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SUBCOMMITTEE ON REGULATORY AFFAIRS, STIMULUS OVERSIGHT AND GOVERNMENT SPENDING

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

COMMITTEE ON EDUCATION AND THE WORKFORCE

September 24, 2012

Mary Schapiro
Chairwoman
Securities and Exchange Commission
100 F Street, Northeast
Washington, DC 20549-0100

Dear Chairwoman Schapiro:

I write to request that the Securities and Exchange Commission (SEC) investigate any and all agreements between the owners and developers of the Prairie State Generating Company (PSGC), such as Peabody Energy Company (Peabody), American Municipal Power (AMP), and the owners' member municipalities such as Cleveland Public Power, in connection with the development and construction of the Prairie State Coal Plant located in Marissa, Illinois.

I request that the SEC investigate whether the entities responsible knew or should have known about the risks surrounding the costs of construction and operation of the power plant, and whether those parties made a full and accurate disclosure regarding these risks. The costs of this project were financed by a series of tax-exempt bond issuances which were secured using "take or pay" power purchase agreements by municipal power, generation and transmission entities across eight states. This occurred as other privately-owned utilities and public power agencies withdrew from the project and voided their agreements, citing the high risks involved. This fact raises troubling questions about the accuracy and thoroughness of the disclosures, particularly when viewed in light of the fact that Peabody Energy's board consists of individuals from the finance and energy industries who are likely quite familiar with the bond financing market and the interests of institutional investors.

To date, there are fundamental problems with the financial stability and the long-term reliability of the plant which remain unaddressed, resulting in an actual cost of power from the Prairie State Energy Campus which is more than 40 percent higher than the costs that communities were promised when the project was marketed to them. I believe that this may be rooted in misstatements, omissions, misrepresentations and/or failure to do due diligence in investigating the claims made by Peabody Energy and/or AMP.

Currently, municipalities and electric coops across the Midwest have signed on to the Prairie State coal plant project and have incurred $4.9 billion in known, but growing project costs. This amounts to over $11.7 billion in principal and interest payments, including a $900 million federal subsidy under the Build America Bond program. The debt incurred covers the cost of the plant, the Lively Grove mine and at least the Jordan Grove ashfill. The Institute for Energy Economics and Financial Analysis estimates that Clevelanders alone are on the hook for $19 million above and beyond what they would have paid had Cleveland Public Power simply bought electricity on the open market. The full project affects 2.5 million ratepayers across 8 states.

Peabody Energy Corporation was the initial developer of the 1,582 MW Prairie State Energy Campus (PSEC) coal-fired power plant. However, beginning as early as 2001, Peabody began an aggressive campaign with promises of long-term low-cost power to induce joint municipal power agencies in states throughout the Midwest to participate in the project. This campaign induced eight power agencies, including AMP, to agree to collectively take on approximately 95 percent of the ownership interest in the project. Peabody now retains only a 5 percent interest in the Prairie State project and has the right to sell even that small ownership share after five years.

The power agencies, in turn, entered into long-term "take-or-pay" contracts, and in some cases, "take-and-pay" contracts, with 217 municipalities and 17 electric coops in Virginia, Ohio, Kentucky, Indiana, Illinois, Michigan, Missouri and West Virginia. Under the take-or-pay contracts, communities are obligated to pay for PSEC whether or not the plant generates any power. Cleveland Public Power and 67 other municipalities signed onto the plant pursuant to their relationship with AMP in Ohio. Under these contracts the utilities' customers will unwittingly bear most of the risk of the venture in the event that new costs must be covered.

Already the price of electricity from the plant is far above that promised to communities when they signed on. It will continue to be more expensive than the going market price for power in the region for the foreseeable future. One recent study put the excess power costs at up to double the originally promised price, which is likely to be underestimated since the plant is reported to be operating at diminished capacity. Initial estimates for the price of power assumed that the plant would be operating at 85% capacity. However, unconfirmed accounts of extended periods of outages in one unit of the plant's operations raise the possibility that the plant is operating at substantially less than 85% capacity.

