

MEMO

Subject: International Coal Group (ICG) – Grounds for a Yes vote on shareholder resolution requesting a report concerning the company’s response to increasing pressure to reduce pollution from operations and from use of ICG’s products

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RESOLVED: *Shareholders request a report (reviewed by a board committee of independent directors) on how the company is responding to increasing regulatory and public pressure to significantly reduce pollution from the company’s operations and use of its primary products. This report will omit proprietary information, be prepared at reasonable cost, and be made available to shareholders by September 1, 2011.*

Rationale for a Yes vote:

1. ICG provides inadequate disclosure of its strategy to build long-term shareholder value despite increasing regulatory and public pressure to significantly reduce pollution from the use of the company’s primary products;
2. ICG provides inadequate disclosure of its greenhouse gas (GHG) emissions and its strategies to reduce risks associated with them.

1. ICG provides inadequate disclosure of its strategy to build long-term shareholder value despite increasing regulatory and public pressure to significantly reduce pollution from the use of the company’s primary products.

ICG is a U.S. coal producer with 12 active mining complexes in central and northern Appalachia and one in the Illinois basin.¹ The combustion of coal provides roughly half of U.S. electricity and most of the negative environmental and health effects associated with electricity production.² According to the U.S. Energy Information Administration (EIA), the five principal emissions associated with coal consumption in the energy sector are:

- Sulfur dioxide (SO₂), which has been linked to acid rain and increased incidence of respiratory illnesses
- Nitrogen oxides (NO_x), which have been linked to the formation of acid rain and photochemical smog

¹ <http://www.intlcoal.com/>

² <http://www.nrdc.org/air/pollution/benchmarking/default.asp>

- Particulates, which have been linked to the formation of acid rain and increased incidence of respiratory illnesses
- Carbon dioxide (CO₂), which is the primary greenhouse gas emission from energy use.
- Mercury, which has been linked with both neurological and developmental damage in humans and other animals. Mercury concentrations in the air usually are low and of little direct concern. However, when mercury enters water — either directly or through deposition from the air — biological processes transform it into methylmercury, a highly toxic chemical that accumulates in fish and the animals (including humans) that eat fish.³

The U.S. Environmental Protection Agency is now moving forward with a regulatory agenda intended to protect public health and minimize negative environmental impacts of electricity production. These regulations include the Mercury and Air Toxics Standards (for emissions of mercury, other toxic metals and acid gases) and the Clean Air Transport Rule (for sulfur dioxide and nitrogen oxide emissions) as well as measures to phase out wet handling of coal combustion waste, regulate greenhouse gas emissions at power plants, and further regulate cooling water intake by power plants.⁴

These regulations are widely expected to add significant costs to using coal as a fuel source for electric power generation, and consequently to diminish domestic demand for coal. Together, the Mercury and Air Toxics Standards and the Clean Air Transport Rule could force the closure of 30 to 70 gigawatts (GW) of U.S. coal-fired electric generating capacity, or 10 to 20 percent of the U.S. coal-fired generating fleet.⁵ Bernstein Research estimates that these closures would diminish U.S. utility demand for coal by about 108 million tons, or roughly 11 percent of U.S. coal production in 2009.⁶

ICG, in its 2010 Form 10K, does discuss EPA's emerging air and water quality regulations and how they may impact the company, including by diminishing demand for coal, ICG's primary product.⁷ For example:

Future legislation, regulations or orders or negative perceptions due to environmental issues 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. (p. 18)

Various new and proposed laws and regulations may require further significant reductions in emissions from coal-fired utilities... These and other future standards could have the effect of making the operation of coal-fired plants less profitable, thereby decreasing demand for coal. (p. 49)

New and pending laws regulating the environmental effects of emissions of greenhouse gases could impose significant additional costs to doing business for the coal industry and/or a shift in consumption to non-fossil fuels. (p. 50)

ICG also points out that a key risk for the company is early termination of contracts resulting

³ http://eia.gov/energyexplained/index.cfm?page=coal_environment

⁴ <http://www.epa.gov/lawsregs/sectors/electric.html>

⁵ Credit Suisse, "Growth By Subtraction: Impact of EPA Rules on Power Markets," September 23, 2010; Bernstein Research, "U.S. Utilities: The EPA's Mercury and Air Toxics Standards Are Tougher Than They Appear," March 17, 2011.

