CONSOL ENERGY INC
Form 10-Q
November 02, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2006 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: 001-14901

CONSOL Energy Inc.

(Exact name of registrant as specified in its charter)

Delaware	**51-0337383**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
1800 Washington Road Pittsburgh, Pennsylvania	**15241**
(Address of principal executive offices)	**(Zip Code)**

(412) 831-4000

(Registrant s telephone number, including area code)

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 ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

Class	**Shares outstanding as of October 23, 2006**
Common stock, $0.01 par value	182,618,859

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PART I

FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

CONSOL ENERGY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Sales Outside	$ 748,145	$ 726,143	$ 2,441,736	$ 2,163,082
Sales Gas Royalty Interests	13,221	12,317	41,714	31,059
Sales Purchased Gas	9,076	88,288	41,206	157,545
Sales Related Party		4,135		4,749
Freight Outside	38,239	30,718	113,007	92,507
Freight Related Party		468		468
Other Income	34,671	17,858	123,840	64,654
Gain on Sale of 18.5% of CNX Gas		327,326		327,326
Total Revenue and Other Income	843,352	1,207,253	2,761,503	2,841,390
Cost of Goods Sold and Other Operating Charges (exclusive of depreciation, depletion and amortization shown below)	552,104	539,526	1,645,560	1,591,680
Gas Royalty Interests Costs	10,808	10,042	34,491	24,505
Purchased Gas Costs	9,340	89,653	42,091	159,739
Freight Expense	38,239	31,186	113,007	92,975
Selling, General and Administrative Expense	25,062	23,976	67,053	59,162
Depreciation, Depletion and Amortization	72,824	64,100	219,088	194,259
Interest Expense	5,685	6,791	17,791	20,904
Taxes Other Than Income	57,145	54,365	195,301	170,178
Total Costs	771,207	819,639	2,334,382	2,313,402
Earnings Before Income Taxes and Minority Interest	72,145	387,614	427,121	527,988
Income Taxes	14,597	7,173	123,631	31,261
Earnings Before Minority Interest	57,548	380,441	303,490	496,727
Minority Interest	(6,962)	(3,459)	(22,524)	(3,459)
Net Income	$ 50,586	$ 376,982	$ 280,966	$ 493,268
Basic Earnings Per Share	$ 0.28	$ 2.05	$ 1.53	$ 2.70
Diluted Earnings Per Share	$ 0.27	$ 2.02	$ 1.51	$ 2.67

Weighted Average Number of Common Shares Outstanding:				
Basic	183,246,777	184,225,540	183,597,117	183,003,898
Dilutive	185,555,687	186,784,578	185,850,322	184,966,356
Dividends Paid Per Share	$ 0.07	$ 0.07	$ 0.21	$ 0.21

The accompanying notes are an integral part of these financial statements.

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CONSOL ENERGY INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	(Unaudited) September 30, 2006	December 31, 2005
ASSETS		
Current Assets:		
Cash and Cash Equivalents	$ 215,569	$ 340,640
Accounts and Notes Receivable:		
Trade	284,986	276,277
Other Receivables	22,714	23,340
Inventories	182,775	140,976
Deferred Income Taxes	142,343	152,730
Prepaid Expenses	90,357	64,537
Total Current Assets	938,744	998,500
Property, Plant and Equipment:		
Property, Plant and Equipment	7,577,316	7,096,660
Less Accumulated Depreciation, Depletion and Amortization	3,749,729	3,561,897
Total Property, Plant and Equipment Net	3,827,587	3,534,763
Other Assets:		
Deferred Income Taxes	338,722	367,228
Investment in Affiliates	54,332	52,261
Other	135,046	134,900
Total Other Assets	528,100	554,389
TOTAL ASSETS	$ 5,294,431	$ 5,087,652

The accompanying notes are an integral part of these financial statements.

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CONSOL ENERGY INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	(Unaudited) September 30, 2006	December 31, 2005
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts Payable	$ 174,733	$ 197,375
Current Portion of Long-Term Debt	57,017	4,629
Accrued Income Taxes	28,219	17,557
Other Accrued Liabilities	547,427	584,361
Total Current Liabilities	807,396	803,922
Long-Term Debt:		
Long-Term Debt	393,240	438,367
Capital Lease Obligations	27,131	
Total Long-Term Debt	420,371	438,367
Deferred Credits and Other Liabilities:		
Postretirement Benefits Other Than Pensions	1,596,316	1,592,907
Pneumoconiosis Benefits	401,326	411,022
Mine Closing	387,188	356,776
Workers Compensation	151,724	134,759
Deferred Revenue	16,333	27,343
Salary Retirement		33,703
Reclamation	26,282	32,183
Other	122,988	137,870
Total Deferred Credits and Other Liabilities	2,702,157	2,726,563
Minority Interest	126,526	93,444
Total Liabilities and Minority Interest	4,056,450	4,062,296
Stockholders Equity:		
Common Stock, $.01 par value; 500,000,000 Shares Authorized, 185,126,526 Issued and 182,604,705 Outstanding at September 30, 2006; 185,050,824 Issued and Outstanding at December 31, 2005	1,851	1,850
Preferred Stock, 15,000,000 Shares Authorized; None Issued and Outstanding		
Capital in Excess of Par Value	910,347	883,316
Retained Earnings	486,543	252,109
Other Comprehensive Loss	(76,691)	(105,162)
Unearned Compensation on Restricted Stock Units		(6,757)
Common Stock in Treasury, at Cost 2,521,821 Shares at September 30, 2006 and -0- Shares at December 31, 2005	(84,069)	
Total Stockholders Equity	1,237,981	1,025,356
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 5,294,431	$ 5,087,652

The accompanying notes are an integral part of these financial statements.

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CONSOL ENERGY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Dollars in thousands, except per share data)

	Common Stock	Capital in Excess of Par Value	Retained Earnings (Deficit)	Other Comprehensive Income (Loss)	Unearned Compensation on Restricted Stock Units	Treasury Stock	Total Stockholders Equity
Balance December 31, 2005	$ 1,850	$ 883,316	$ 252,109	$ (105,162)	$ (6,757)	$	$ 1,025,356
(Unaudited)							
Net Income			280,966				280,966
Treasury Rate Lock (Net of $40 tax)				(61)			(61)
Minority Interest in Other Comprehensive Income and Stock-based Compensation of Gas		(1,996)		(6,484)			(8,480)
Gas Cash Flow Hedge (Net of ($22,470) tax)				35,016			35,016
Comprehensive Income (Loss)		(1,996)	280,966	28,471			307,441
Issuance of Treasury Stock		(11,703)	(7,901)			32,381	12,777
Purchases of Treasury Stock						(116,450)	(116,450)
Stock Options Exercised	1	1,361					1,362
Tax Benefit from Stock-Based Compensation		37,878					37,878
Amortization of Stock-Based Compensation Awards		8,248					8,248
Elimination of Unearned Compensation on Restricted Stock Units		(6,757)			6,757		
Dividends ($.21 per share)			(38,631)				(38,631)
Balance September 30, 2006	$ 1,851	$ 910,347	$ 486,543	$ (76,691)	$	$ (84,069)	$ 1,237,981

The accompanying notes are an integral part of these financial statements.