The cost increases were mostly foreseeable and preventable had the sellers or buyers provided full disclosure and/or done their due diligence. It is likely that the financial weaknesses of the proposed plant were well known to Peabody and PSGC as it developed the project and then sold to state and local governments:

First, it was widely known that new coal plants were a bad financial risk. Peabody and AMP both canceled plans to build other coal plants because of rising costs between 2004 and the present. The cost of PSEC rose from $1.7 billion to its current price of $4.9 billion during this period. PSGC rejected warnings from government financial officers, consultants, and others about the rising costs.

The increase in the price of electricity from the plant is driven largely by massive increases in the capital costs of the plant, including the mine and ashfill. The plant has already suffered from construction defects which caused a major delay in opening one of the units, and it is apparently suffering from additional operational problems. The debt and debt service on the plant will now be a permanent part of the increased price of electricity charged to consumers. I believe the SEC should investigate whether Peabody fully and accurately revealed the risk of rising plant construction costs (or any other risks) when it was marketing ownership shares in PSEC. I also believe that the SEC should investigate whether AMP and the other joint municipal power agencies fully revealed the risks of participating in PSEC when local communities across eight states were being enticed to enter into long-term purchase agreements.

Second, Peabody Energy's representations of the quality and supply of coal available in the mine are highly questionable, particularly in light of Peabody's subsequent divestment of ownership from 100% down to 5% of total project ownership. The plant and project were sold to communities by Peabody Energy as part of package that included a purported thirty year supply of cheap coal from the Lively Grove mine near the plant. The mine was owned by Peabody Energy. Peabody secured permits from the State of Illinois. After the sale of Peabody's interest in the plant, Peabody remained under contract with PSGC to oversee mine construction and operations. Peabody's plan to mine coal at the Lively Grove facility was rejected by the Mine Safety and Health Administration (MSHA). While the matter is still unresolved at MSHA, if Peabody adheres to the MSHA ruling the coal reserves at Lively Grove would only serve the plant for 22 years. It is disclosed in bond documents that Peabody stands ready to sell PSGC yet another coal reserve. Even if Peabody reaches an accommodation with MSHA the risk will remain with the communities long after Peabody exits the contract and its investment. The real cost of electricity for Prairie State communities is therefore not fully disclosed to participants.

Third, Peabody's representations regarding the quality of the permits issued for the ashfill are questionable, and its poor management of the ashfill is driving up costs. The plant and project were sold to communities by Peabody Energy as part of a package which included the Jordan Grove ashfill, a "permitted" site. The site came with a purported 23 year useful life. Upon investigation, PSGC learned that the ashfill had only a useful life of 12 years. PSGC has purchased a new site and is currently in the permit review process. The cost of full and complete ashfill capacity is not currently known but is part of the cost of PSGC's electricity that will be passed on to customers.

The current market for power is producing electricity at prices far below that of the Prairie State plant. While the plant was supposed to be a hedge against high prices, it is now a source of upward pressure on prices. Rather than an asset that can help keep electricity prices down, it is a liability that makes publicly provided power less competitive. Communities that should be benefitting in the form of lower rates, improved services or financial relief are now pressed to use, market and sell expensive electricity at a loss.

The damage is already being experienced. Earlier this year communities throughout the Midwest have been saddled with bills from the Prairie State plant to pay for electricity they have never received. Local systems were paying hundreds of thousands per month out of reserves for electricity not received and then buying actual electricity on the market at additional costs. Cleveland, for example, paid $250,000 per month in March, April, and May for debt service with no electricity received.

I am requesting that the SEC conduct a full investigation of the Prairie State energy deal, and related transactions that are subject to the SEC's jurisdiction. As part of such an investigation, it will be essential to know whether the risks of entering into power plant construction contracts as well as long-term contracts to purchase power from PSGC were adequately disclosed to investors. After this matter is assigned for investigation, please contact my office to schedule a meeting.

My staff and I stand ready to assist in any way possible to ensure the protection of the Midwest ratepayer and the investors in this project.

Sincerely,

Dennis J. Kucinich

Dennis J. Kucinich
Member of Congress