent special committee consisting of all of its non-Ashland and non-management members to consider whether the proposal was in the best interest of the Company and its other shareholders and to negotiate the terms and conditions upon which a spin-off might occur. The Company also confirmed that the special committee is in discussions with Ashland concerning the proposal. The proposed spin-off would require negotiation and execution of an acceptable agreement between Ashland and the Company, receipt by Ashland of a favorable ruling from the Internal Revenue Service and the approval by the Company's special committee,

its Board of Directors and its shareholders of certain matters to facilitate the spin-off on a tax-free basis. The proposed spin-off could take several months to complete. There has been no immediate impact on the operations of the Company as a result of such proposal, and the Company is focusing on its five chief financial objectives: (i) aggressively paying down debt, (ii) further strengthening cash generation, (iii) improving earnings, (iv) increasing productivity, and (v) reducing costs throughout the Company.

LIQUIDITY AND CAPITAL RESOURCES

The following is a summary of cash provided by or used in each of the indicated types of activities during the nine months ended September 30, 1999 and 1998:

	1999	1998
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	(in thousands)	

Cash provided by (used in):		
Operating activities	\$ 195,964	\$ 182,168
Investing activities	(65,342)	(1,184,458)
Financing activities	(153,896)	1,018,283

Cash provided by operating activities increased in the nine months ended September 30, 1999 compared to the same period of 1998 due primarily to increased operating activity resulting from the Arch Western transaction, including distributions from the Company's investment in Canyon Fuel. This increase was partially offset by a reduction in accounts payable and accrued expenses, increased interest payments resulting from increased borrowings associated with the Arch Western transaction, and lower sales of surplus land during the current year.

A portion of the distributions from the Company's investment in Canyon Fuel were a result of Canyon Fuel amending coal supply agreements with the Intermountain Power Agency's Intermountain Power Project ("IPA") during January 1999. Pursuant to the amended coal supply agreements, Canyon Fuel will supply coal to IPA through 2010 with a mutual option to extend the terms of the agreements to 2015 at a rate of approximately 2.2 million tons per year. Canyon Fuel and IPA settled a pending arbitration and related litigation resulting from IPA's assertion of a gross inequity under the coal supply contracts and disagreements over the price escalation provisions of the contracts. As part of the settlement, IPA agreed to pay to Canyon Fuel \$12.7 million, which had been withheld due to the dispute. The members of Canyon Fuel also agreed to terminate certain indemnification rights, including indemnification rights relating to the IPA coal supply agreements, arising in connection with the December 1996 acquisition of Canyon Fuel from The Coastal Corporation, and the Company agreed to terminate certain indemnification rights relating to the IPA coal supply agreements under agreements relating to the Arch Western transaction. In the aggregate, the Company will receive \$29.9 million over three years for termination of the indemnity rights. The proceeds from the termination of the indemnity rights will be used to repay debt and for other corporate purposes.

The decrease in cash used for investing activities from the first nine months of 1998 primarily results from payment of \$1.1 billion in cash in the Arch Western transaction during the second quarter of 1998. In addition, the Company amended a coal supply agreement acquired in the Arch Western transaction. The amendment changed the contract terms from above-market to market-based pricing. As a result of the amendment, the Company received proceeds of \$14.9 million (net of royalty and tax obligations) from the customer. Proceeds from the disposition of property, plant and equipment decreased \$6.7 million primarily as a result of the sale of inactive coal properties in eastern Kentucky during 1998. This was partially offset during 1999 by the sale of a portion of the Thundercloud lease to Kennecott Energy for approximately \$12 million (for additional discussion of this matter see the "Outlook" section above). In addition, the Company's expenditures for property, plant and equipment were \$76.1 million and \$65.3 million for the nine months ended September 30, 1999 and 1998, respectively. Expenditures in 1999 included approximately \$34.8 million for equipment upgrades and re-erection costs for assets at the Arch Western operation's Thunder Basin Coal Company, including \$16.5 million for the construction of a fourth dragline at the Black Thunder Mine. The Company also spent \$10.9 million at its Samples Mine to acquire a new spread of equipment and to relocate a shovel from the Wylo operation. Also included in the nine months ended September 30, 1999 were equipment upgrades at Mingo Logan and Mountain Coal Company of \$3.2 million and \$8.6 million, respectively. The Company also purchased leased equipment

associated with the Dal-Tex operation for \$14.4 million, several pieces of which were subsequently moved to the Company's western operations.

Cash used in financing activities reflects a reduction in borrowings of \$127.9 million during the first nine months of 1999. During the same period of 1998, there was an increase in borrowings of \$1.2 billion primarily associated with the Arch Western transaction, net of associated debt repayment. In addition, in January 1998, a sale and leaseback of equipment resulted in net proceeds of \$45.4 million. The Company also repurchased 1,373,800 shares of its own common stock for \$15.4 million during 1999 as part of a stock repurchase program. The repurchases were partially offset by the issuance of 189,506 treasury shares for approximately \$2.5 million associated with the Company's dividend reinvestment plan.

The Company periodically establishes uncommitted lines of credit with banks. These agreements generally provide for short-term borrowings at market rates. At September 30, 1999, there were \$65 million of such agreements in effect, of which \$51.2 million were outstanding.

The Company is exposed to market risk associated with interest rates. At September 30, 1999, debt included \$1.236 billion of floating-rate debt which is, at the Company's option, the PNC Bank base rate or a rate based on LIBOR and current market rates for bank lines of credit. To manage these exposures, the Company enters into interest-rate swap agreements to modify the interest-rate characteristics of outstanding Company debt. At September 30, 1999, the Company had interest-rate swap agreements having a total notional value of \$862.5 million. These swap agreements are used to convert variable-rate debt to fixed-rate debt. Under these swap agreements, the Company pays a weighted average fixed rate of 5.47% (before the credit spread over LIBOR) and receives a weighted average variable rate based upon 30-day and 90-day LIBOR. The Company accrues amounts to be paid or received under interest-rate swap agreements over the lives of the agreements. Such amounts are recognized as adjustments to interest expense over the lives of agreements, thereby adjusting the effective interest rate on the Company's debt. The fair values of the swap agreements are not recognized in the financial statements. Gains and losses on terminations of interest-rate swap agreements would be deferred on the balance sheet (in other long-term liabilities) and amortized as an adjustment to interest expense over the remaining term of the terminated swap agreement. The remaining terms of the swap agreements at September 30, 1999 ranged from 35 to 59 months. All instruments are entered into for other than trading purposes.

The discussion below presents the sensitivity of the market value of the Company's financial instruments to selected changes in market rates and prices. The range of changes reflects the Company's view of changes that are reasonably possible over a one-year period. Market values are the present value of projected future cash flows based on the market rates and prices chosen. The major accounting policies for these instruments are described in Note 1 to the consolidated financial statements of the Company as of and for the year ended December 31, 1998 as filed on Form 10-K with the Securities and Exchange Commission.

Changes in interest rates have different impacts on the fixed- and variable-rate portions of the Company's debt portfolio. A change in interest rates on the fixed portion of the debt portfolio impacts the net financial instrument position but has no impact on interest incurred or cash flows. A change in interest rates on the variable portion of the debt portfolio impacts the interest incurred and cash flows but does not impact the net financial instrument position.

The sensitivity analysis related to the fixed portion of the Company's debt portfolio assumes an instantaneous 100-basis-point move in interest rates from their levels at September 30, 1999 with all other variables held constant. A 100-basis-point decrease in market interest rates would result in an increase in the net financial instrument position of the fixed portion of debt of \$29.2 million at September 30, 1999. Based on the variable-rate debt included in the Company's debt portfolio as of September 30, 1999, after considering the effect of the swap agreements, a 100-basis-point increase in interest rates would result in an annualized additional \$3.7 million of interest expense incurred based on quarter-end debt levels.

CONTINGENCIES

Reclamation

The federal Surface Mining Control and Reclamation Act of 1977 ("SMCRA") and similar state statutes require that mine property be restored in accordance with specified standards and an approved reclamation plan. The Company accrues for the costs of final mine closure reclamation over the estimated useful mining life of the property. These costs relate to reclaiming the pit and support acreage at surface mines and sealing portals at deep mines. Other costs of final mine closure common to surface and underground mining are related to reclaiming refuse and slurry ponds. The Company also accrues for significant reclamation that is completed during the mining process prior to final mine closure. The establishment of the final mine closure reclamation liability and the other ongoing reclamation liability is based upon permit requirements and requires various estimates and assumptions, principally associated with costs and productivities.

The Company reviews its entire environmental liability annually and makes necessary adjustments, including permit changes and revisions to costs and productivities to reflect current experience. These recosting adjustments are recorded to cost of coal sales. Adjustments recorded in the three and nine months ended September 30, 1999 resulted in a \$.7 million charge to expense. There were no adjustments recorded in the three or nine months ended September 30, 1998. The Company's management believes it is making adequate provisions for all expected reclamation and other associated costs.

Legal Contingencies

The Company is a party to numerous claims and lawsuits with respect to various matters, including those discussed below. The Company provides for costs related to contingencies, including environmental matters, when a loss is probable and the amount is reasonably determinable. The Company estimates that its probable aggregate loss as a result of such claims as of September 30, 1999 is \$3.8 million (included in other noncurrent liabilities) and believes that probable insurance recoveries of \$.1 million (included in other assets) related to these claims will be realized. The Company estimates that its reasonably possible aggregate losses from all material litigation that is currently pending could be as much as \$.5 million (before taxes) in excess of the probable loss previously recognized. After conferring with counsel, it is the opinion of management that the ultimate resolution of these claims, to the extent not previously provided for, will not have a material adverse effect on the consolidated financial position, results of operations or liquidity of the Company.