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CONSOL ENERGY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Operating Activities:		
Net Income	$ 280,966	$ 493,268
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation, Depletion and Amortization	219,088	194,259
Stock-based Compensation	10,325	2,654
Gain on the Sale of Assets	(5,476)	(12,854)
Gain on Sale of 18.5% Interest in Gas Segment		(327,326)
Change in Minority Interest	22,524	3,459
Amortization of Mineral Leases	4,069	3,974
Deferred Income Taxes	8,641	(10,575)
Equity in Earnings of Affiliates	(669)	(1,952)
Changes in Operating Assets:		
Accounts Receivable Securitization		(125,000)
Accounts and Notes Receivable	(5,533)	(47,808)
Inventories	(40,895)	(10,320)
Prepaid Expenses	(25,051)	(17,405)
Changes in Other Assets	308	5,785
Changes in Operating Liabilities:		
Accounts Payable	(23,960)	5,307
Other Operating Liabilities	(27,602)	37,711
Changes in Other Liabilities	16,213	(4,957)
Other	6,349	2,149
Net Cash Provided by Operating Activities	439,297	190,369
Investing Activities:		
Capital Expenditures	(469,417)	(287,262)
Acquisition of Mon River Towing and J.A.R. Barge Lines	(24,750)	
Additions to Mineral Leases	(5,670)	(7,826)
Net Investment in Equity Affiliates	(1,402)	1,901
Proceeds from Sale of 18.5% Interest in Gas Segment		420,167
Proceeds from Sales of Assets	44,028	32,236
Net Cash (Used in) Provided by Investing Activities	(457,211)	159,216
Financing Activities:		
Payments on Miscellaneous Borrowings	(4,093)	(284)
Proceeds from Short Term Borrowings		2,200
Payments on Revolver		(1,700)
Tax Benefit from Stock-Based Compensation	37,878	
Dividends Paid	(38,631)	(38,377)
Issuance of Treasury Stock	12,777	
Purchases of Treasury Stock	(116,450)	

Stock Options Exercised	1,362	35,369
Net Cash Used in Financing Activities	(107,157)	(2,792)
Net (Decrease) Increase in Cash and Cash Equivalents	(125,071)	346,793
Cash and Cash Equivalents at Beginning of Period	340,640	6,422
Cash and Cash Equivalents at End of Period	$ 215,569	$ 353,215

The accompanying notes are an integral part of these financial statements.

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CONSOL ENERGY INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(Dollars in thousands, except per share data)

NOTE 1 BASIS OF PRESENTATION:

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and nine-month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for future periods.

On May 4, 2006, CONSOL Energy s Board of Directors declared a two-for-one stock split of the common stock payable on or about May 31, 2006 to shareholders of record on May 15, 2006. The stock split was effected in the form of a stock dividend. This stock split resulted in the issuance of approximately 92.5 million additional shares of common stock and was accounted for by the transfer of approximately $925 from capital in excess of par value to common stock. This transfer of $925 has been retroactively presented on the December 31, 2005 balance sheet. The stock split also resulted in additional shares available for awards under the CONSOL Energy Inc. Equity Incentive Plan. Earnings per share and dividends paid per share amounts on the face of the consolidated income statement are reflected on a post-split basis.

The balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date but does not include all the notes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and related notes for the year ended December 31, 2005 included in CONSOL Energy s Form 10-K.

Certain reclassifications of 2005 data have been made to conform to the nine months ended September 30, 2006 classifications.

Effective January 1, 2006, CONSOL Energy adopted Emerging Issues Task Force Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty (EITF 04-13). EITF 04-13 defines when a purchase and a sale of inventory with the same party that operates in the same line of business is recorded at fair value or considered a single non-monetary transaction subject to the fair value exception of Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions. The purchase and sale transactions may be pursuant to a single contractual arrangement or separate contractual arrangements and the inventory purchased or sold may be in the form of raw materials, work-in-process, or finished goods. In general, two or more transactions with the same counter party are treated as one if they are entered into in contemplation of each other. In accordance with EITF 04-13, CONSOL Energy has applied this accounting to new or modified agreements after January 1, 2006. Previously, these transactions were recorded on a gross basis. The adoption of EITF 04-13 did not have an impact on net income or cash flows.

Effective January 1, 2006, CONSOL Energy adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (SFAS 123R), using the modified prospective transition method and therefore has not restated results for prior periods. Under this transition method, stock-based compensation expense for the three and nine months ended September 30, 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS

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No. 123, Accounting for Stock-Based Compensation (SFAS 123). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. CONSOL Energy recognizes these compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option vesting term. Prior to the adoption of SFAS 123R, CONSOL Energy recognized stock-based compensation expense in accordance with Accounting Principles Board Opinion No. 25. Accounting for Stock Issued to Employees, (APB 25). In March 2005, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC s interpretation of SFAS 123R and the valuation of share-based payments for public companies. CONSOL Energy has applied the provisions of SAB 107 in its adoption of SFAS 123R. See Note 3 to the Consolidated Condensed Financial Statements for a further discussion on stock-based compensation.

Basic earnings per share are computed by dividing net income by the weighted average shares outstanding during the reporting period. Diluted earnings per share are computed similarly to basic earnings per share except that the weighted average shares outstanding are increased to include additional shares from the effect of dilutive potential common shares outstanding during the period as calculated in accordance with SFAS 123R. The number of additional shares is calculated by assuming that restricted stock units were converted and outstanding stock options were exercised and that the proceeds from such activity was used to acquire shares of common stock at the average market price during the reporting period. Options to purchase 756,807 shares and 689 shares of common stock were outstanding for the three and nine month period ended September 30, 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share because the effect would be antidilutive.

The computations for basic and diluted earnings per share from continuing operations are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net Income	$ 50,586	$ 376,982	$ 280,966	$ 493,268
Average shares of common stock outstanding:				
Basic	183,246,777	184,225,540	183,597,117	183,003,898
Effect of stock-based compensation awards	2,308,910	2,559,038	2,253,205	1,962,458
Dilutive	185,555,687	186,784,578	185,850,322	184,966,356
Earnings per share:				
Basic	$ 0.28	$ 2.05	$ 1.53	$ 2.70
Diluted	$ 0.27	$ 2.02	$ 1.51	$ 2.67

NOTE 2 ACQUISITIONS AND DISPOSITIONS:

On March 28, 2006, CONSOL Energy, through a subsidiary, completed a sale/lease back of longwall equipment. Cash proceeds from the sale were $36,363 which was equal to our basis in the equipment. Accordingly, no gain or loss was recorded on the transaction. The lease has been accounted for as a capital lease. The lease term is five years.

In January 2006, CONSOL Energy, through a subsidiary, completed the acquisition of Mon River Towing and J.A.R. Barge Lines, LLC, from The Guttman Group for a cash payment of $24,750. The acquisition included 13 towboats and more than 350 barges with the capacity to transport 13 million tons of coal annually. Mon River Towing transports petroleum products, coal, limestone and other bulk commodities to various locations along the navigable rivers of Pennsylvania, Ohio, West Virginia and Kentucky. J.A.R. Barge Lines, LLC charters motor vessels and barges to other river transportation firms along the inland waterways. CONSOL Energy expects to continue to provide these business services through its river and dock operations.

In July 2005, CONSOL Energy announced that it had created CNX Gas Corporation (CNX Gas), a wholly owned subsidiary of CONSOL Energy, to conduct its gas exploration and production activities. CONSOL Energy

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contributed or leased substantially all of the assets of its gas business, including all of CONSOL Energy s rights to coalbed methane associated with 4.5 billion tons of coal reserves owned or controlled by CONSOL Energy as well as all of CONSOL Energy s rights to conventional gas. CONSOL Energy entered into various agreements with CNX Gas that define various operating and service relationships between the two companies. In August 2005, CNX Gas sold 27.9 million shares in a private transaction. The shares were sold to qualified institutional, foreign and accredited investors in a private transaction exempt from registration under Rule 14A, Regulation S and Regulation D. CNX Gas received proceeds of $420,167, which it used to pay a special dividend to CONSOL Energy. Following the close of the transaction, CONSOL Energy holds approximately 122.9 million shares, or approximately 81.5 percent, of the outstanding shares of CNX Gas common stock (before issuance of any shares under CNX Gas 2.5 million shares equity incentive plan). The pre-tax gain recognized on this transaction was $327,326.

In June 2005, CONSOL Energy completed a sale/lease-back transaction for its headquarters building and certain surrounding land located in Upper Saint Clair, Pennsylvania. Cash proceeds from the sale were $14,000 and resulted in a pretax gain of $8,304, which has been deferred and will be recognized over the initial lease term of 13 years. The lease agreement includes an option to extend the lease term for two five-year periods. The lease is accounted for as an operating lease. Annual rental payments are $1,176 and are payable in equal quarterly installments of $294. The agreement provides for a possible Consumer Price Index adjustment to the annual rental payments at the beginning of the fourth lease year and every four years thereafter.

