

ARCH COAL INC  
Form DEF 14A  
March 20, 2007

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**SCHEDULE 14A**

**(Rule 14a-101)**

**Schedule 14A Information**

**Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No.    )**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies.

(3) Per unit or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount previously paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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**Table of Contents**

One CityPlace Drive, Suite 300  
St. Louis, Missouri 63141  
(314) 994-2700

March 19, 2007

Dear fellow stockholder:

You are cordially invited to attend the annual meeting of stockholders of Arch Coal, Inc. on Thursday, April 26, 2007. We will hold the meeting at 10:00 a.m., St. Louis time, in the lower level auditorium at our headquarters at CityPlace One, One CityPlace Drive, St. Louis, Missouri 63141. You can find maps with directions to our headquarters near the back of the proxy statement that accompanies this letter.

In connection with the annual meeting, we have enclosed a notice of the meeting, a proxy statement and a proxy card. We have also enclosed a copy of our annual report for 2006 which contains detailed information about us and our operating and financial performance.

I hope that you will be able to attend the meeting, but I know that not every stockholder will be able to do so. Whether or not you plan to attend, I encourage you to vote your shares. You may vote by telephone or on the Internet, or complete, sign and return the enclosed proxy card in the postage-prepaid envelope, also enclosed. The prompt execution of your proxy will be greatly appreciated.

Sincerely,

Steven F. Leer  
*Chairman of the Board and Chief Executive Officer*

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**Table of Contents**

One CityPlace Drive, Suite 300  
St. Louis, Missouri 63141  
(314) 994-2700

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**DATE:** Thursday, April 26, 2007

**TIME:** 10:00 a.m., St. Louis time

**PLACE:** Lower Level Auditorium  
CityPlace One  
One CityPlace Drive  
St. Louis, Missouri 63141

**Matters to be voted on:**

Election of four directors

Any other matters if properly introduced at the meeting

Stockholders of record at the close of business on March 1, 2007 may vote at the annual meeting and any adjournments. Your vote is important. Whether you plan to attend the annual meeting or not, **please cast your vote by phone or on the Internet, or complete, date and sign your proxy card and return it in the envelope provided.** If you attend the annual meeting and prefer to vote in person, you may do so even if you have previously voted by proxy. You can find maps with directions to our headquarters on page 45 of the enclosed proxy statement.

By order of the Board of Directors of Arch Coal, Inc.

Robert G. Jones  
*Vice President Law, General Counsel and Secretary*  
St. Louis, Missouri

March 19, 2007

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One CityPlace Drive, Suite 300  
St. Louis, Missouri 63141  
(314) 994-2700

**PROXY STATEMENT**

**TABLE OF CONTENTS**

	<b>Page</b>
<u>INFORMATION ABOUT THE ANNUAL MEETING</u>	1
<u>CORPORATE GOVERNANCE</u>	4
<u>Overview</u>	4
<u>Director Independence</u>	4
<u>Code of Conduct</u>	5
<u>Conflicts of Interest</u>	5
<u>Communicating with the Board of Directors</u>	5
<u>ELECTION OF DIRECTORS (Proxy Item No. 1)</u>	6
<u>Structure of the Board of Directors</u>	6
<u>Nominees for a Three-Year Term That Will Expire in 2010</u>	7
<u>Directors Whose Terms Will Expire in 2008</u>	7
<u>Directors Whose Terms Will Expire in 2009</u>	8
<u>Board Meetings and Committees</u>	8
<u>Audit Committee Report</u>	12
<u>Personnel and Compensation Committee Report</u>	13
<u>Compensation Committee Interlocks and Insider Participation</u>	14
<u>Director Compensation for the Year Ended December 31, 2006</u>	14
<u>OWNERSHIP OF ARCH COAL COMMON STOCK</u>	16
<u>Ownership by Directors and Executive Officers</u>	16
<u>Ownership by Others</u>	17
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	18
<u>COMPENSATION OF EXECUTIVE OFFICERS</u>	19
<u>Compensation Discussion and Analysis</u>	19
<u>Summary Compensation Table</u>	27
<u>Grants of Plan-Based Awards for the Year Ended December 31, 2006</u>	29
<u>Outstanding Equity Awards at December 31, 2006</u>	30
<u>Option Exercises and Stock Vested for the Year Ended December 31, 2006</u>	32
<u>Pension Benefits</u>	33
<u>Non-Qualified Deferred Compensation</u>	34
<u>Potential Payments Upon Termination of Employment or Change-in-Control</u>	35
<u>ADDITIONAL INFORMATION</u>	43
<u>Independent Registered Public Accounting Firm</u>	43
<u>Information About Stockholder Proposals</u>	43
<u>Solicitation of Proxies</u>	44
<u>Electronic Access to Proxy Statement and Annual Report</u>	44
<u>Directions to the Annual Meeting</u>	45