Dal-Tex Litigation. On July 16, 1998, ten individuals and The West Virginia Highlands Conservancy filed suit in U.S. District Court for the Southern District of West Virginia against the director of the West Virginia DEP and officials of the U.S. Army Corps of Engineers (the "Corps") alleging violations of SMCRA and the Clean Water Act. The plaintiffs alleged that the West Virginia DEP and the Corps have violated their duties under SMCRA and the Clean Water Act by authorizing the construction of "valley fills" under certain surface coal mining permits. These fills are the large, engineered works into which the excess earth and rock extracted above and between the seams of coal that are removed during surface mining are placed. The plaintiffs also alleged that the West Virginia DEP has failed to require that lands mined be restored to "approximate original contour" and that approved post-mining land uses are enforced following reclamation.

Four indirect, wholly owned subsidiaries of the Company hold nine permits that were identified in the complaint as violating the legal standards that the plaintiffs requested the district court interpret. In addition, a pending permit application for the Company's Dal-Tex operation (known as the "Spruce Fork Permit") was specifically identified as a permit the issuance of which should be enjoined. Three subsidiaries of the Company intervened in the lawsuit in support of the Corps and the West Virginia DEP on August 6, 1998.

A partial settlement between the plaintiffs and the Corps was reached on December 23, 1998. Pursuant to that settlement, all claims were dismissed against the Corps for its alleged failure to execute its duties under the Clean Water Act. The settlement agreement reached between the Corps and the plaintiffs requires the preparation of a programmatic

environmental impact statement (an "EIS") under the National Environmental Policy Act of 1969 ("NEPA") to evaluate the environmental effects of mountaintop mining. This EIS is scheduled to be completed by January 2001. Until it is completed, any proposed fill greater than 250 acres in size must secure an individual Clean Water Act Section 404 "dredge and fill" permit, instead of a general permit like the one to be issued by the Corps under its nationwide authorization program for the Dal-Tex operation. The Spruce Fork Permit was not included in the settlement, and the claims against the Corps with respect to that permit were not dismissed.

On March 3, 1999, the district court issued a preliminary injunction which prohibited the Corps from issuing a general Clean Water Act Section 404 "dredge and fill" permit for the Dal-Tex operation and enjoined the Company from future operations on the permit until a full trial on the merits is held. As a result of the entry of the preliminary injunction, the Company announced on March 8, 1999 that it would idle the mine and lay off more than 250 employees. As announced, the Company laid off the employees and, on July 23, 1999, idled the Dal-Tex mine.

On July 26, 1999, the plaintiffs and West Virginia DEP tendered to the district court a proposed consent decree which would resolve most of the remaining issues in the case. Pursuant to the proposed consent decree, the West Virginia DEP agreed in principal to amend its regulations and procedures to correct deficiencies that were alleged by the plaintiffs. In addition, the parties agreed in principal on a new definition of "approximate original contour" as it applies to mountaintop mining, as well as to certain regulatory changes involving post-mining land uses. The court invited public comment on the proposed consent decree through the end of September 1999 and ruled that it will not approve the consent decree until the West Virginia legislature approves the proposed rule changes set forth in such decree.

The Company's Hobet Mining subsidiary agreed as part of the proposed consent decree to revise portions of its Spruce Fork Permit application to conform to the new definition of "approximate original contour" that would be adopted pursuant to the consent decree. Hobet Mining also agreed to seek an individual Clean Water Act Section 404 "dredge and fill" permit from the Corps as part of its future mining operation. Before issuing that permit, the Corps must first complete an EIS to comply with the provisions of NEPA. The completion of this EIS and issuance of all permits are not expected until mid-2001 at the earliest.

One issue not resolved by the proposed consent decree is the applicability of a regulation which imposes a "buffer zone" around intermittent and perennial segments of streams. The plaintiffs alleged this regulation prohibits the construction of valley fills in such stream segments. On October 20, 1999, the district court entered a permanent injunction against the West Virginia DEP prohibiting the issuance of any new permits that authorize the construction of valley fills as part of mining operations. The court concluded that the excess spoil that is placed in a valley fill during mining is not fill material, which should be permitted under Section 404 of the Clean Water Act. Instead, the court construed excess spoil as "waste," which must be regulated under Section 402 of the Clean Water Act and which may not be placed in intermittent and perennial streams because the disposal of such material cannot meet water quality standards that apply to these streams.

The West Virginia DEP immediately complied with the district court's injunction by issuing an administrative order banning the expansion of nearly all existing valley fills as well as prohibiting the issuance of nearly all new permits of valley fills. The West Virginia DEP also filed an appeal of the district court's decision with the U.S. Court of Appeals for the Fourth Circuit. On October 29, 1999, the district court granted a stay of its decision, pending the outcome of the appeal. The West Virginia DEP rescinded its order on November 1, 1999 in response to the district court's action.

Assuming there are no further court orders or regulatory changes pending a review of the district court's decision, the Company does not believe that any of its existing operations in West Virginia will be materially affected during the six to twelve months that it is expected to take the Fourth Circuit to hear and decide the appeal. If, however, the district court's decision is upheld, coal mining operations in West Virginia may be forced to close because of the prohibition on constructing "valley fills" for their existing and future mines. Moreover, because the court's decision does not distinguish between surface and underground mining, the prohibition could be interpreted to apply to underground mining and not merely to the mountaintop operations that the lawsuit initially sought to enjoin.

Skyline Partners Litigation. In October 1999, Canyon Fuel and Skyline Partners reached an agreement in principal to settle the litigation between them. The

litigation arose from an agreement between a subsidiary of The Coastal

Corporation, Canyon Fuel's predecessor in interest, and the Skyline Partners' predecessor. The agreement pertains to certain annual advance royalty payments that Canyon Fuel, as the current lessee of the coal reserves comprising its Skyline Mine, is required to pay Skyline Partners. For further discussion of the litigation, see the "Management's Discussion and Analysis of Financial Condition and Results of Operations - Contingencies - Legal Contingencies" section of the Company's Quarterly Reports on Form 10-Q for the Quarters Ended June 30, 1999 and March 31, 1999.

The settlement includes a \$7 million payment by Canyon Fuel to Skyline Partners representing disputed amounts of advance minimum royalties, interest, reimbursement of legal fees, a grant of an overriding royalty interest to Skyline Partners covering land adjacent to the Skyline Mine reserves and a reduction in the total amount of advance minimum royalties available for recoupment by Canyon Fuel. The settlement is subject to the parties entering into a definitive agreement and to approval by the Utah and Colorado Federal District Courts, as well as other necessary approvals. The Company's Condensed Consolidated Balance Sheet as of September 30, 1999 reflects a reserve for a material portion of this settlement amount.

Lone Mountain Litigation. On October 24, 1996, the rock strata overlaying an abandoned underground mine adjacent to the coal-refuse impoundment used by the Lone Mountain preparation plant failed, resulting in an accidental discharge of approximately 6.3 million gallons of water and fine coal slurry into a tributary of the Powell River in Lee County, Virginia. At the request of the Environmental Protection Agency (the "EPA") and the U.S. Fish and Wildlife Service, the United States Attorney for the Western District of Virginia opened a criminal investigation of the 1996 incident. In resolution of this matter, on November 1, 1999, Lone Mountain pleaded guilty to violating two misdemeanor counts of the federal Clean Water Act. It also agreed to pay a fine of \$85,000 and restitution of \$1.5 million which will be used to improve local water quality through sewage treatment projects. The Company's Condensed Consolidated Balance Sheet as of September 30, 1999 reflects a reserve for the full amount of the fine and restitution.

The U.S. Department of the Interior notified the Company that it intends to file a civil action under the Clean Water Act and the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA") to recover the natural resource damages suffered as a result of the October 24, 1996 discharge. The Interior Department alleges that fresh water mussels listed on the federal Endangered Species List that reside in the Powell River were affected as a consequence of the discharge. The Company and the Interior Department have reached an agreement in principal to settle this matter. The settlement requires a payment of \$2.5 million by the Company. The settlement is subject to the Company and the Interior Department entering into a definitive agreement. The Company's Condensed Consolidated Balance Sheet as of September 30, 1999 reflects a reserve for a material portion of this settlement amount.

Other Litigation. On October 31, 1997, the EPA notified a Company subsidiary that it was a potentially responsible party in the investigation and remediation of two hazardous waste sites located in Kansas City, Kansas, and Kansas City, Missouri. The Company's involvement arises from the subsidiary's sale, in the mid-1980s, of fluids containing small quantities of polychlorinated biphenyls ("PCBs") to a company authorized to engage in the processing and disposal of these wastes. Some of these waste materials were sent to one of the sites for final disposal. The Company responded to the information request submitted by the EPA on December 1, 1997. Any liability which might be asserted by the EPA against the Company is not believed to be material because of the de minimis quantity and concentration of PCBs linked to the Company. Moreover, the party with which the subsidiary contracted to dispose of the waste material has agreed to indemnify the Company for any costs associated with this action.

CERTAIN TRENDS AND UNCERTAINTIES

Substantial Leverage; Variable Interest Rates; Restrictive Covenants

The Company has substantial leverage, including significant debt service and lease payment obligations. As of September 30, 1999, the Company had outstanding consolidated indebtedness of \$1.242 billion, representing approximately 68% of capital employed.

The Company's ability to satisfy its debt service and lease payment obligations will depend upon the future operating

performance of its subsidiaries, which will be affected by prevailing economic conditions in their markets, as well as financial, business and other factors, certain of which are beyond their control. Based upon current levels of operations, the Company believes that cash flow from operations and available cash, together with available borrowings under the Company's credit facilities, will be adequate to meet the Company's future liquidity needs for at least the next several years. However, there can be no assurance that the Company's business will generate sufficient cash flow from operations or that future borrowings will be available in an amount sufficient to enable the Company to fund its debt service and lease payment obligations or its other liquidity needs.