On March 30, 2005, CONSOL Energy through its subsidiary, CONSOL of West Virginia, LLC, acquired a 49% interest in Southern West Virginia Energy, LLC for a cash payment of $6,200. In addition, CONSOL Energy agreed to assume the perpetual care liability after certain bond release work is completed by Southern West Virginia Energy, LLC. The discounted liability assumed by CONSOL Energy was $10,159. Southern West Virginia Energy, LLC through its subsidiary will mine low sulfur bituminous coal. The acquisition was accounted for under the equity method of accounting in the period ending June 30, 2005. In the period ending September 30, 2005, after all agreements were substantially completed, the acquisition was fully consolidated in accordance with Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities.

NOTE 3 STOCK-BASED COMPENSATION:

CONSOL Energy adopted the CONSOL Energy Inc. Equity Incentive Plan on April 7, 1999. The plan provides for grants of stock-based awards to key employees and to non-employee directors. Amendments to the plan have been approved by the Board of Directors since the commencement of the plan, and the total number of shares of common stock that can be covered by grants at September 30, 2006 is 18,200,000 of which 2,600,000 are available for issuance of awards other than stock options. No award of stock options may be exercised under the plan after the tenth anniversary of the effective date of the award.

The total stock-based compensation expense was $3,190 and $8,248 for the three and nine months ended September 30, 2006 and the related deferred tax benefit totaled $1,241 and $3,208 respectively. Prior to January 1, 2006, CONSOL Energy accounted for stock-based compensation under the recognition and measurement provisions of Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, as amended. Generally, no stock-based employee compensation cost for stock options is reflected in net income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. Prior to January 1, 2006, CONSOL Energy provided pro forma disclosure amounts in accordance with Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an Amendment of SFAS No. 123 (SFAS 148), as if the fair value method defined by Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation (SFAS 123) had been applied to its stock-based compensation.

Effective January 1, 2006, CONSOL Energy adopted the fair value recognition provisions of SFAS 123R, Share-Based Payment (SFAS 123R) using the modified prospective transition method and therefore has not restated prior periods results. Under this transition method, stock-based compensation expense for the nine months ended September 30, 2006 included compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. CONSOL Energy recognizes these compensation costs net of a forfeiture rate and recognizes the compensation costs for only those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the option vesting term.

As a result of adopting SFAS 123R, pretax income and net income for the three months ended September 30, 2006 was $2,046 and $1,250 lower, respectively, than if we had continued to account for stock-based compensation under APB 25. Pretax income and net income for the nine months ended September 30, 2006 was $5,312 and $3,246 lower, respectively, than if we had continued to account for stock-based compensation under APB 25. The impact on basic and diluted earnings per share for the three months ended September 30, 2006 was less than $0.01 per share and $0.01 per share, respectively. The impact on basic and diluted earnings per share for the nine months ended September 30, 2006 was $0.02 per share. Upon the adoption of SFAS 123R, tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as cash provided by financing activities on our consolidated statement of cash flows.

The pro forma table below reflects net earnings and basic and diluted earnings per share for the three and nine months ended September 30, 2005, had CONSOL Energy applied the fair value recognition provisions of SFAS 123:

	Three Months Ended September 30,		Nine Months Ended September 30,	
		2005		2005
Net income as reported	$	376,982	$	493,268
Add: Stock-based compensation due to change in vesting period		220		955
Add: Stock-based compensation expense for restricted stock units		857		1,919
Deduct: Total stock-based employee compensation expense determined under Black-Scholes option pricing model and stock-based compensation expense for restricted stock units		(2,837)		(7,276)
Pro forma net income	$	375,222	$	488,866
Earnings per share:				
Basic as reported	$	2.05	$	2.70
Basic pro forma	$	2.04	$	2.67
Diluted as reported	$	2.02	$	2.67
Diluted pro forma	$	2.01	$	2.65

As a result of SFAS 123R, CONSOL Energy reevaluated its assumptions used in estimating the fair value of employee options granted. As part of this assessment, management determined that a combination of historical and implied volatility is a better indicator of expected volatility and future stock price trends than solely historical volatility. Therefore, expected volatility for the three and nine month periods ended September 30, 2006 was based on a combination of historical and market-based implied volatility.

As part of its SFAS 123R adoption, CONSOL Energy also examined its historical pattern of option exercises in an effort to determine if there were any discernable activity patterns based on certain employee populations. From this analysis, CONSOL Energy identified two distinct employee populations. CONSOL Energy used the Black-Scholes option pricing model to value the options for each of the employee populations. The table below presents the weighted average expected life in years of the combined employee populations. The expected life computation is based upon historical exercise patterns and post-vesting termination behavior of the

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populations. The risk-free interest rate was determined for each vesting tranche of an award based upon the calculated yield on U.S. Treasury obligations for the expected term of the award. The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model with the following assumptions and weighted average fair values:

	For the Nine Months Ended September 30,	
	2006	2005
Weighted average fair value of grants	$ 15.46	$ 11.88
Risk-free interest rate	5.0%	3.6%
Dividend yield	0.6%	1.5%
Expected Forfeiture Rate	2.0%	
Expected volatility	38.5%	45.6%
Expected life in years	4.3	2.5

Option activity under the option plans as of September 30, 2006 and changes during the nine months ended September 30, 2006 were as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2005	6,450,314	$ 13.98		
Granted	751,953	43.33		
Exercised	(919,052)	15.37		
Forfeited	(41,803)	17.15		
Outstanding at September 30, 2006	6,241,412	$ 17.30	7.06	$ 98,811
Vested and expected to vest at September 30, 2006	6,228,005	$ 17.24	7.04	$ 98,811
Exercisable at September 30, 2006	3,851,874	$ 12.43	6.28	$ 74,366

These stock options will terminate ten years after the date on which they were granted. The employee stock options, covered by the Equity Incentive Plan adopted April 7, 1999, vest 25% per year, beginning one year after the grant date. There are 5,292,174 stock options outstanding under this plan. Additionally, there are 792,814 employee stock options outstanding which are fully vested. These stock options had vesting terms ranging from six months to one year. Non-employee director stock options vest 33% per year, beginning one year after the grant date. There are 156,424 stock options outstanding under these grants. The vesting of the options will accelerate in the event of death, disability or retirement and may accelerate upon a change of control of CONSOL Energy.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between CONSOL Energy s closing stock price on the last trading day of the nine months ended September 30, 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2006. This amount changes based on the fair market value of CONSOL Energy s stock. Total intrinsic value of options exercised for the three and nine months ended September 30, 2006 was $2,143 and $22,465 respectively. Total pre-tax fair value of options vested was $787 and $5,399 for the three and nine months ended September 30, 2006, respectively.

Cash received from option exercises for the three and nine months ended September 30, 2006 was $1,047 and $14,139. The windfall tax benefit realized for the tax deduction from option exercises totaled $2,082 and $37,878 for the three and nine months ended September 30, 2006. As of September 30, 2006, $28,264 of total unrecognized compensation cost related to unvested awards is expected to be recognized over a weighted-average period of 2.86 years.

Under the equity incentive plan, CONSOL Energy granted certain employees restricted stock unit awards. These awards entitle the holder to receive shares of common stock as the award vests. A total of 493,285

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restricted stock units were outstanding at September 30, 2006, vesting over a weighted average remaining period of 2.01 years. Compensation expense will be recognized over the vesting period of the units. The following represents the unvested restricted stock units and corresponding fair value (based upon the closing share price) at the date of grant:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	477,572	$ 18.48
Granted	163,775	$ 42.85
Vested	(148,062)	$ 17.20
Nonvested at September 30, 2006	493,285	$ 26.95

NOTE 4 COMPONENTS OF PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS NET PERIODIC BENEFIT COSTS:

Components of net periodic costs for the three and nine months ended September 30 are as follows:

	Pension Benefits				Other Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005	2006	2005	2006	2005
Service cost	$ 3,952	$ 5,539	$ 11,855	$ 16,618	$ 2,523	$ 3,175	$ 7,570	$ 9,526
Interest cost	7,062	7,255	21,186	21,765	32,416	34,854	97,249	104,563
Expected return on plan assets	(6,531)	(5,114)	(19,593)	(15,342)				
Settlement loss	21,809		21,809					
Amortization of prior service costs (credit)	(271)	54	(814)	162	(14,156)	(1,843)	(42,464)	(5,527)
Recognized net actuarial loss	4,171	4,851	12,514	14,552	16,077	11,603	48,226	34,806
Net periodic benefit cost	$ 30,192	$ 12,585	$ 46,957	$ 37,755	$ 36,860	$ 47,789	$ 110,581	$ 143,368

Our defined benefit pension plan for salaried employees allows such employees to receive a lump-sum distribution in lieu of annual payments when they retire from CONSOL Energy. Statement of Financial Accounting Standards (SFAS) No. 88, Employers Accounting for Settlements & Curtailments of Defined Benefit Pension Plans and for Termination Benefits, requires that when the lump-sum distributions made for a plan year, which for CONSOL Energy is October 1 to September 30, exceed the total of the service cost and interest cost for the plan year, an adjustment equaling the unrecognized actuarial gain or loss resulting from each individual who received a lump sum in that year be recognized. CONSOL Energy recognized a settlement loss of $21,809 in the three and nine months ended September 30, 2006. The settlement loss was included in costs of goods sold and other charges and selling, general and administrative expenses.