⁶ Bernstein Research, "U.S. Utilities: Coal-Fired Generation is Squeezed in the Vice of EPA Regulation; Who Wins and Who Loses?," October 2010.

⁷ Available at <http://www.sec.gov/Archives/edgar/data/1320934/000132093411000004/0001320934-11-000004-index.htm>

from increasing costs and pressures against coal:

The majority of our coal supply agreements contain provisions that allow a purchaser to terminate its contract if legislation is passed that either restricts the use or type of coal permissible at the purchaser's plant or results in specified increases in the cost of coal or its use. (p. 49)

While ICG does acknowledge rising pressures against coal and the possibility that its business could be negatively affected, this recognition does not amount to a strategy. Facing declining sales and increasing pressures against its product, ICG fails to articulate a plan for remaining profitable despite these challenges. This is information investors need to know.

A coal company's strategy for maintaining profitability and competitive positioning amid increasingly stringent environmental regulation might consist of either or both of the following:

1. Investment in and support for advanced pollution control technologies required to maintain coal's market share in the generation of electric power;
2. Diversification beyond coal.

ICG's competitors provide examples of such strategies. Peabody Energy's 2010 Form 10K⁸ states that:

To maximize our coal assets and land holdings for long-term growth, we are... pursuing Btu Conversion projects that would convert coal to natural gas or transportation fuels and advancing clean coal technologies... Btu Conversion involves projects designed to expand the uses of coal through coal-to-liquids (CTL) and coal gasification technologies... We also own an equity interest in GreatPoint Energy, Inc., which is commercializing its coal-to-pipeline quality natural gas technology. (p.5)

We continue to support clean coal technology development and other "green coal" initiatives seeking to reduce global atmospheric levels of carbon dioxide and other emissions. We are the only non-Chinese equity partner in GreenGen, which is constructing a near-zero emissions coal-fueled power plant with carbon capture and storage (CCS) near Tianjin, China. The first phase of GreenGen operations is expected to be online in 2011. In Australia, we made a 10-year commitment to the Australian COAL21 Fund designed to support clean coal technology demonstration projects and research in Australia. (p. 6)

CONSOL Energy, another ICG competitor, now bills itself as a "diversified energy provider" after acquiring competitor Dominion Resources' natural gas exploration and production business in 2010.⁹ CONSOL's 2010 Form 10-K¹⁰ describes its expansion beyond coal into unconventional natural gas resources:

CONSOL Energy is an industry leader in the development of coalbed methane production in the Eastern United States and is also a leader in the development of the Marcellus shale... At December 31, 2010, we had 12,587 net producing wells... Additionally, we provide energy services, including river and dock services, terminal services, industrial supply services, coal waste disposal services and land resource management services. (p. 5)

ICG does disclose involvement in a coalbed methane project, but its disclosure (and possibly

⁸ Available at <http://phx.corporate-ir.net/phoenix.zhtml?c=129849&p=irol-sec>

⁹ <http://www.consolenergy.com/Powering/OurNaturalGas.aspx>

¹⁰ Available at <http://phx.corporate-ir.net/phoenix.zhtml?c=66439&p=irol-sec>

its activities) lag behind its competitors. Investors need to know that ICG is positioning itself to deliver long-term value to shareholders despite mounting public and regulatory pressures, rising costs and possible declining sales of its primary product.

2. ICG provides inadequate disclosure of its greenhouse gas (GHG) emissions and its strategies to reduce risks associated with them.

ICG does acknowledge in its 2010 Form 10K that concerns about climate change and legislative and/or regulatory approaches to control heat-trapping greenhouse gas emissions pose risks to its business:

Global climate change concerns have a potentially far-reaching impact upon our business, including our reputation and results of operations. Concerns over measurements, estimates and projections of global climate change, particularly global warming, have resulted in widespread calls for the reduction, by regulation and voluntary measures, of the emission of greenhouse gases, which include carbon dioxide and methane. These measures could impact the market for our coal and coalbed methane, increase our own energy costs and affect the value of our coal reserves. (p. 22)

These risks aren't limited to the emissions associated with the use of ICG's coal, but also extend to include its mining operations. As ICG explains:

In addition to materially adversely impacting our markets and the demand for our products, regulations enacted due to climate change concerns could affect our operations by increasing our costs. Our energy costs could increase and we may have to incur higher costs to control emissions of carbon dioxide, methane or other pollutants from our operations... If... controls on methane emissions from coal mines are ultimately imposed on the coal industry by federal or state governments or pursuant to international treaty, our operating costs may be materially and adversely affected. (p. 23)

But what are ICG's GHG emissions? Nowhere in its 2010 Form 10K – or anywhere else, apparently – does the company disclose its GHG footprint, the extent of its possible GHG-related financial liabilities, GHG emissions reductions targets, or strategies to comply with future mandated GHG emissions reductions at lowest overall cost.

ICG, unlike some of its industry peers and more than 3,000 companies around the world, has not provided carbon emissions data to the Carbon Disclosure Project (CDP), which represents over 500 international investors with US\$71 trillion in assets under management.¹¹

By contrast, mining company Rio Tinto's 2010 CDP response¹² provides investors with an estimated net present value of the potential impact of climate legislation on the company (over \$1 billion) as well as the company's actions to respond to risks associated with climate change:

An Energy and Climate Strategy team has been formed at Group level to develop a comprehensive strategy, which includes:

- Engaging directly with policymakers and advocating for economically and environmentally sound climate policy, particularly in Australia, the US, the EU, Canada and New Zealand
- Analyzing the commercial and financial implications of regulatory risks

¹¹ <https://www.cdproject.net/en-US/WhatWeDo/Pages/overview.aspx>

¹² Available at <https://www.cdproject.net/en-US/Results/Pages/responses.aspx>

- Engaging in collaborative efforts, such as the US Climate Action Partnership and various industry bodies
- Setting targets for improved energy efficiency and emissions performance of the Group
- A global corporate program of ensuring that emissions reporting meets increased regulatory requirements
- Sharing information across the Group that enables analysis undertaken for one jurisdiction is available for use in others.

Rio Tinto also reports two GHG emissions targets – an intensity target¹³ of 6% below 2008 emissions levels by 2013, and 10% by 2015 – and provides investors with detailed information about its current and planned efforts to reduce GHG emissions. Rio Tinto also discloses a particularly robust strategy for addressing the physical risks associated with climate change (e.g., changes in precipitation patterns and the frequency and intensity of extreme weather events, which could significantly impact mining operations):

To manage these risks, each operating site for which a climatological model has been used, uses these results in their risk management process. In the case of projects these results are considered in the formal technical review which is conducted prior to the approval of large projects. Some of the ways in which operating sites adapt to the risk of climate change include:

- Including the results of the modeling in water management programs
- Ensuring engineering design is sufficiently robust for extreme weather events
- Mitigation plans for operations that rely on ice roads

While no companies in the coal sector have set an explicit target for GHG reductions from products yet, emissions from products are significantly larger than operational emissions and are more likely to be affected by climate regulations. Other companies recognize the importance of addressing the issue. Xstrata, for instance, discloses on its website the carbon footprint of its products (approximately 227 million tons), points out that this is 10 times greater than its operational emissions, and explains that its strategy is to “support the research, development and commercialization of low carbon emission technologies that will reduce the impacts associated with our customers' use of the coal we produce, in partnership with other coal producers, governments, and scientific and academic organizations.”¹⁴

ICG, like the rest of the mining industry, will be required by the EPA to report its greenhouse gas emissions in 2012 for the year 2011. How prepared ICG is to produce audit-quality data about its GHG footprint and subsequently manage and reduce this footprint while building long-term shareholder value is anyone's guess.

Conclusion

Shareholders need to know that ICG has a plan for remaining profitable despite increasing regulatory and public pressure to significantly reduce pollution from the company's operations and use of its primary product, coal. Relative to leading peers, ICG provides shareholders with very limited information about whether or how the company will adapt. A Yes vote on this resolution will encourage management to develop and disclose this strategy. We urge shareholders to vote in support of this proposal.

¹³ An intensity target, unlike an absolute target, is normalized to commodity production.

¹⁴ <http://www.xstrata.com/sustainability/environment/climatechange/reducingemissionsfromcoal/>