The degree to which the Company is leveraged could have material consequences to the Company and its business, including, but not limited to: (i) making it more difficult for the Company to satisfy its debt service, lease payment and other obligations; (ii) increasing the Company's vulnerability to general adverse economic and industry conditions; (iii) limiting the Company's ability to obtain additional financing to fund future acquisitions, working capital, capital expenditures or other general corporate requirements; (iv) reducing the availability of cash flow from operations to fund acquisitions, working capital, capital expenditures or other general corporate purposes; (v) limiting the Company's flexibility in planning for, or reacting to, changes in its business and the industry in which it competes and (vi) placing the Company at a competitive disadvantage when compared to competitors with less debt.

A significant portion of the Company's indebtedness bears interest at variable-rates that are linked to short-term interest rates. If interest rates rise, the Company's costs relative to those obligations would also rise.

Terms of the Company's credit facilities and leases contain financial and other restrictive covenants that limit the ability of the Company to, among other things, pay dividends, effect acquisitions or dispositions and borrow additional funds and require the Company to, among other things, maintain various financial ratios and comply with various other financial covenants. Failure by the Company to comply with such covenants could result in an event of default which, if not cured or waived, could have a material adverse effect on the Company.

Environmental and Regulatory Factors

Federal, state and local governmental authorities regulate the coal mining industry on matters as diverse as employee health and safety, air quality standards, water pollution, groundwater quality and availability, plant and wildlife protection, the reclamation and restoration of mining properties, the discharge of materials into the environment and surface subsidence from underground mining. In addition, federal legislation mandates certain benefits for various retired coal miners represented by the United Mine Workers of America ("UMWA"). These regulations and legislation have had and will continue to have a significant effect on the Company's costs of production and competitive position.

New legislation, regulations or orders may be adopted or become effective which may adversely affect the Company's mining operations or cost structure or the ability of the Company's customers to use coal. For example, new legislation, regulations or orders may require the Company to incur increased costs or to significantly change its operations. New legislation, regulations or orders may also cause coal to become a less attractive fuel source, resulting in a reduction in coal's share of the market for fuels used to generate electricity. Any such regulation, legislation or order could have an adverse effect on the Company's business, results of operations and financial condition and, depending upon the nature and scope of the legislation, regulations or orders, the effect could be material.

Permits. Mining companies must obtain numerous permits that impose strict regulations on various environmental and health and safety matters in connection with coal mining, including the emission of air and water borne pollutants, the manner and sequencing of coal extractions and reclamation, the storage, use and disposal of waste and other substances, some of which may be hazardous, and the construction of fills and impoundments. Because regulatory authorities have considerable discretion in the timing of permit issuance and because both private individuals and the public at large possess rights to comment on and otherwise engage in the permitting process, including through intervention in the courts, no assurance can be made that permits necessary for mining operations will be issued or, if issued, that such issuance would be timely or that permitting requirements will not be changed or interpreted in a manner adversely affecting the Company.

As indicated by the legal action involving the Company's Dal-Tex operation which is discussed in "Contingencies - Legal Contingencies - Dal-Tex Litigation" above, the regulatory environment in West Virginia is changing with respect to coal mining. No assurance can be made that the Fourth Circuit will overturn the district court's decision in such legal action or that a legislative or other solution will be achieved. If the district court's ruling is not overturned or a legislative or other solution is not achieved, there could be a material adverse effect on the Company's financial condition or results of operations.

NOx Emissions. The use of explosives in surface mining causes oxides of nitrogen ("NOx") to be emitted into the air. The emission of NOx from the use of explosives at surface mines in the Powder River Basin is gaining increased scrutiny from regulatory agencies and the public. The Company has taken steps to monitor the level of NOx emitted during blasting activities at its surface mines in the Powder River Basin and is continuing efforts to find a method of reducing these NOx emissions. Any increase in the regulation of NOx emissions from blasting activities could have an adverse effect on the Company's Powder River Basin surface mines. Depending upon the nature and scope of such regulations, the effect on the mines could be material.

Kyoto Protocol. On December 11, 1997, the U.S. government representatives at the climate change negotiations in Kyoto, Japan, agreed to reduce the emissions of greenhouse gases (including carbon dioxide and other gas emissions that are believed to be trapping heat in the atmosphere and warming the earth's climate) in the United States. The U.S. adoption of the requirements of the Kyoto protocol is subject to conditions which may not occur and is also subject to the protocol's ratification by the U.S. Senate. The U.S. Senate has indicated that it will not ratify an agreement unless certain conditions, not currently provided for in the Kyoto protocol, are met. At present, it is not possible to predict whether the Kyoto protocol will attain the force of law in the United States or what its impact would be on the Company. Further developments in connection with the Kyoto protocol could have a material adverse affect on the Company's financial condition and results of operations.

Customers. In July 1997, the EPA proposed that twenty-two eastern states, including states in which many of the Company's customers are located, make substantial reductions in nitrous oxide emissions. The EPA expects the states to achieve these reductions by requiring power plants to reduce their nitrous oxide emissions by an average of 85%. To achieve such reductions, power plants would be required to install reasonably available control technology ("RACT") and additional control measures. Installation of RACT and additional control measures required under the EPA's proposal would make it more costly to operate coal-fired utility power plants and, depending on the requirements of individual state implementation plans and the development of revised new source performance standards, could make coal a less attractive fuel alternative in the planning and building of utility power plants in the future.

The EPA is also proposing to implement stricter ozone standards by 2003. The U.S. Court of Appeals for the District of Columbia Circuit has, however, enjoined the EPA from implementing the new ozone standards on constitutional and other legal grounds. As a result, implementation of the standards may be delayed or precluded. The decision may also result in modification of the proposed ozone standards.

The U.S. Department of Justice, on behalf of the EPA, recently filed a lawsuit against seven investor-owned utilities and brought an administrative action against one government-owned utility for alleged violations of the Clean Air Act. The EPA claims that over thirty of these utilities' power stations have failed to obtain permits required under the Clean Air Act for major improvements which have extended the useful service of the stations or increased their generating capacity. The Company supplies coal to seven of the eight utilities. It is impossible to predict with certainty the outcome of this legal action. Any outcome that adversely affects the Company's customers or makes coal a less attractive fuel source could, however, have a material adverse effect on the Company's financial condition or results of operations.

Reserve Degradation and Depletion

The Company's profitability depends substantially on its ability to mine coal reserves that have the geologic characteristics that enable them to be mined at competitive costs. There can be no assurance that replacement reserves, particularly in central Appalachia, will be available when required or, if available, that such replacement reserves can be mined at costs comparable to those characteristic of the depleting mines. Exhaustion of reserves at particular mines can also have an adverse effect on operating results that is disproportionate to the percentage of overall production and operating income represented by such mines. Mingo Logan's Mountaineer Mine is estimated to exhaust its longwall mineable reserves in 2002. The Mountaineer Mine generated \$49.5 million of the Company's total operating income for the nine months ended September 30, 1999.

Reliance on and Terms of Long-Term Coal Supply Contracts

The Company sells a substantial portion of its coal production pursuant to long-term coal supply agreements and, as a consequence, may experience fluctuations in operating results due to the expiration or termination of, or sales price redeterminations or suspensions of deliveries under such coal supply agreements. Other short- and long-term contracts define base or optional tonnage requirements by reference to the customer's requirements, which are subject to change as a result of factors beyond the Company's (and in certain instances the customer's) control, including utility deregulation. In addition, certain price adjustment provisions permit a periodic increase or decrease in the contract price to reflect increases and decreases in production costs, changes in specified price indices or items such as taxes or royalties. Price reopener provisions provide for an upward or downward adjustment in the contract price based on market factors. The Company has from time to time renegotiated contracts after execution to extend the contract term or to accommodate changing market conditions. The contracts also typically include stringent minimum and maximum coal quality specifications and penalty or termination provisions for failure to meet such specifications and force majeure provisions allowing suspension of performance or termination by the parties during the duration of certain events beyond the control of the affected party. Contracts occasionally include provisions that permit a utility to terminate the contract if changes in the law make it illegal or uneconomic for the utility to consume the Company's coal or if the utility has unexpected difficulties in utilizing the Company's coal. Imposition of new nitrous oxide emissions limits in connection with Phase II of the Clean Air Act in 2000 could result in price adjustments or in affected utilities seeking to terminate or modify long-term contracts in reliance on such termination provisions. If the parties to any long-term contracts with the Company were to modify, suspend or terminate those contracts, the Company could be adversely affected to the extent that it is unable to find alternative customers at a similar or higher level of profitability.

From time to time, disputes with customers may arise under long-term contracts relating to, among other things, coal quality, pricing and quantity. The Company may thus become involved in arbitration and legal proceedings regarding its long-term contracts. There can be no assurance that the Company will be able to resolve such disputes in a satisfactory manner.

Although the Company cannot predict changes in its costs of production and coal prices with certainty, the Company believes that in the current economic environment of low to moderate inflation, the price adjustment provisions in its older long-term contracts will largely offset changes in the costs of providing coal under those contracts, except for those costs related to changes in productivity. However, the increasingly short terms of sales contracts and the consequent absence of price adjustment provisions in such contracts also make it more likely that inflation related increases in mining costs during the contract term will not be recovered by the Company through a later price adjustment.

Potential Fluctuations in Operating Results; Seasonality

The Company may experience significant fluctuations in operating results in the future, both on an annual and quarterly basis, as a result of one or more factors beyond its control, including expiration or termination of, or sales price redeterminations or suspensions of deliveries under, coal supply agreements; disruption of transportation services; changes in mine operating conditions; changes in laws or regulations, including permitting requirements; unexpected results in litigation; work stoppages or other labor difficulties; competitive and overall coal market conditions; and general economic conditions.