For the three and nine month period ended September 30, 2006, $70,648 and $71,222 have been paid to the pension plan. CONSOL Energy presently does not anticipate contributing any additional funds to the pension plan in 2006.

We do not expect to contribute to the other post employment benefit plan in 2006. We intend to pay benefit claims as they become due. For the three and nine month period ended September 30, 2006, $30,698 and $92,229 of other post employment benefits have been paid.

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NOTE 5 COMPONENTS OF COAL WORKERS PNEUMOCONIOSIS (CWP) AND WORKERS COMPENSATION NET PERIODIC BENEFIT COSTS:

Components of net periodic costs (benefits) for the three and nine months ended September 30 are as follows:

	CWP				Workers Compensation			
	Three Months Ended September 30,		Nine Months Ended September 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005	2006	2005	2006	2005
Service cost	$ 1,490	$ 948	$ 4,472	$ 2,845	$ 7,574	$ 7,162	$ 22,721	$ 21,486
Interest cost	3,017	2,991	9,051	8,972	2,092	2,110	6,276	6,327
Amortization of actuarial gain	(5,462)	(5,652)	(16,387)	(16,957)	(692)	(872)	(2,075)	(2,615)
State administrative fees and insurance bond premiums					2,352	4,834	5,655	15,339
Legal and administrative costs	675	675	2,025	2,025	872	968	2,616	2,905
Net periodic (benefit) cost	$ (280)	$ (1,038)	$ (839)	$ (3,115)	$ 12,198	$ 14,202	$ 35,193	$ 43,442

CONSOL Energy does not expect to contribute to the CWP plan in 2006. We intend to pay benefit claims as they become due. For the three and nine months ended September 30, 2006, $1,809 and $7,551 of CWP benefit claims have been paid, respectively.

CONSOL Energy does not expect to contribute to the workers compensation plan in 2006. We intend to pay benefit claims as they become due. For the three and nine months ended September 30, 2006, $7,241 and $30,654 of workers compensation benefits, state administrative fees and surety bond premiums have been paid.

NOTE 6 INCOME TAXES:

The following is a reconciliation, stated in dollars and as a percentage of pretax income, of the U. S. statutory federal income tax rate to CONSOL Energy s effective tax rate:

	For the Nine Months Ended September 30,			
	2006		2005	
	Amount	Percent	Amount	Percent
Statutory U.S. federal income tax rate	$ 149,492	35.0%	$ 184,796	35.0%
Effect of gain on Sale of 18.5% of CNX Gas			(114,564)	(21.7)
Excess tax depletion	(41,056)	(9.6)	(40,065)	(7.6)
Effect of Domestic Production Activities Deduction	(1,896)	(0.5)		
Effect of Medicare Prescription Drug, Improvement and Modernization Act of 2003	1,206	0.3	(7,425)	(1.4)
Net Effect of state tax	15,576	3.7	8,264	1.6
Other	309	0.1	255	
Income Tax Expense / Effective Rate	$ 123,631	29.0%	$ 31,261	5.9%

The effective tax rate for the nine months ended September 30, 2006 was calculated using the annual effective rate projection on recurring earnings.

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The effective tax rate for the nine months ended September 30, 2005 was calculated using the annual effective rate projection on recurring earnings and a discrete tax calculation for the impact of the sale of 18.5% of CNX Gas Corporation (CNX Gas), a subsidiary of CONSOL Energy. In August 2005, CNX Gas sold 27.9 million shares of common stock. CNX Gas received proceeds of $420,167, which it used to pay a special dividend to CONSOL Energy. The pre-tax gain recognized on this transaction was $327,326. In accordance with Statement of Financial Accounting Standards Board Statement 109, Accounting for Income Taxes, no deferred tax has been provided on this sale as current tax law provides a means by which the excess of the reported amount of this investment over its tax basis can be recovered tax-free. Also, management has no current intention of entering into a transaction that would cause CNX Gas to leave the consolidated tax group.

NOTE 7 INVENTORIES:

Inventory components consist of the following:

	September 30, 2006	December 31, 2005
Coal	$ 90,029	$ 52,853
Merchandise for resale	16,662	16,995
Supplies	76,084	71,128
Total Inventories	$ 182,775	$ 140,976

NOTE 8 ACCOUNTS RECEIVABLE SECURITIZATION

In April 2003, CONSOL Energy and certain of our U.S. subsidiaries are party to a trade accounts receivable facility with financial institutions for the sale on a continuous basis of eligible trade accounts receivable. CONSOL Energy formed CNX Funding Corporation, a wholly owned, special purpose, bankruptcy-remote subsidiary for the sole purpose of buying and selling eligible trade receivables generated by certain subsidiaries of CONSOL Energy. Under the receivables facility, CONSOL Energy and certain subsidiaries, irrevocably and without recourse, sell all of their eligible trade accounts receivable to financial institutions and their affiliates, while maintaining a subordinated interest in a portion of the pool of trade receivables. CONSOL Energy will continue to service the sold trade receivables for the financial institutions for a fee based upon market rates for similar services.

The receivables facility allows CONSOL Energy to receive on a revolving basis, up to $125,000. The cost of funds is based upon commercial paper rates, plus a charge for administrative services paid to the financial institutions. Costs associated with the receivables facility totaled $42 and $295 for the three and nine months ended September 30, 2006, respectively. Costs associated with the receivables facility totaled $362 and $2,476 for the three and nine months ended September 30, 2005, respectively. These costs have been recorded as financing fees, which are included in Cost of Goods Sold and Other Operating Charges in the consolidated statements of income. No servicing asset or liability has been recorded. The receivables facility expires in April 2007.

At September 30, 2006 and December 31, 2005, eligible accounts receivable totaled approximately $114,700 and $116,100, respectively. The subordinated retained interest approximated $114,700 and $116,100 at September 30, 2006 and December 31, 2005, respectively. No accounts receivable were removed from the consolidated balance sheet at September 30, 2006 because CONSOL Energy retained the total eligible accounts receivable. Reductions of $125,000 in the accounts receivable securitization program for the nine months ended September 30, 2005 were reflected in cash flows from operating activities in the consolidated statement of cash flows.

The key economic assumptions used to measure the retained interest at the date of the securitization for all such sales completed in 2006 were a discount rate of 5.81% and an estimated life of 32 days. At September 30,

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2006 an increase in the discount rate or estimated life of 10% and 20% would have reduced the fair value of the retained interest by $59 and $118, respectively. These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumption to the change in fair value may not be linear. Also, in this example, the effect of a variation in a particular assumption on the fair value of the subordinated retained interest is calculated without changing any other assumption. Changes in any one factor may result in changes in others.

NOTE 9 PROPERTY, PLANT AND EQUIPMENT:

The components of property, plant and equipment are as follows:

	September 30, 2006	December 31, 2005
Plant & equipment	$ 4,333,421	$ 4,020,837
Coal properties and surface lands	1,109,075	1,079,202
Airshafts	861,847	789,270
Mine development	463,517	404,771
Leased Coal Lands	451,343	449,587
Advance Mining Royalties	358,113	352,993
Total Gross	7,577,316	7,096,660
Less: Accumulated depreciation, depletion and amortization	3,749,729	3,561,897
Total net property, plant and equipment	$ 3,827,587	$ 3,534,763

NOTE 10 DEBT:

CONSOL Energy has a $750,000 revolving credit facility which expires in 2010. The facility is collateralized by liens on substantially all of the assets of CONSOL Energy and our wholly-owned subsidiaries. Collateral is shared equally and ratably with the holders of CONSOL Energy s 7.875% bonds that mature in 2012 and CONSOL Energy s subsidiary s 8.25% medium-term notes maturing in 2007. Fees and interest rate spreads are based on a ratio of financial covenant debt to twelve month trailing earnings before interest, taxes, depreciation, depletion and amortization (EBITDA), measured quarterly. Covenants in the facility limit our ability to dispose of assets, make investments, purchase or redeem CONSOL Energy common stock and merge with another corporation. The facility includes a leverage ratio covenant of not more than 3.25 to 1.00, measured quarterly. The leverage ratio covenant was 0.60 to 1.00 at September 30, 2006. The facility also includes an interest coverage ratio covenant of no less than 4.50 to 1.00, measured quarterly. The interest coverage ratio covenant was 17.88 to 1.00 at September 30, 2006. At September 30, 2006, the $750,000 facility had no borrowings outstanding and $388,197 of letters of credit outstanding, leaving $361,803 of capacity available for borrowings and the issuance of letters of credit.

CNX Gas, an 81.5% subsidiary of CONSOL Energy, has a $200,000 revolving credit facility that is unsecured, however it does contain a negative pledge provision restricting CNX Gas assets from being used to secure other obligations. Fees and interest rate spreads are based on the percentage of facility utilization, measured quarterly. Covenants in the facility limit CNX Gas ability to dispose of assets, make investments, purchase or redeem CNX Gas stock and merge with another corporation. The facility includes a leverage ratio covenant of not more than 3.0 to 1.0, measured quarterly. The leverage ratio was 0.0 to 1.0 at September 30, 2006. The facility also includes an interest coverage ratio of no less than 3.0 to 1.0, measured quarterly. The interest coverage ratio was met at September 30, 2006. At September 30, 2006, the CNX Gas credit agreement had no borrowings outstanding and $16,847 of letters of credit outstanding, leaving $183,153 of capacity available for borrowings and the issuance of letters of credit.

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NOTE 11 COMMITMENTS AND CONTINGENCIES:

CONSOL Energy has various purchase commitments for materials, supplies and items of permanent investment incidental to the ordinary conduct of business. Such commitments are not at prices in excess of current market values.

One of our subsidiaries, Fairmont Supply Company, which distributes industrial supplies, currently is named as a defendant in approximately 24,801 asbestos claims in state courts in Pennsylvania, Ohio, West Virginia, Maryland, Mississippi and New Jersey. Because a very small percentage of products manufactured by third parties and supplied by Fairmont in the past may have contained asbestos and many of the pending claims are part of mass complaints filed by hundreds of plaintiffs against a hundred or more defendants, it has been difficult for Fairmont to determine how many of the cases actually involve valid claims or plaintiffs who were actually exposed to asbestos-containing products supplied by Fairmont. In addition, while Fairmont may be entitled to indemnity or contribution in certain jurisdictions from manufacturers of identified products, the availability of such indemnity or contribution is unclear at this time and, in recent years, some of the manufacturers named as defendants in these actions have sought protection from these claims under bankruptcy laws. Fairmont has no insurance coverage with respect to these asbestos cases. For the nine months ended September 30, 2006 and the year ended December 31, 2005, payments by Fairmont with respect to asbestos cases have not been material. Our current estimates related to these asbestos claims, individually and in the aggregate, are immaterial to the results of operations or cash flows of CONSOL Energy. However, it is reasonably possible that payments in the future with respect to pending or future asbestos cases may be material to the results of operations or cash flows of CONSOL Energy.

CONSOL Energy is subject to various lawsuits and claims with respect to such matters as personal injury, wrongful death, damage to property, exposure to hazardous substances, governmental regulations including environmental remediation, employment and contract disputes, and other claims and actions arising out of the normal course of business. Our current estimates related to these pending claims, individually and in the aggregate, are immaterial to the results of operations or cash flows of CONSOL Energy. However, it is reasonably possible that the ultimate liabilities in the future with respect to these lawsuits and claims may be material to the results of operations and cash flows of CONSOL Energy.

CONSOL Energy was notified in November 2004 by the United States Environmental Protection Agency (EPA) that it is a potentially responsible party (PRP) under Superfund legislation with respect to the Ward Transformer site in Wake County, North Carolina. At that time, the EPA also identified 38 other PRPs for the Ward Transformer site. On September 16, 2005, EPA, CONSOL Energy and three other PRPs entered into an administrative Settlement Agreement and Order on Consent, requiring those PRPs to undertake and complete a PCB soil removal action, at and in the vicinity of the Ward Transformer property. In December 2005, EPA approved the PRPs work plan, and field work began the first week of January 2006. The current estimated cost of remedial action including payment of EPA s past and future costs, is approximately $17,000. CONSOL Energy s interim allocation among the participating PRPs is 46%. Accordingly, CONSOL Energy recognized a $7,820 liability, of which $3,000 was recognized prior to December 31, 2005. This liability is included in other accrued liabilities. CONSOL Energy and the other participating PRPs are investigating contribution claims against other, non-participating PRPs, and such claims will be brought to recover a share of the costs incurred. To date, CONSOL Energy s portion of probable recoveries are estimated to be $3,194. Accordingly, an asset has been included in other assets for these claims. The net cost of the liability and the asset has been included in Cost of Goods Sold and Other Charges. There were $1,626 of costs which were recognized in the nine months ended September 30, 2006. No costs were recognized in Cost of Goods Sold and Other Charges for the three months ended September 30, 2006. CONSOL Energy has funded $626 and $1,878 in the three and nine month period ended September 30, 2006, respectively, to an independent trust established for this remediation. CONSOL Energy expects the majority of payments related to this liability to be made over the next twelve to eighteen months. In addition, the EPA has advised the PRPs that it is investigating additional areas of potential contamination allegedly related to the Ward Transformer site.

On October 21, 2003 a complaint was filed in the United States District Court for the Western District of Pennsylvania on behalf of Seth Moorhead against CONSOL Energy, J. Brett Harvey and William J. Lyons. The complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated under the Exchange Act and that during the period between January 24, 2002 and July 18, 2002 the defendants issued false and misleading statements to the public that failed to disclose or misrepresented the following, among other things that: (a) CONSOL utilized an aggressive approach regarding its spot market sales by reserving 20% of its production to that market, and that by increasing its exposure to the spot market, CONSOL Energy was subjecting itself to increased risk and uncertainty as the price and demand for coal could be volatile; (b) CONSOL Energy was experiencing difficulty selling the production that it had allocated to the spot market, and, nonetheless, CONSOL Energy maintained its production levels which caused its coal inventory to increase; (c) CONSOL Energy s increasing coal inventory was causing its expenses to rise dramatically, thereby weakening its financial condition; (d) CONSOL Energy s production problems and costs thereof were also weakening its financial condition; and (e) based on the foregoing, defendants positive statements regarding CONSOL Energy s earnings and prospects were lacking in a reasonable basis at all times and therefore were materially false and misleading. The complaint asks the court to (1) award unspecified damages to plaintiff and (2) award plaintiff reasonable costs and expenses incurred in connection with this action, including counsel fees and expert fees. The defendants have entered into an agreement in principle to settle with the plaintiff under terms which are not material to CONSOL Energy. The settlement is subject to court approval and the court s certification of a class.

As part of conducting mining activities at the Buchanan Mine, our subsidiary, Consolidation Coal Company (CCC), has to remove water from the mine. Several actions have arisen with respect to the untreated water removed from the Buchanan Mine:

Yukon Pocahontas Coal Company, Buchanan Coal Company, and Sayers-Pocahontas Coal Company filed an action on March 22, 2004 against CCC which is presently pending in the Circuit Court of Buchanan County, Virginia (the Yukon Action). The action related to untreated water in connection with mining activities at CCC s Buchanan Mine being deposited in the void spaces of nearby mines of one of our other subsidiaries, Island Creek Coal Company (ICCC). The plaintiffs are seeking to stop CCC from depositing any additional water in these areas, to require CCC to remove the water that is stored there along with any remaining impurities, to recover $300,000 of compensatory and trebled damages and to recover punitive damages. On July 26, 2006, plaintiffs filed a motion to amend the original complaint which was granted. The amended complaint asserts damage claims of $3,252,000 in compensatory damages and $350 in punitive damages against CCC, adds CONSOL Energy, CNX Gas Company, LLC and ICCC as additional defendants and asserts damage claims of $150,000 against these additional defendants.