The Company's mining operations are also subject to factors beyond its control that can negatively or positively affect the level of production and thus the cost of mining at particular mines for varying lengths of time. These factors include weather conditions, equipment replacement and repair requirements; variations in coal seam thickness, amount of overburden, rock and other natural materials; and other surface or subsurface conditions. Such production factors frequently result in significant fluctuations in operating results.

Third quarter results of operations are frequently adversely affected by lower production and resultant higher costs due to scheduled vacation periods at the majority of the Company's mines. In addition, costs are typically somewhat higher during vacation periods because of maintenance activity carried on during those periods. These adverse effects may prevent the third quarter from being comparable to the other quarters and also prevent the third quarter results from being indicative of results to be expected for the full year.

Certain Contractual Arrangements

Arch Western Resources, LLC ("Arch Western") owns the coal reserves and operating assets acquired in the Arch Western transaction. The Limited Liability Company Agreement pursuant to which Arch Western was formed provides that a subsidiary of the Company, as the managing member of Arch Western, generally has exclusive power and authority to conduct, manage and control the business of Arch Western. However, if Arch Western at the time has a debt rating less favorable than Ba3 from Moody's Investors Service or BB- from Standard & Poors Ratings Group or does not meet certain specified indebtedness and interest coverage ratios, then a proposal that Arch Western make certain distributions, incur indebtedness, sell properties or merge or consolidate with any other entity would require the consent of all the members of Arch Western.

In connection with the Arch Western transaction, the Company entered into an agreement pursuant to which the Company agreed to indemnify another member of Arch Western against certain tax liabilities in the event that such liabilities arise as a result of certain actions taken prior to June 1, 2013, including the sale or other disposition of certain properties of Arch Western, the repurchase of certain equity interests in Arch Western by Arch Western or the reduction under certain circumstances of indebtedness incurred by Arch Western in connection with the Arch Western transaction. Depending on the time at which any such indemnification obligation were to arise, it could have a material adverse effect on the business, results of operations and financial condition of the Company.

The membership interests in Canyon Fuel are owned 65% by Arch Western and 35% by a subsidiary of ITOCHU Corporation, a Japanese corporation. The agreement which governs the management and operations of Canyon Fuel provides for a Management Board to manage its business and affairs. Generally, the Management Board acts by affirmative vote of the representatives of the members holding more than 50% of the membership interests. However, certain actions require either the unanimous approval of the members or the approval of representatives of members holding more than 70% of the membership interests. The Canyon Fuel agreement also contains various restrictions on the transfer of membership interests in Canyon Fuel.

Ashland currently owns approximately 58% of the Company's outstanding common stock. Pursuant to a stockholders agreement among the Company, Ashland and Carboex S.A. ("Carboex"), the Company has agreed to nominate for election as a director of the Company a person designated by Carboex, and Ashland has agreed to vote its shares of common stock in a manner sufficient to cause the election of such nominee, in each case for so long (subject to earlier termination in certain circumstances) as shares of common stock owned by Carboex represent at least 63% of the shares of common stock acquired by Carboex in the Company's merger with Ashland's subsidiary, Ashland Coal, Inc. In addition, for so long as the various trusts for the benefit of descendants of H.L. and Lyda Hunt and various corporations owned by trusts for the benefit of descendants of H.L. and Lyda Hunt (collectively the "Hunt Entities") have the collective voting power to elect by cumulative voting one or more persons to serve on the Board of Directors of the Company, the Company has agreed to nominate for election as directors of the Company that number of persons designated by certain of the Hunt Entities that could be elected to the Board by the Hunt Entities by exercise of such cumulative voting power.

The Company's Restated Certificate of Incorporation requires the affirmative vote of the holders of at least two-thirds of outstanding common stock voting thereon to approve a merger or consolidation and certain other fundamental actions involving or affecting control of the Company. The Company's Bylaws require the affirmative vote of at least two-thirds of the members of the Board of Directors of the Company in order to declare dividends and to authorize certain other actions.

Transportation

The coal industry depends on rail, trucking and barge transportation to deliver shipments of coal to customers. Disruption of these transportation services could temporarily impair the Company's ability to supply coal to its customers and thus adversely affect the Company's business and operating results. In addition, transportation costs are a significant component of the total cost of supplying coal to customers and can significantly affect a coal producer's competitive position and profitability. Increases in the Company's transportation costs, or changes in such costs relative to transportation costs incurred by providers of competing coal or of other fuels, could have an adverse effect on the Company's business and results of operations.

Importance of Acquisitions and Related Risks

The Company has grown, in part, through the acquisition of coal companies, coal properties, coal leases and related assets, and management believes that such acquisitions will continue to be important to the Company. Acquisitions involve a number of special risks, including diversion of management's attention, failure to retain key acquired personnel, risks associated with unanticipated events or liabilities and difficulties in the assimilation of the operations of the acquired companies, some or all of which could have a material adverse effect on the Company's business, results of operations and financial condition. There can be no assurance that the Company will be successful in the development of such acquisitions or that acquired operations will achieve anticipated benefits to the Company.

Reliance on Estimates of Reserves; Title

There are numerous uncertainties inherent in estimating quantities of recoverable reserves, including many factors beyond the control of the Company. Estimates of economically recoverable coal reserves and net cash flows necessarily depend upon the number of variable factors and assumptions, such as geological and mining conditions (which may not be fully identified by available exploration data and/or differ from experience in current operations), historical production from the area compared with production from other producing areas, the assumed effects of regulation by governmental agencies and assumptions concerning coal prices, operating costs, severance and excise taxes, development costs and reclamation costs, all of which may cause estimates to vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities attributable to any particular group of properties, classifications of such reserves based on risk of recovery and estimates of net cash flows expected therefrom prepared by different engineers or by the same engineers at different times may vary substantially. Actual coal tonnage recovered from identified reserve areas or properties and revenues and expenditures with respect to the Company's reserves may vary from estimates, and such variances may be material. No assurance can be given that these estimates are an accurate reflection of the Company's actual reserves.

The Company's mining operations are conducted on properties owned or leased by the Company. The loss of any lease could adversely affect the Company's ability to develop the applicable reserves. Because title to most of the Company's leased properties and mineral rights is not usually verified until a commitment is made by the Company to develop a property, which may not occur until after the Company has obtained necessary permits and completed exploration of the property, the Company's right to mine certain of its reserves may be adversely affected if defects in title or boundaries exist. In addition, there can be no assurance that the Company can successfully negotiate new leases or mining contracts for properties containing additional reserves or maintain its leasehold interests in properties on which mining operations are not commenced during the term of the lease.

Year 2000 Readiness Disclosure

Computer programs used by the Company for financial and operational purposes are being reprogrammed to be "Year 2000" compliant. The "Year 2000 problem" exists because many existing computer programs and embedded chip microprocessors were programmed to read the "00" in a year 2000 entry as 1900 or will fail to recognize "00" as a date at all. Failure to read the date properly or at all may cause miscalculations or may simply cause the program or microprocessor to send errant commands or cease functioning.

Assessment/Remediation Plan. The Company began its assessment of its exposure to the Year 2000 problem prior to the Company's merger with Ashland Coal, Inc. in June 1997 when, in connection with the necessary integration of the two companies' information services technology, a comprehensive plan for achieving an internal information services system free of Year 2000 concerns was adopted. Implementation of this plan commenced upon consummation of the merger and essentially required company-wide replacement of key financial, informational and operational computer systems with standardized equipment and programs that were programmed to properly process Year 2000 entries. The plan for standardizing key internal systems was modified to incorporate the key internal information systems acquired in the Arch Western transaction.

In April 1998, the Company implemented the first phase of its Year 2000 plan by installing a new Oracle General Ledger running on Year 2000-compliant HP 9000 servers and operating systems. In October 1998, the Company implemented Oracle's Human Resource System, and on November 1, 1999, the Company completed the rollout of a new Oracle Payroll System to its individual mines. On November 1, 1999, the Company also completed the rollout of Mincom Inc. systems to replace non-compliant inventory and accounts payable systems. The Company has replaced or upgraded all non-compliant desktop computers connected to its local and wide area networks. All NT servers have been upgraded to Microsoft's Service Pack 5.

In late 1997, the Company began the process of evaluating potential Year 2000 problems within its mining and processing equipment and within its systems and processes interfacing with, and hence dependent upon, third party systems. The effort to identify potential Year 2000 problems within the Company's mining and processing equipment and in its interfaces with third parties has been completed. The Company has contacted key customers, financial institutions, vendors, manufacturers, transportation companies and others with which the Company conducts business which, if interrupted, could have a material adverse effect on the Company, and the Company plans to make cost-effective efforts to remediate or minimize possible Year 2000 problems.

Assuming the cooperation of third parties in connection with the Company's Year 2000 efforts, the Company believes that it will be able to complete its remediation of Year 2000 problems within its mining and processing equipment and within such third party systems and processes sufficiently in advance of January 1, 2000, where such measures are possible and cost-effective. The Company continues such remediation of its mining and processing equipment and expects to complete the remediation by the end of November 1999.

Costs of Plan. To date, the Company has expended approximately \$9.7 million of the total estimated \$10.5 million required to eliminate Year 2000 concerns within the Company's internal information systems. The cost of the project is based on management's best estimates, and there can be no assurance that these estimates will be achieved.