Levisa Coal Company filed an action on July 10, 2006 against CCC which is presently pending in the Circuit Court of Buchanan County, Virginia (the Levisa Action). The action is for injunctive relief and declaratory judgment and seeks a court order prohibiting CCC from depositing water from its Buchanan Mine into the void spaces of ICCC s VP3 mine, part of which is under lease from Levisa Coal Company. The plaintiff claims the water will adversely affect its remaining coal reserves and coal bed methane production, thereby impacting the plaintiff s future royalties. Plaintiff has also moved for a temporary restraining order prohibiting further depositing of mine water into VP3 and a hearing could occur as early as November, 2006.

CCC has obtained environmental permits from the Virginia Department of Mines, Minerals and Energy (DMME) to deposit water from its Buchanan Mine into void spaces of VP3. CCC also has obtained a revised environmental permit to permit it in the future to discharge mine water into the nearby Levisa River. Plaintiffs in the Yukon Action and the Levisa Action along with the Town of Grundy, Virginia have requested the DMME to reconsider allowing CCC s depositing of mine water into VP3 and discharging mine water into the Levisa River. They have also requested temporary relief to stop CCC from making any such deposits or discharges pending a final hearing. The DMME has scheduled a formal hearing on this matter including the request for temporary relief and a hearing could occur as early as November, 2006. The plaintiffs in the Yukon Action on June 13, 2006 also filed an action against the DMME in the Circuit Court of Buchanan County, Virginia challenging DMME s issuance of the revised permit and have notified DMME that they will file a similar action challenging the VP3 permit. CONSOL has moved to intervene in that action and will likely seek to intervene in any similar actions. In addition, Buchanan County, Virginia on August 31, 2006 commenced an action against CCC in the Circuit Court of Buchanan County, Virginia seeking to enjoin any discharge by CCC of mine water into the Levisa River notwithstanding the permit issued to CCC by DMME. That action has been removed to the United States District Court for the Western District of Virginia.

We believe that CCC had and continues to have the right to deposit mine water from Buchanan Mine into void spaces at nearby mines, including VP3. We also believe DMME properly issued environmental permits to CCC with respect to depositing water into VP3 as well as discharging water into the Levisa River. CCC and the other CONSOL defendants deny all liability and intend to vigorously defend the actions filed against them. CCC also intends to vigorously defend the environmental permits issued to it. Consequently, we have not recognized any liability related to these actions. However, if a temporary restraining order or an injunction were to be issued against CCC, if the environmental permits were temporarily suspended or revoked, or if damages were awarded to plaintiffs, the result may be material to the results of operations or cash flows of CONSOL Energy.

On October 24, 2006 CONSOL Energy and CCC were served with a summons in the name of the Commonwealth of Virginia with the Circuit Court of Buchanan County, Virginia regarding a special grand jury presentment in response to citizens complaints that noise resulting from the ventilation fan at the Buchanan Mine constitutes a public nuisance. CONSOL Energy and CCC deny that the operation of the ventilation fan is a public nuisance and intend to vigorously defend this proceeding. However, if the operation of the ventilation fan is ordered to be stopped, the result may be material to the results of operations or cash flows of CONSOL Energy.

As previously disclosed, we expensed and paid approximately $28,000 to the Combined Fund for the plan year beginning October 1, 2003 related to a premium differential announced by the Social Security Administration for the past eleven plan years for beneficiaries assigned to CONSOL Energy. The premium differential is the difference between the lower premium rates determined by the National Coal Association v. Chater case and the higher premium rates determined by the Holland v. Barnhart case. Additionally, CONSOL Energy has expensed approximately $2,000 related to the premium differential for the plan year beginning October 1, 2004. In August 2005, a court ruling determined that the UMWA Health and Retirement Funds were illegally charging the premium differential. CONSOL Energy was also assessed an unassigned beneficiary premium increase of approximately $5,000 for the plan years beginning October 1, 2002 and October 1, 2003. We believe the calculation of the unassigned beneficiary premium is not accurate and, therefore, we have not paid this premium. CONSOL Energy has accrued an estimated liability related to this premium. The Combined Fund is protesting the court s decision. If the courts rule in CONSOL Energy s favor, the premium differential may be refunded to us and the unassigned beneficiary premium liability may be reduced. However, the legal process is lengthy and its outcome cannot be predicted with certainty. No estimates of refunds have been recorded and no amounts have been received from the UMWA Health and Retirement Funds to date.

On September 16, 2005, CONSOL Energy s Buchanan Mine, located near Keen Mountain, Virginia, had an accident with its skip hoist, the device that lifts coal from underground to the surface, forcing the mine to suspend coal production. The braking mechanism on the hoist failed to hold a loaded skip at the surface before it could dump its load. The loaded skip fell approximately 1,600 feet back through the shaft to the bottom. Simultaneously, the empty skip was propelled upward to the surface as the loaded skip fell, causing the empty skip to strike the top of the hoist mechanism before also falling back to the shaft bottom. The mine resumed production on December 13, 2005. This accident is covered under our property and business interruption insurance policy, subject to certain deductibles. No insurance recovery for business interruption was received for this incident in the three months ended September 30, 2006. Insurance recovery for business interruption of $21,392 was received for this incident in the nine months ended September 30, 2006, and accordingly was recognized as other income. CONSOL Energy is pursuing additional reimbursement from the insurance carriers. There can be no assurance that we will obtain any additional recovery from our insurance carriers.

In February 2005, CONSOL Energy s Buchanan Mine, experienced a cave-in behind the longwall mining machinery and an ignition of methane gas that started a fire. The mine was evacuated safely and was sealed on

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February 16, 2005 in order to extinguish any fire by cutting off oxygen to the mine s underground atmosphere. Costs related to the fire of approximately $1,570 and $38,428, net of recognized insurance recovery, were incurred for the three and nine months ended September 30, 2005, respectively. Costs to CONSOL Energy were primarily reflected in Cost of Goods Sold and Other Charges and Depreciation, Depletion and Amortization on the consolidated statement of income. In the year ended December 31, 2005, CONSOL Energy received $31,585 of insurance proceeds related to this incident. No receivables related to this incident were remaining at December 31, 2005. In the three and nine month period ended September 30, 2006, CONSOL Energy recognized $13,400 and $38,415 of insurance proceeds related to this incident in other income. No additional reimbursement from the insurance carriers related to this claim will be recovered.

In January 2003, Mine 84, near Washington, Pennsylvania experienced a fire along several hundred feet of the conveyor belt servicing the longwall section of the mine. The fire was extinguished approximately two weeks later. Recognized insurance recovery for damages of approximately $1,034 were reflected in Other Receivables at September 30, 2006 and December 31, 2005. CONSOL Energy received $1,785 of insurance proceeds related to this incident in the year ended December 31, 2005. CONSOL Energy has filed suit against one of the underwriter insurance carriers for insurance proceeds and bad faith settlement practices.

Certain excise taxes paid on export sales of coal were determined to be unconstitutional. CONSOL Energy filed claims with the Internal Revenue Service (IRS) seeking refunds for these excise taxes that were paid during the period 1991 through 1999. Accordingly, CONSOL Energy recognized receivables for these claims in 2001. The IRS completed an audit of our refund claims and confirmed the validity of the claim filed for the period 1994 through 1999. We received the refunds for this portion of the claim in 2003 and 2002. The United States Supreme Court denied review of the refund claim under the Tucker Act, which allows the refunds of taxes for the period 1991 through 1993. CONSOL Energy has a receivable of $26,006, which excludes an interest component, for this portion of the claim classified in Other Assets at September 30, 2006 and December 31, 2005. We also have a payable of $1,914 related to this claim classified in Other Liabilities at September 30, 2006 and December 31, 2005. Litigation has been filed with the Department of Justice regarding interest on the claims for the 1991 through 1993 period. CONSOL Energy believes the refund claim will be collected, although there can be no assurance that we will obtain any interest on the claim.