Year 2000 Risk. The risks posed to the Company by the Year 2000 problems are difficult to quantify with certainty. The Company's Year 2000 plan for reconfiguring and standardizing internal information systems to properly process Year 2000 information depends upon several factors beyond the Company's immediate control. These factors include, for example, retention of qualified information services personnel in a highly competitive labor market and integrity of local and long distance carriers' Year 2000 telecommunication networks, which will be necessary for operation of the Company's wide area network. The Company has successfully completed the Year 2000 testing of its MIMS, Billing, and Canyon Fuel accounting systems. Year 2000 validations testing for the remaining core systems is scheduled for November 1999. The Company does not believe that there is a significant risk that these systems will fail to function properly in the Year 2000.

The unavailability of the Company's internal information systems for a sustained period would have an adverse effect

on the Company. Depending upon the nature of the unavailability of the Company's internal information systems, the adverse effect on the Company could be material.

With respect to the Company's mining and processing equipment, the Company believes the greatest risk posed is the possibility that any of its multitude of sampling, processing and loading equipment at its mines, loadouts and terminals would cease to function as a result of a processing error not identified and/or corrected in the Company's assessment and remediation plan. Such failures could result in breaches in or defaults under the Company's coal sales contracts (some of which contain prices substantially above current market). Termination of certain or multiple coal sales contracts could have an adverse effect on the Company, and depending on the contracts involved, the adverse effect on the Company could be material.

Finally, the Company believes the greatest Year 2000 risks are posed by the Company's interfaces with third party services, systems and processes. Chief among these risks is the loss of electrical power or transportation services at mine sites where the Company is captive to a single service provider and alternatives are unavailable or economically impractical. Loss of service from any of these single service providers would have an adverse effect on the Company. Depending upon the nature of the loss of service, the adverse effect on the Company could be material.

Contingency Plans. The Company has successfully implemented new core systems at all its facilities eliminating the need to invoke the contingency plans designed to provide alternative methods of paying and creating invoices and creating payroll checks for its corporate and operating facilities. Should significant unforeseen Year 2000 problems occur at a mining facility, key personnel from a facility can be relocated to other mining facilities. Other alternatives are to bring or send their data to the St. Louis corporate offices for processing. The Company's new MIMS system allows for global searches of inventory parts across multiple warehouses for the eastern mines should a local supplier be unable to provide the required parts. Additionally, central purchasing has developed plans to obtain supplies from multiple sources should a major vendor be unable to supply the required goods and services.

The Company will continue to monitor the Year 2000 status of its key service providers and customers for their Year 2000 compliance. Any information that may change their Year 2000 status will be assessed and appropriate action taken where cost-effective alternatives are available. As a precautionary measure, the Company has eliminated staff vacations for its Information Services Department during the latter part of December 1999 and early part of January 2000. All production systems will be tested over the weekend of January 1, 2000. Many of the corporate and mining functional staff will also work on January 1 to validate that the production systems are processing correctly. Hotlines have been established by Oracle and Mincom to address Year 2000 problems should they occur over this same time period.

Factors Routinely Affecting Results of Operations

Any one or a combination of the following factors may occur at times or in a manner that causes results of the Company's operations to deviate from expectations: changing demand; fluctuating selling prices; contract penalties, suspensions or terminations; operational, geologic, transportation and weather-related factors; unexpected regulatory changes; results of litigation; or labor disruptions. Any event disrupting substantially all production at any of the Company's principal mines for a prolonged period would have a material adverse effect on the Company's current and projected results of operations. The effect of such a disruption at the Mingo Logan operations would be particularly severe because of the high volume of coal produced by those operations and the relatively high contribution to operating income from the sale of such coal.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this Item is contained under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report and is incorporated herein by reference.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information required by this Item is contained in the second through fourteenth paragraphs of the "Contingencies - Legal Contingencies" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report and is incorporated herein by reference.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a)

- 2.1 Purchase and Sale Agreement dated as of March 22, 1998 among Atlantic Richfield Company, ARCO Uinta Coal Company, Arch Coal, Inc. and Arch Western Acquisition Corporation (incorporated herein by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K filed June 15, 1998)
- 2.2 Contribution Agreement among Arch Coal, Inc., Arch Western Acquisition Corporation, Atlantic Richfield Company, Delta Housing, Inc., and Arch Western Resources LLC, dated as of March 22, 1998 (incorporated herein by reference to Exhibit 2.2 of the Company's Current Report on Form 8-K filed June 15, 1998)
- 3.1 Restated Certificate of Incorporation of Arch Coal, Inc. (incorporated herein by reference to Exhibit 3.2 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 3.2 Restated and Amended Bylaws of Arch Coal, Inc. (incorporated herein by reference to Exhibit 3.4 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 4.1 Stockholders Agreement, dated as of April 4, 1997, among Carboex International, Ltd., Ashland Inc. and Arch Coal, Inc. (formerly Arch Mineral Corporation) (incorporated herein by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 4.2 Assignment of Rights, Obligations and Liabilities under the Stockholders Agreement between Carboex International, Limited and Carboex, S.A. effective as of October 15, 1998 (incorporated herein by reference to Exhibit 4.2 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1998)
- 4.3 Registration Rights Agreement, dated as of April 4, 1997, among Arch Coal, Inc. (formerly Arch Mineral Corporation), Ashland Inc., Carboex International, Ltd. and the entities listed on Schedules I and II thereto (incorporated herein by reference to Exhibit 4.2 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997, except for amended Schedule I thereto, incorporated herein by reference to Exhibit 4.2 of the Company's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1998)
- 4.4 Assignment of Registration Rights between Carboex International, Limited and Carboex, S.A. effective as of October 15, 1998 (incorporated herein by reference to Exhibit 4.4 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1998)
- 4.5 Agreement Relating to Nonvoting Observer, executed as of April 4, 1997, among Carboex International, Ltd., Ashland Inc., Ashland Coal, Inc. and Arch Coal, Inc. (formerly Arch Mineral Corporation) (incorporated herein by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 4.6 Assignment of Right to Maintain a Non-Voting Observer at Meetings of the Board of Directors of Arch Coal, Inc. between Carboex International, Limited and Carboex, S.A. effective as of October 15, 1998

(incorporated herein by reference to Exhibit 4.6 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1998)

- 4.7 Agreement for Termination of the Arch Mineral Corporation Voting Agreement and for Nomination of Directors, dated as of April 4, 1997, among Hunt Coal Corporation, Petro-Hunt Corporation, each of the trusts listed on Schedule I thereto, Ashland Inc. and Arch Mineral Corporation (incorporated herein by reference to Exhibit 4.4 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
 - 4.8 \$600,000,000 Revolving Credit Facility, \$300,000,000 Term Loan Credit Agreement by and among Arch Coal, Inc., the Lenders party thereto, PNC Bank, National Association, as Administrative Agent, Morgan Guaranty Trust Company of New York, as Syndication Agent, and First Union National Bank, as Documentation Agent, dated as of June 1, 1998 (incorporated herein by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K filed June 15, 1998)
 - 4.9 \$675,000,000 Term Loan Credit Agreement by and among Arch Western Resources LLC, the Banks party thereto, PNC Bank, National Association, as Administrative Agent, Morgan Guaranty Trust Company of New York, as Syndication Agent, and NationsBank N.A., as Documentation Agent dated as of June 1, 1998 (incorporated herein by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed June 15, 1998)
 - 4.10 Omnibus Amendment Agreement dated as of June 1, 1998 in respect to Arch Coal Trust no. 1998-1, Parent Guaranty and Suretyship Agreement, Lease Intended as Security, Subsidiary Guaranty and Suretyship Agreement, each dated as of January 15, 1998, among Apogee Coal Company, Catenary Coal Company, Hobet Mining, Inc., Arch Coal, Inc., Great-West Life & Annuity Insurance Company, Bank of Montreal, Barclays Bank, PLC, First Union National Bank, BA Leasing and Capital Corporation, First Security Bank, National Association, Arch Coal Sales Company, Inc., Ark Land Company and Mingo Logan Coal Company (incorporated herein by reference to Exhibit 4.3 of the Company's Current Report on Form 8-K filed June 15, 1998)
 - 4.11 Lease Intended as Security dated as of January 15, 1998, among Apogee Coal Company, Catenary Coal Company and Hobet Mining, Inc., as Lessees; The First Security Bank, National Association, as Lessor, and the Certificate Purchasers named therein. (incorporated herein by reference to Exhibit 4.5 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1997)
 - 10 Federal Coal Lease dated as of October 1, 1999 between the United States Department of the Interior and Canyon Fuel Company, LLC (filed herewith)
 - 18 Preferability Letter of Ernst & Young LLP dated May 11, 1999 (incorporated herein by reference to Exhibit 18 of the Company's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 1999)
 - 27 Financial Data Schedule
- (b) Reports on Form 8-K

A report on Form 8-K dated October 7, 1999 (confirming (i) the Company's receipt of a proposal from Ashland Inc. that contemplates a tax-free spin-off of Ashland's interest in the Company and (ii) that a special committee of the Company's Board of Directors is in discussions with Ashland concerning such proposal) was filed during the period covered by this report and up to and including the date of filing of this report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARCH COAL, INC.
(Registrant)

Date: November 14, 1999

/s/ John W. Lorson

John W. Lorson
Controller
(Chief Accounting Officer)

Date: November 14, 1999

/s/ Jeffry N. Quinn

Jeffry N. Quinn
Senior Vice President,
General Counsel and Secretary
(Duly Authorized Officer)

INDEX TO EXHIBITS

- 2.1 Purchase and Sale Agreement dated as of March 22, 1998 among Atlantic Richfield Company, ARCO Uinta Coal Company, Arch Coal, Inc. and Arch Western Acquisition Corporation (incorporated herein by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K filed June 15, 1998)
- 2.2 Contribution Agreement among Arch Coal, Inc., Arch Western Acquisition Corporation, Atlantic Richfield Company, Delta Housing, Inc., and Arch Western Resources LLC, dated as of March 22, 1998 (incorporated herein by reference to Exhibit 2.2 of the Company's Current Report on Form 8-K filed June 15, 1998)
- 3.1 Restated Certificate of Incorporation of Arch Coal, Inc. (incorporated herein by reference to Exhibit 3.2 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 3.2 Restated and Amended Bylaws of Arch Coal, Inc. (incorporated herein by reference to Exhibit 3.4 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 4.1 Stockholders Agreement, dated as of April 4, 1997, among Carboex International, Ltd., Ashland Inc. and Arch Coal, Inc. (formerly Arch Mineral Corporation) (incorporated herein by reference to Exhibit 4.1 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 4.2 Assignment of Rights, Obligations and Liabilities under the Stockholders Agreement between Carboex International, Limited and Carboex, S.A. effective as of October 15, 1998 (incorporated herein by reference to Exhibit 4.2 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1998)
- 4.3 Registration Rights Agreement, dated as of April 4, 1997, among Arch Coal, Inc. (formerly Arch Mineral Corporation), Ashland Inc., Carboex International, Ltd. and the entities listed on Schedules I and II thereto (incorporated herein by reference to Exhibit 4.2 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997, except for amended Schedule I thereto, incorporated herein by reference to Exhibit 4.2 of the Company's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1998)
- 4.4 Assignment of Registration Rights between Carboex International, Limited and Carboex, S.A. effective as of October 15, 1998 (incorporated herein by reference to Exhibit 4.4 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1998)
- 4.5 Agreement Relating to Nonvoting Observer, executed as of April 4, 1997, among Carboex International, Ltd., Ashland Inc., Ashland Coal, Inc. and Arch Coal, Inc. (formerly Arch Mineral Corporation) (incorporated herein by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)
- 4.6 Assignment of Right to Maintain a Non-Voting Observer at Meetings of the Board of Directors of Arch Coal, Inc. between Carboex International, Limited and Carboex, S.A. effective as of October 15, 1998 (incorporated herein by reference to Exhibit 4.6 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1998)
- 4.7 Agreement for Termination of the Arch Mineral Corporation Voting Agreement and for Nomination of Directors, dated as of April 4, 1997, among Hunt Coal Corporation, Petro-Hunt Corporation, each of the trusts listed on Schedule I thereto, Ashland Inc. and Arch Mineral Corporation (incorporated herein by reference to Exhibit 4.4

of the Company's Registration Statement on Form S-4 (Registration No. 333-28149) filed on May 30, 1997)

- 4.8 \$600,000,000 Revolving Credit Facility, \$300,000,000 Term Loan Credit Agreement by and among Arch Coal, Inc., the Lenders party thereto, PNC Bank, National Association, as Administrative Agent, Morgan Guaranty Trust Company of New York, as Syndication Agent, and First Union National Bank, as Documentation Agent, dated as of June 1, 1998 (incorporated herein by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K filed June 15, 1998)
- 4.9 \$675,000,000 Term Loan Credit Agreement by and among Arch Western Resources LLC, the Banks party thereto, PNC Bank, National Association, as Administrative Agent, Morgan Guaranty Trust Company of New York, as Syndication Agent, and NationsBank N.A., as Documentation Agent dated as of June 1, 1998 (incorporated herein by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed June 15, 1998)
- 4.10 Omnibus Amendment Agreement dated as of June 1, 1998 in respect to Arch Coal Trust no. 1998-1, Parent Guaranty and Suretyship Agreement, Lease Intended as Security, Subsidiary Guaranty and Suretyship Agreement, each dated as of January 15, 1998, among Apogee Coal Company, Catenary Coal Company, Hobet Mining, Inc., Arch Coal, Inc., Great-West Life & Annuity Insurance Company, Bank of Montreal, Barclays Bank, PLC, First Union National Bank, BA Leasing and Capital Corporation, First Security Bank, National Association, Arch Coal Sales Company, Inc., Ark Land Company and Mingo Logan Coal Company (incorporated herein by reference to Exhibit 4.3 of the Company's Current Report on Form 8-K filed June 15, 1998)
- 4.11 Lease Intended as Security dated as of January 15, 1998, among Apogee Coal Company, Catenary Coal Company and Hobet Mining, Inc., as Lessees; The First Security Bank, National Association, as Lessor, and the Certificate Purchasers named therein. (incorporated herein by reference to Exhibit 4.5 of the Company's Annual Report on Form 10-K for the Year Ended December 31, 1997)
- 10 Federal Coal Lease dated as of October 1, 1999 between the United States Department of the Interior and Canyon Fuel Company, LLC (filed herewith)
- 18 Preferability Letter of Ernst & Young LLP dated May 11, 1999 (incorporated herein by reference to Exhibit 18 of the Company's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 1999)
- 27 Financial Data Schedule

EXHIBIT 10

Form 3400-12
(April 1986)

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

Serial Number
UTU-76195

COAL LEASE

PART I: LEASE RIGHTS GRANTED

This lease, entered into by and between the United States of America, hereinafter called the lessor, through the Bureau of Land Management, and (Name and Address)

Canyon Fuel Company, LLC
6955 S. Union Park Center, Suite 540
Midvale, UT 84047

hereinafter called the lessee, is effective (date) OCT 1 1999, for a period of 20 years and for so long thereafter as coal is produced in commercial quantities from the leased lands, subject to readjustment of lease terms at the end of the 20th lease year and each 10-year period thereafter.

Sec. 1. This lease issued pursuant and subject to the terms and provisions of the:

[X] Mineral Lands Leasing Act of 1920, Act of February 25, 1920, as amended, 41 Stat. 437, 30 U.S.C. 181-287, hereinafter referred to as the Act;

[] Mineral Leasing Act for Acquired Lands, Act of August 7, 1947, 61 Stat. 913, 30 U.S.C. 351-359;

and to the regulations and formal orders of the Secretary of the Interior which are now or hereafter in force, when not inconsistent with the express and specific provisions herein.

Sec. 2. Lessor, in consideration of any bonuses, rents and royalties to be paid, and the conditions and covenants to be observed as herein set forth, hereby grants and leases to lessee the exclusive right and privilege to drill for, mine, extract, remove or otherwise process and dispose of the coal deposits in, upon, or under the following described lands:

T. 20 S., R. 5 E., SLM, Utah
Sec. 35, S2NE, SENW, NESW, S2SW, SE;
Sec. 36, W2SW, SESW.

T. 21 S., R. 5 E., SLM, Utah
Sec. 1, lots 3,4, S2SW, SWSE;
Sec. 2, lots 1-4, S2S2;
Sec. 10, E2;
Sec. 11, all;
Sec. 12, all;
Sec. 13, all;
Sec. 14, all;
Sec. 15, E2;
Sec. 22, E2;
Sec. 23, all;
Sec. 24, all;
Sec. 25, N2, N2S2;
Sec. 26, N2, NESW, E2NWSW, SE.

T. 21 S., R. 6 E., SLM, Utah
Sec. 19, lots 3,4, E2SW;
Sec. 30, lots 1-3, E2NW, NESW.

containing 7,171.66 acres, more or less, together with the right to construct such works, buildings, plants, structures, equipment and appliances and the right to use such on-lease rights-of-way which may be necessary and convenient in the exercise of the rights and privileges granted, subject to the conditions herein provided.

PART II. TERMS AND CONDITIONS

Sec. 1. (a) RENTAL RATE - Lessee shall pay lessor rental annually and in advance for each acre or fraction thereof during the continuance of the lease at the rate of \$3.00/acre for each lease year.

(b) RENTAL CREDITS - Rental shall not be credited against either production or advance royalties for any year.

Sec. 2 (a) PRODUCTION ROYALTIES - The royalty shall be 8 per cent of the value of the coal as set forth in the regulations. Royalties are due to lessor the

final day of the month succeeding the calendar month in which the royalty obligation accrues.

(b) ADVANCE ROYALTIES - Upon request by the lessee, the authorized officer may accept, for a total of not more than 10 years, the payment of advance royalties in lieu of continued operation, consistent with the regulations. The advance royalty shall be based on a percent of the value of a minimum number of tons determined in the manner established by the advance royalty regulations in effect at the time the lessee requests approval to pay advance royalties in lieu of continued operation.

Sec. 3. BONDS - Lessee shall maintain in the proper office a lease bond in the amount of \$13,686,000. The authorized officer may require an increase in this amount when additional coverage is determined appropriate.

Sec. 4. DILIGENCE - This lease is subject to the conditions of diligent development and continued operation, except that these conditions are excused when operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the lessee. The lessor, in the public interest, may suspend the condition of continued operation upon payment of advance royalties in accordance with the regulations in existence at the time of the suspension. Lessee's failure to produce coal in commercial quantities at the end of 10 years shall terminate the lease. Lessee shall submit an operation and reclamation plan pursuant to Section 7 of the Act not later than 3 years after lease issuance.

The lessor reserves the power to assent to or under the suspension of the terms and conditions of this lease in accordance with, inter alia, Section 39 of the Mineral Leasing Act, 30 U.S.C. 209.

Sec. 5. LOGICAL MINING UNIT (LMU) - Either upon approval by the lessor of the lessee's application or at the direction of the lessor, this lease shall become an LMU or part of an LMU, subject to the provisions set forth in the regulations.

The stipulation established in an LMU approval in effect at the time of LMU approval will supersede the relevant inconsistent terms of this lease so long as the lease remains committed to the LMU. If the LMU of which this lease is a part is dissolved, the lease shall then be subject to the lease terms which would have been applied if the lease had not been included in an LMU.

Sec. 6. DOCUMENTS, EVIDENCE AND INSPECTION - At such times and in such form as lessor may prescribe, lessee shall furnish detailed statements showing the amounts and quality of all products removed and sold from the lease, the proceeds therefrom, and the amount used for production purposes or unavoidably lost.