In 2005, there was a settlement related to the Harmar Environmental Trust (the Trust). The Trust Settlement was due to the court s decision to terminate a Trust Agreement among CONSOL Energy and other parties. The Trust was established in 1988 to provide funding for water treatment related to the now closed Harmar Mine. Other parties funded the Trust. CONSOL Energy was responsible for completing water treatment activities, but all costs associated with these activities were funded by the Trust. Any excess funding upon completion of water treatment or a specified date in the future were to be distributed to the parties that originally funded the trust. In the decision, all previously funded, but unused amounts remaining in the Trust were distributed. CONSOL Energy s portion of the distributed funds, which was $15,000, was placed into an escrow account pending provision of financial assurance supporting CONSOL Energy water treatment obligations. The financial assurances were provided and the money was released to CONSOL Energy. CONSOL Energy recorded the funding and $8,517 for present value of the water treatment liability, resulting in $6,483 of income in the nine months ended September 30, 2005.

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At September 30, 2006, CONSOL Energy and certain subsidiaries have provided the following financial guarantees. We believe that these guarantees will expire without being funded, and therefore the commitments will not have a material adverse effect on financial condition. The fair value of all liabilities associated with these guarantees have been properly recorded and reported in the financial statements.

	Total Amounts Committed	Less Than 1 Year	1-3 Years	3-5 Years	Beyond 5 Years
Letters of Credit:					
Employee-Related	$ 300,845	$ 90,088	$ 210,757	$	$
Environmental	77,399	73,695	3,704		
Gas	16,847	16,847			
Other	9,953	1,353	8,600		
Total Letters of Credit	$ 405,044	$ 181,983	$ 223,061	$	$
Surety Bonds:					
Employee-Related	$ 245,751	$ 245,751	$	$	$
Environmental	247,197	246,168	1,026	3	
Gas	1,182	1,182			
Other	6,885	6,847	38		
Total Surety Bonds	$ 501,015	$ 499,948	$ 1,064	$ 3	$
Guarantees:					
Coal	$ 186,828	$ 78,385	$ 40,041	$ 53,292	$ 15,110
Gas	88,421	84,716	605		3,100
Other	82,169	30,492	39,924	10,028	1,725
Total Guarantees	$ 357,418	$ 193,593	$ 80,570	$ 63,320	$ 19,935
Total Commitments	$ 1,263,477	$ 875,524	$ 304,695	$ 63,323	$ 19,935

Employee-related financial guarantees have primarily been extended to support the United Mine Workers of America s 1992 Benefit Plan and various state workers compensation self-insurance programs. Environmental financial guarantees have primarily been extended to support various performance bonds related to reclamation and other environmental issues. Gas financial guarantees have primarily been provided to support various performance bonds related to land usage and restorative issues. Other contingent liabilities have been extended to support insurance policies, legal matters and various other items necessary in the normal course of business.

CONSOL Energy and certain of its subsidiaries have also provided guarantees for the delivery of specific quantities of coal and gas to various customers. These guarantees are several or joint and several. Other guarantees have also been provided to promise the full and timely payments to lessors of mining equipment and support various other items necessary in the normal course of business.

NOTE 12 FAIR VALUE OF FINANCIAL INSTRUMENTS:

The following methods and assumptions were used to estimate the fair values of financial instruments:

Cash and cash equivalents: The carrying amount reported in the balance sheets for cash and cash equivalents approximates its fair value due to the short maturity of these instruments.

Current and Long-term debt: The fair values of long-term debt are estimated using discounted cash flow analyses, based on CONSOL Energy s current incremental borrowing rates for similar types of borrowing arrangements.

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Capital Leases: The carrying amount reported in the balance sheet for capital leases approximates its fair value due to recording the obligation at the present value of minimum lease payments.

The carrying amounts and fair values of financial instruments, excluding derivative financial instruments disclosed in Item 3 Quantitative and Qualitative Disclosure About Market Risk, are as follows:

	September 30, 2006		December 31, 2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 215,569	$ 215,569	$ 340,640	$ 340,640
Long-term debt	$ (443,561)	$ (446,774)	$ (442,996)	$ (468,701)
Capital leases	$ (33,827)	$ (33,827)	$	$

NOTE 13 SEGMENT INFORMATION:

CONSOL Energy has two principal business units: Coal and Gas. The principal activities of the Coal unit are mining, preparation and marketing of steam coal, sold primarily to power generators, and metallurgical coal, sold to metal and coke producers. The Coal unit includes four reportable segments. These reportable segments are Northern Appalachian, Central Appalachian, Metallurgical and Other Coal. Each of these reportable segments includes a number of operating segments (mines). For the three and nine months ended September 30, 2006, the Northern Appalachian aggregated segment includes the following mines: Shoemaker, Blacksville #2, Robinson Run, McElroy, Loveridge, Bailey, Enlow Fork, Mine 84 and Mahoning Valley. For the three and nine months ended September 30, 2006, Central Appalachian aggregated segment includes the following mines: Jones Fork, Mill Creek and Wiley-Mill Creek. For the three and nine months ended September 30, 2006, the Metallurgical aggregated segment includes the following mines: Buchanan, Amonate and V.P. #8. The Other Coal segment includes our purchased coal activities, idled mine cost, coal segment business units not meeting aggregation criteria, as well as various other activities assigned to the coal segment but not allocated to each individual mine. The principal activity of the Gas unit is to produce pipeline quality methane gas for sale primarily to gas wholesalers. CONSOL Energy s All Other Classification is made up of the Company s terminal services, river and dock services, industrial supply services and other business activities, including rentals of buildings and flight operations. The 2005 segment information was reclassified to conform to the 2006 presentation. Gas royalty income, gas miscellaneous revenues and expenses and various gas assets previously reported within Coal and All Other segments are now included in the Gas segment.

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Industry segment results for the three months ended September 30, 2006:

	Northern Appalachian	Central Appalachian	Metallurgical	Other Coal	Total Coal	Gas	All Other	Corporate Adjustments & Eliminations	Consolidated
Sales outside	$ 423,502	$ 51,670	$ 75,509	$ 54,481	$ 605,162	$ 94,233	$ 48,750	$	$ 748,145
Sales gas royalty interest						13,221			13,221
Sales purchased gas						9,076			9,076
Freight outside				38,239	38,239				38,239
Intersegment transfers						993	30,764	(31,757)	
Total Sales and Freight	$ 423,502	$ 51,670	$ 75,509	$ 92,720	$ 643,401	$ 117,523	$ 79,514	$ (31,757)	$ 808,681
Earnings (Loss) Before Income Taxes	$ 21,365	$ (1,743)	$ 42,726	$ (43,407)	$ 18,941	$ 60,867	$ 1,991	$ (9,654)	$ 72,145(A)
Segment assets					$ 3,451,670	$ 1,046,165	$ 204,408	$ 592,188	$ 5,294,431(B)
Depreciation, depletion and amortization					$ 58,924	$ 9,546	$ 4,354	$	$ 72,824
Capital Expenditures (including acquisitions)					$ 136,406	$ 34,078	$ 4,549	$	$ 175,033

(A) Includes equity in earnings (losses) of unconsolidated affiliates of ($44) and ($6) for Gas and All Other, respectively.
(B) Includes investments in unconsolidated equity affiliates of $51,658 and $2,674 for Gas and All Other, respectively. Also, included in the Coal segment is $26,006 of receivables related to the Export Sales Excise Tax resolution.

Industry segment results for the three months ended September 30, 2005:

	Northern Appalachian	Central Appalachian	Metallurgical	Other Coal	Total Coal	Gas	All Other	Corporate Adjustments & Eliminations	Consolidated
Sales outside	$ 451,560	$ 57,256	$ 66,413	$ 44,297	$ 619,526	$ 72,890	$ 33,727	$	$ 726,143
Sales related party				4,135	4,135				4,135
Sales gas royalty interest						12,317			12,317
Sales purchased gas						88,288			88,288
Freight outside				30,718	30,718				30,718
Freight related party				468	468				468
Intersegment transfers						716	26,614	(27,330)	
Total Sales and Freight	$ 451,560	$ 57,256	$ 66,413	$ 79,618	$ 654,847	$ 174,211	$ 60,341	$ (27,330)	$ 862,069
Earnings (Loss) Before Income Taxes	$ 59,710	$ (1,106)	$ 4,634	$ (26,988)	$ 36,250	$ 42,098	$ (8,088)	$ 317,354	$ 387,614(C)
Segment assets					$ 3,081,583	$ 826,321	$ 170,271	$ 866,349	$ 4,944,524(D)
Depreciation, depletion and amortization					$ 52,081	$ 8,671	$ 3,348	$	$ 64,100

Capital Expenditures	$ 82,770	$ 33,565	$ 1,365	$	$ 117,700

(C) Includes equity in earnings (losses) of unconsolidated affiliates of ($551),$147 and $538 for Coal, Gas and All Other, respectively.