Lessee shall keep open at all reasonable times for the inspection of any duly authorized officer of lessor, the leased premises and all surface and underground improvements, works, machinery, ore stockpiles, equipment, and all books, accounts, maps, and records relative to operations, surveys, or investigations on or under the leased lands.

Lessee shall allow lessor access to and copying of documents reasonably necessary to verify lessee compliance with terms and conditions of the lease.

While this lease remains in effect, information obtained under this section shall be closed to inspection by the public in accordance with the Freedom of Information Act (5 U.S.C. 552).

Sec. 7. DAMAGES TO PROPERTY AND CONDUCT OF OPERATIONS - Lessee shall comply at its own expense with all reasonable orders of the Secretary, respecting diligent operations, prevention of waste, and protection of other resources.

Lessee shall not conduct exploration operations, other than casual use, without an approved exploration plan. All exploration plans prior to the commencement of mining operations within an approved mining permit area shall be submitted to the authorized officer.

Lessee shall carry on all operations in accordance with approved methods and practices as provided in the operating regulations, having due regard for the prevention of injury to life, health, or property, and prevention of waste, damage, or degradation to any land, air, water, cultural, biological, visual, and other resources, including mineral deposits and formations of mineral deposits not leased hereunder, and to other land uses or users. Lessee shall take measures deemed necessary by lessor to accomplish the intent of this lease term. Such measures may include, but are not limited to, modification to proposed siting or design of facilities, timing of operations, and specification of interim and final reclamation procedures. Lessor reserves to itself the right to lease, sell or otherwise dispose of the surface or other mineral deposits in the lands and the right to continue existing uses and to authorized future uses upon or in the leased lands, including issuing leases for mineral deposits not covered hereunder and approving easements or rights-of-way. Lessor shall condition such uses to prevent unnecessary or unreasonable interference with rights of lessee as may be consistent with concepts of multiple use and multiple mineral development.

Sec. 8. PROTECTION OF DIVERSE INTERESTS, AND EQUAL OPPORTUNITY - Lessee shall: pay when due all taxes legally assessed and levied under the laws of the State or the United States; accord all employees complete freedom of purchase; pay all wages at least twice each month in lawful money of the United States; maintain a safe working environment in accordance with standard industry practices; restrict the workday to not more than 8 hours in any one day for underground workers, except in emergencies; and take measures necessary to protect the health and safety of the public. No person under the age of 16 years shall be employed in any mine below the surface. To the extent that laws of the State in which the lands are situated are more restrictive than the provisions in the paragraph, then the State laws apply.

Lessee will comply with all provisions of Executive Order No. 11246 of September 24, 1965, as amended, and the rules, regulations, and relevant orders of the Secretary of Labor. Neither lessee nor lessee's subcontractors shall maintain segregated facilities.

Sec. 9. (a) TRANSFERS

This lease may be transferred in whole or in part to any person, association or corporation qualified to hold such lease interest.

This lease may be transferred in whole or in part to another public body, or to a person who will mine the coal on behalf of, and for the use of, the public body or to a person who for the limited purpose of creating a security interest in favor of a lender agrees to be obligated to mine the coal on behalf of the public body.

This lease may only be transferred in whole or in part to another small business qualified under 13 CFR 121.

Transfers of record title, working or royalty interest MUST be approved in accordance with the regulations.

(b) RELINQUISHMENT - The lessee may relinquish in writing at any time all rights under this lease or any portion thereof as provided in the regulations. Upon lessor's acceptance of the relinquishment, lessee shall be relieved of all future obligations under the lease or the relinquished portion thereof, whichever is applicable.

Sec. 10. DELIVERY OF PREMISES, REMOVAL OF MACHINERY, EQUIPMENT, ETC. - At such time as all portions of this lease are returned to lessor, lessee shall deliver up to lessor the land leased, underground timbering, and such other supports and structures necessary for the preservation of the mine workings on the leased premises or deposits and place all workings in condition for suspension or abandonment. Within 180 days thereof, lessee shall remove from the premises all other structures, machinery, equipment, tools, and materials that it elects to or as required by the authorized officer. Any such structures, machinery, equipment, tools and materials remaining on the leased lands beyond 180 days or approved extension thereof, shall become the property of the lessor, but lessee shall either remove any or all such property or shall continue to be liable for the cost of removal and disposal in the amount actually incurred by the lessor. If the surface is owned by third parties, lessor shall waive the requirement for removal, provided the third parties do not object to such waiver. Lessee shall, prior to the termination of bond liability or at any other time when required and in accordance with all applicable laws and regulations, reclaim all lands the surface of which has been disturbed, dispose of all debris or solid waste, repair the offsite and onsite damage caused by lessee's activity or activities incidental thereto, and reclaim access roads or trails.

Sec. 11. PROCEEDINGS IN CASE OF DEFAULT - If lessee fails to comply with applicable laws, existing regulations, or the terms, conditions and stipulations of this lease, and the noncompliance continues for 30 days after written notice thereof, this lease shall be subject to cancellation by the lessor only by judicial proceedings. This provision shall not be construed to prevent the exercise by lessor of any other legal and equitable remedy, including waiver of the default. Any such remedy or waiver shall not prevent later cancellation for the same default occurring at any other time.

Sec. 12. HEIRS AND SUCCESSORS-IN-INTEREST - Each obligation of this lease shall extend to and be binding upon, and every benefit hereof shall inure to, the heirs, executors, administrators, successors, or assigns of the respective parties hereto.

Sec. 13. INDEMNIFICATION - Lessee shall indemnify and hold harmless the United States from any and all claims arising out of the lessee's activities and operations under this lease.

Sec. 14. SPECIAL STATUTES - This lease is subject to the Clean Water Act (33 U.S.C. 1252 et. seq.), the Clean Air Act (42 U.S.C. 4274 et. seq.), and to all other applicable laws pertaining to exploration activities, mining operations and reclamation, including the Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1201 et. seq.).

SEC. 15. SPECIAL STIPULATIONS -

This coal lease is subject to termination if the lessee is determined at the time of issuance to be in noncompliance with Section 2(a)2(A) of the Mineral Leasing Act.

SEC. 15. SPECIAL STIPULATIONS (Cont'd.)-

SEE ATTACHED STIPULATIONS

----- Canyon Fuel Company, LLC ----- Company or Lessee Name	The United States of America By Bureau of Land Management -----
/s/ Jeffry N. Quinn ----- (Signature of Lessee)	/s/ Christopher J. Merritt ----- (Signing Officer)
Vice President and Secretary ----- (Title)	Acting Branch Chief, Minerals Adjudication ----- (Title)
July 1, 1999 ----- (Date)	September 1, 1999 ----- (Date)

=====
Title 18 U.S.C. Section 1001, makes it a crime for any person knowingly and willfully to make to any department or agency of the United States any false, fictitious or fraudulent statements or representations as to any matter within its jurisdiction.
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This form does not constitute an information collection as defined by 44 U.S.C. 3502 and therefore does not require OMB approval.
=====

Special Coal Lease Stipulations
Pines Tract
UTU-76195

Federal Regulations 43 CFR 3400 pertaining to Coal Management make provisions for the Surface Management Agency, the surface of which is under the jurisdiction of any Federal Agency other than the Department of the Interior, to consent to leasing and to prescribe conditions to insure the use and protection of the lands. All or part of this lease contain lands the surface of which are managed by the United States Department of Agriculture, Forest Service-Manti-LaSal National Forest.

The following stipulations pertain to the Lessee responsibility for mining operations on the lease area and on adjacent areas as may be specifically designated on National Forest System Lands.

Stipulation #1.

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Before undertaking activities that may disturb the surface of previously undisturbed leased lands, the Lessee may be required to conduct a cultural resource inventory and a paleontological appraisal of the areas to be disturbed. These studies shall be conducted by qualified professional cultural resource specialists or qualified paleontologists, as appropriate, and a report prepared itemizing the findings. A plan will then be submitted making recommendations for the protection of, or measures to be taken to mitigate impacts for identified cultural or paleontological resources.

If cultural resources or paleontological remains (fossils) of significant scientific interest are discovered during operations under this lease, the Lessee prior to disturbance shall immediately bring them to the attention of the appropriate authority. Paleontological remains of significant scientific interest do not include leaves, ferns or dinosaur tracks commonly encountered during underground mining operations.

The cost of conducting the inventory, preparing reports, and carrying out mitigating measures shall be borne by the Lessee.

Stipulation #2.

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If there is reason to believe that Threatened or Endangered (T&E) species of plants or animals, or migratory bird species of high Federal interest occur in the area, the Lessee shall be required to conduct an intensive field inventory of the area to be disturbed and/or impacted. The inventory shall be conducted by a qualified specialist and a report of findings will be prepared. A plan will be prepared making recommendations for the protection of these species or action necessary to mitigate the disturbance.

The cost of conducting the inventory, preparing reports and carrying out mitigating measures shall be borne by the Lessee.

Stipulation #3.

- - - - -

The Lessee shall be required to perform a study to secure adequate baseline data to quantify the existing surface resources on and adjacent to the lease area. Existing data may be used if such data are adequate for the intended purposes. The study shall be adequate to locate, quantify, and demonstrate the interrelationship of the geology, topography, surface and groundwater hydrology, vegetation and wildlife. Baseline data will be established so that future programs of observation can be incorporated at regular intervals for comparison.

Stipulation #4.

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Powerlines used in conjunction with the mining of coal from this lease shall be constructed so as to provide adequate protection for raptors and other large birds. When feasible, powerlines will be located at least 100 yards from public roads.

Stipulation #5.

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The limited area available for mine facilities at the coal outcrop, steep topography, adverse winter weather, and physical limitations on the size and design of access roads, are factors which will determine the ultimate size of the surface area utilized for the mine. A site-specific environmental analysis will be prepared for each new mine site development and for major improvements to existing developments to examine alternatives and mitigate conflicts.

Stipulation #6.

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Consideration will be given to site selection to reduce adverse visual impacts. Where alternative sites are available, and each alternative is technically feasible, the alternative involving the least damage to the scenery and other resources shall be selected. Permanent structures and facilities will be designed, and screening techniques employed to reduce visual impacts, and where possible, achieve a final landscape compatible with the natural surroundings. The creation of unusual, objectionable, or unnatural landforms and vegetative landscape features will be avoided.

Stipulation #7.

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The Lessee shall be required to establish a monitoring system to locate, measure and quantify the progressive and final effects of underground mining activities on the topographic surface, underground and surface hydrology and vegetation. The monitoring system shall utilize techniques which will provide a continuing record of change over time and an analytical method and measurement of a number of points over the lease area. The monitoring shall incorporate and be an extension of the baseline data.

Stipulation #8.

- - - - -

The Lessee shall provide for the suppression and control of fugitive dust on haul roads and at coal handling and storage facilities. On Forest Development Roads (FDR), Lessees may perform their share of road maintenance by a commensurate share agreement if a significant degree of traffic is generated that is not related to their activities.

Stipulation #9.

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Except at specifically approved locations, underground mining operations shall be conducted in such a manner so as to prevent surface subsidence that would: (1) cause the creation of hazardous conditions such as potential escarpment failure and landslides, (2) cause damage to existing surface structures, and (3) damage or alter the flow of perennial streams. The Lessee shall provide specific measures for the protection of escarpments, and determine corrective measures to assure that hazardous conditions are not created.

Stipulation #10.

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In order to avoid surface disturbance on steep canyon slopes and to preclude the need for surface access, all surface breakouts for ventilation tunnels shall be constructed from inside the mine, except at specific approved locations.

Stipulation #11.

- - - - -

If removal of timber is required for clearing of construction sites, etc., such timber shall be removed in accordance with the regulations of the surface management agency.

Stipulation #12.

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The coal contained within, and authorized for mining under this lease shall be extracted only by underground mining methods.

Stipulation #13.

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Existing Forest Service owned or permitted surface improvements will need to be protected, restored, or replaced to provide for the continuance of current land uses.

Stipulation #14.

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In order to protect big-game wintering areas, elk calving and deer fawning areas, sage grouse strutting areas, and other key wildlife habitat and/or activities, specific surface uses outside the mine development area may be curtailed during specified periods of the year.

Stipulation #15.

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Support facilities, structures, equipment, and similar developments will be removed from the lease area within two years after the final termination of use of such facilities. This provision shall apply unless the requirement of Section 10 of the lease forms is applicable. Disturbed areas and those areas previously occupied by such facilities will be stabilized and rehabilitated, drainages reestablished, and the areas returned to a pre-mining use.

Stipulation #16.

The Lessee, at the conclusion of the mining operation, or at other times as surface disturbance related to mining may occur, will replace all damaged, disturbed or displaced corner monuments (section corners, 1/4 corners etc.), their accessories and appendages (witness trees, bearing trees, etc.), or restore them to their original condition and location, or at other locations that meet requirements of the rectangular surveying system. This work shall be conducted at the expense of the Lessee, by a professional land surveyor registered in the State of Utah, and to the standards and guidelines found in the Manual of Surveying Instructions, United States Department of the Interior.

Stipulation #17.

The Lessees, at their expense, will be responsible to replace any surface water and/or developed ground-water source identified for protection, that may be lost or adversely affected by mining operations, with water from an alternate source in sufficient quantity and quality to maintain existing riparian habitat, fishery habitat, livestock and wildlife use, or other land uses (authorized by 36 CFR 251).

Stipulation #18.

STIPULATION FOR LANDS OF THE NATIONAL FOREST SYSTEM
UNDER JURISDICTION OF
THE DEPARTMENT OF AGRICULTURE

The licensee/permitee/lessee must comply with all the rules and regulations of the Secretary of Agriculture set forth at Title 36, Chapter II, of the Code of Federal Regulations governing the use and management of the National Forest System (NFS) when not inconsistent with the rights granted by the Secretary of the Interior in the license/permit/lease. The Secretary of Agriculture's rules and regulations must be complied with for (1) all use and occupancy of the NFS prior to approval of a permit/operation plan by the Secretary of the Interior, (2) uses of all existing improvements, such as Forest Development Roads, within and outside the area licensed, permitted or leased by the Secretary of the Interior, and (3) use and occupancy of the NFS not authorized by a permit/operating plan approved by the Secretary of the Interior.

All matters related to this stipulation are to be addressed to:

Forest Supervisor
Manti-LaSal National Forest
599 West Price River Drive
Price, Utah 84501
Telephone: 435-637-2817

who is the authorized representative of the Secretary of Agriculture.

Stipulation #19.

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ABANDONMENT OF EQUIPMENT: The lessee/operator is responsible for compliance and reporting regarding toxic and hazardous material and substances under Federal Law and all associated amendments and regulations for the handling of such materials on the land surface and in underground mine workings.

The lessee/operator must remove mine equipment and materials not needed for continued operations, roof support and mine safety from underground workings prior to abandonment of mine sections. Exceptions can be approved by the Authorized Officer (BLM) in consultation with the surface management agency. Any on-site disposal of non-coal waste must comply with 30 CFR section 817.89 and must be approved by the regulatory authority responsible for the enforcement of the Surface Mining Control and Reclamation Act (30 U.S.C. 1201, et seq.). Creation of a situation that would prevent removal of such material and equipment by retreat or abandonment of mine sections without prior authorization would be considered noncompliance with lease terms and conditions and subject to appropriate penalties under the lease.

All safe and accessible areas shall be inspected prior to being sealed. The lessee shall notify the Authorized Officer in writing 30 days prior to the sealing of any areas in the mine and state the reason for closure. Prior to seals being put into place, the lessee shall inspect the area and certify through documentation any equipment/machinery, hazardous substances, and used oil that is intended to be left underground. The Authorized Officer may participate in this inspection. The purpose of this inspection will be: (1) to provide documentation for compliance with 42 U.S.C. 9620 section 120(h) and State Management Rule R-315-15, and to assure that certification will be meaningful at the time of lease relinquishment, (2) to document the inspection with a mine map showing location of equipment/machinery (model, type of fluid, amount remaining, batteries etc.) that is proposed to be left underground. In addition, these items will be photographed at the lessee's expense and shall be submitted to the Authorized Officer as part of the certification.

WASTE CERTIFICATION: The lessee shall provide on a yearly basis and prior to lease relinquishment, certification to the lessor that, based upon a complete search of all the operator's records for the mine and upon their knowledge of past operations, there has been no hazardous substances defined as per (40 CFR 302.4) or used oil as per Utah State Management Rule R-315-15, deposited within the lease, either on the surface or underground, or that all remedial action necessary has been taken to protect human health and the environment with respect to any such substances remaining on the property. The back-up documentation to be provided shall be described by the lessor prior to the first certification and shall include all documentation applicable to the Emergency Planning and Community Right-to-know Act (EPCRA), Public Law 99-499, Title III of the Superfund Amendments and Reauthorization Act of 1986 or equivalent.

Stipulation #20.

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Notwithstanding the approval of a resource recovery and protection plan by the BLM, lessor reserves the right to seek damages against the operator/lessee in the event (1) the operator/lessee fails to achieve maximum economic recovery [as defined at 43 CFR section 3480.0-5(21)] of the recoverable coal reserves or (2) the operator/lessee is determined to have caused a wasting of recoverable coal reserves. Damages shall be measured on the basis of the royalty that would have been payable on the wasted or unrecovered coal.

The parties recognize that under an approved R2P2, conditions may require a modification by the operator/lessee of that plan. In the event a coal bed or portion thereof is not to be mined or is rendered unminable by the operation, the operator shall submit appropriate justification to obtain approval by the Authorized Officer to leave such reserves unmined. Upon approval by the Authorized Officer, such coal beds or portions thereof shall not be subject to damages as described above. Further, nothing in this section shall prevent the operator/lessee from exercising its right to relinquish all or a portion of the lease as authorized by statute and regulation.

In the event the Authorized Officer determines that the R2P2 as approved will not attain MER as the result of changed conditions, the Authorized Officer will give proper notice to the operator/lessee as required under applicable regulations. The Authorized Officer will order a modification if necessary, identifying additional reserves to be mined in order to attain MER. Upon a final administrative or judicial ruling upholding such an ordered modification, any reserves left unmined (wasted) under the plan will be subject to damages as described in the first paragraph under this section.

Subject to the right to appeal hereinafter set forth, payment of the value of the royalty on such unmined recoverable coal reserves shall become due and payable upon determination by the Authorized Officer that the coal reserves have been rendered unminable or at such time that the lessee has demonstrated an unwillingness to extract the coal.

The BLM may enforce this provision either by issuing a written decision requiring payment of the MMS demand for such royalties, or by issuing a notice of non-compliance. A decision or notice of non-compliance issued by the lessor that payment is due under this stipulation is appealable as allowed by law.

This schedule contains summary financial information extracted from form 10-Q and is qualified in its entirety by reference to such financial statements.

1,000

9-MOS
DEC-31-1999

SEP-30-1999
4,140

0
228,699

0
76,174

330,666
2,671,185

812,115
2,748,274

313,810
0

0
0
397
593,873

2,748,274
1,153,877

1,194,654
1,071,187

1,147,329

0
0
68,445
(20,141)
18,400

(1,741)
0
0
3,813

2,072
.05
.05