(D) Includes investments in unconsolidated equity affiliates of $49,850 and $3,608 for Gas and All Other, respectively. Also, included in the Coal segment is $26,006 of receivables related to the Export Sales Excise Tax resolution.

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Industry segment results for the nine months ended September 30, 2006:

	Northern Appalachian	Central Appalachian	Metallurgical	Other Coal	Total Coal	Gas	All Other	Corporate Adjustments & Eliminations	Consolidated
Sales outside	$ 1,392,625	$ 180,788	$ 249,789	$ 182,495	$ 2,005,697	$ 288,837	$ 147,202	$	$ 2,441,736
Sales gas royalty interest						41,714			41,714
Sales purchased gas						41,206			41,206
Freight outside				113,007	113,007				113,007
Intersegment transfers						3,410	101,241	(104,651)	
Total Sales and Freight	$ 1,392,625	$ 180,788	$ 249,789	$ 295,502	$ 2,118,704	$ 375,167	$ 248,443	$ (104,651)	$ 2,637,663
Earnings (Loss) Before Income Taxes	$ 216,573	$ 6,810	$ 118,625	$ (79,715)	$ 262,293	$ 195,749	$ 7,888	$ (38,809)	$ 427,121(E)
Segment assets					$ 3,451,670	$ 1,046,165	$ 204,408	$ 592,188	$ 5,294,431(F)
Depreciation, depletion and amortization					$ 178,577	$ 27,437	$ 13,074	$	$ 219,088
Capital Expenditures (including acquisitions)					$ 335,686	$ 117,087	$ 41,394	$	$ 494,167

(E) Includes equity in earnings (losses) of unconsolidated affiliates of $728 and ($59) for Gas and All Other, respectively.

(F) Includes investments in unconsolidated equity affiliates of $51,658 and $2,674 for Gas and All Other, respectively. Also, included in the Coal segment is $26,006 of receivables related to the Export Sales Excise Tax resolution.

Industry segment results for the nine months ended September 30, 2005:

	Northern Appalachian	Central Appalachian	Metallurgical	Other Coal	Total Coal	Gas	All Other	Corporate Adjustments & Eliminations	Consolidated
Sales outside	$ 1,379,770	$ 170,705	$ 188,905	$ 133,793	$ 1,873,173	$ 196,861	$ 93,048	$	$ 2,163,082
Sales related party				4,749	4,749				4,749
Sales gas royalty interest						31,059			31,059
Sales purchased gas						157,545			157,545
Freight outside				92,507	92,507				92,507
Freight related party				468	468				468
Intersegment transfers						1,342	82,348	(83,690)	
Total Sales and Freight	$ 1,379,770	$ 170,705	$ 188,905	$ 231,517	$ 1,970,897	$ 386,807	$ 175,396	$ (83,690)	$ 2,449,410
Earnings (Loss) Before Income Taxes	$ 214,148	$ (4,889)	$ 37,278	$ (95,038)	$ 151,499	$ 112,234	$ (12,849)	$ 277,104	$ 527,988(G)
Segment assets					$ 3,081,583	$ 826,321	$ 170,271	$ 866,349	$ 4,944,524(H)
Depreciation, depletion and amortization					$ 158,232	$ 25,883	$ 10,144	$	$ 194,259
Capital Expenditures (including acquisitions)					$ 213,587	$ 70,207	$ 3,468	$	$ 287,262

(G) Includes equity in earnings (losses) of unconsolidated affiliates of ($1,758), $366 and $3,344 for Coal, Gas and All Other, respectively.

(H) Includes investments in unconsolidated equity affiliates of $49,850 and $3,608 for Gas and All Other, respectively. Also, included in the Coal segment is $26,006 of receivables related to the Export Sales Excise Tax resolution.

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Reconciliation of Segment Information to Consolidated Amounts:

Earnings Before Income Taxes:

	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2005
Segment earnings before income taxes for total reportable business segments	$ 79,808	$ 78,348	$ 458,042	$ 263,733
Segment earnings (loss) before income taxes for all other businesses	1,991	(8,088)	7,888	(12,849)
Incentive compensation (A)	(1,410)	(1,515)	(14,448)	(16,291)
Compensation from restricted stock unit grants and stock options (A)	(3,190)	(1,077)	(8,248)	(2,874)
Gain on Sale of 18.5% of CNX Gas		327,326		327,326
Interest income (expense), net and other non-operating activity (A)	(5,054)	(7,380)	(16,113)	(31,057)
Earnings Before Income Taxes	$ 72,145	$ 387,614	$ 427,121	$ 527,988

Total Assets:

	September 30, 2006	September 30, 2005
Segment assets for total reportable business segments	$ 4,497,835	$ 3,907,904
Segment assets for all other businesses	204,408	170,271
Items excluded from segment assets:		
Cash and other investments (A)	109,296	324,486
Deferred tax assets	481,065	539,418
Intangible asset overfunded pension plan		248
Bond issuance costs	1,827	2,197
Total Consolidated Assets	$ 5,294,431	$ 4,944,524

(A) Excludes amounts specifically related to the Gas segment.

NOTE 14 GUARANTOR SUBSIDIARIES FINANCIAL INFORMATION:

The payment obligations under the $250,000 7.875 percent Notes due 2012 issued by CONSOL Energy in 2002 are fully and unconditionally guaranteed by several subsidiaries of CONSOL Energy. In accordance with positions established by the Securities and Exchange Commission, the following financial information sets forth separate financial information with respect to the parent, the guarantor subsidiaries and the non-guarantor subsidiaries. The principal elimination entries eliminate investments in subsidiaries and certain intercompany balances and transactions. CONSOL Energy, the parent and a guarantor subsidiary manage several assets and liabilities of all of their subsidiaries. For example, these include deferred tax assets, cash and other post-employment liabilities. These assets and liabilities are reflected as parent company or guarantor company amounts for purposes of this presentation.

Income Statement for the Three Months ended September 30, 2006:

	Parent	Guarantors	Non-Guarantors	Elimination	Consolidated
Sales Outside	$	$ 702,365	$ 45,759	$ 21	$ 748,145
Sales Gas Royalty Interests		13,221			13,221
Sales Purchased Gas		9,076			9,076
Freight Outside		38,239			38,239
Other Income (including equity earnings)	62,569	23,979	8,929	(60,806)	34,671
Total Revenue and Other Income	62,569	786,880	54,688	(60,785)	843,352
Cost of Goods Sold and Other Operating Charges	9,818	489,603	9,974	42,709	552,104
Gas Royalty Interests Costs		10,808			10,808
Purchased Gas Costs		9,340			9,340
Related Party Activity	(809)	13,839	31,536	(44,566)	
Freight Expense		38,239			38,239
Selling, General and Administrative Expense		24,100	962		25,062
Depreciation, Depletion and Amortization	1,737	69,239	1,984	(136)	72,824
Interest Expense	5,060	480	145		5,685
Taxes Other Than Income	860	54,371	1,914		57,145
Total Costs	16,666	710,019	46,515	(1,993)	771,207
Earnings (Loss) Before Income Taxes and Minority Interest	45,903	76,861	8,173	(58,792)	72,145
Income Tax Expense (Benefit)	(4,683)	16,420	2,860		14,597
Earnings (Loss) before Minority Interest	50,586	60,441	5,313	(58,792)	57,548
Minority Interest		(6,962)			(6,962)
Net Income (Loss)	$ 50,586	$ 53,479	$ 5,313	$ (58,792)	$ 50,586

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Balance Sheet at September 30, 2006:

	Parent	Guarantors	Non-Guarantors	Elimination	Consolidated
Assets:					
Current Assets:					
Cash and Cash Equivalents	$ 100,365	$ 108,805			