---

**Table of Contents**

**INFORMATION ABOUT THE ANNUAL MEETING**

**Why am I receiving these proxy materials?**

Our board of directors is soliciting proxies to be voted at the 2007 annual meeting of stockholders. This proxy statement includes information about the issues to be voted upon at the meeting.

On March 19, 2007, we began mailing these proxy materials to all stockholders of record at the close of business on March 1, 2007, the record date. On the record date, there were 142,404,167 shares of our common stock outstanding. As required by Delaware law, we will make a list of stockholders entitled to vote at the annual meeting available at and for ten days prior to the meeting, during normal business hours, at our offices, CityPlace One, One CityPlace Drive, Suite 300, St. Louis, Missouri 63141.

**Where and when is the annual meeting?**

The annual meeting will take place on April 26, 2007 in the lower level auditorium at our headquarters, located at CityPlace One, One CityPlace Drive, St. Louis, Missouri 63141. The meeting will begin at 10:00 a.m., St. Louis time. You can find maps with directions to our headquarters on page 45 of this proxy statement.

**What am I voting on?**

We are aware of the following items to be voted on by stockholders at the annual meeting:

Election of four directors: Brian J. Jennings, Steven F. Leer, Robert G. Potter and Theodore D. Sands; and

Any other matter if properly introduced at the annual meeting.

**How many votes do I have?**

You have one vote for each share of our common stock that you owned at the close of business on the record date. These shares include:

Shares registered directly in your name with our transfer agent, for which you are considered the stockholder of record;

Shares held for you as the beneficial owner through a broker, bank, or other nominee in street name; and

Shares credited to your account in our Employee Thrift Plan or the Mingo Logan Savings Plan.

**If I am a stockholder of record, how can I vote my shares?**

You can vote by proxy or in person.

**Table of Contents**

**How do I vote by proxy?**

If you are a stockholder of record, you may vote your proxy by telephone, Internet, or mail. Our telephone and Internet voting procedures are designed to authenticate stockholders by using individual control numbers. Voting by telephone or Internet will help us reduce costs.

Voting your proxy by telephone

In the U.S. and Canada, you can vote your shares by telephone by calling the toll-free telephone number on your proxy card. Telephone voting is available 24 hours a day, 7 days a week, until 11:59 p.m., Eastern time, on the day before the meeting. Easy-to-follow voice prompts allow you to vote your shares and confirm that your instructions have been properly recorded. If you vote by telephone, you do not need to return your proxy card.

Voting your proxy by Internet

You can also choose to vote via the Internet. The web site for Internet voting is on your proxy card. Internet voting is also available 24 hours a day, 7 days a week, until 11:59 p.m., Eastern time, on the day before the meeting. If you vote via the Internet, you do not need to return your proxy card.

Voting your proxy by mail

If you choose to vote by mail, simply mark your proxy card, date and sign it, and return it in the postage-paid envelope provided.

If you vote by proxy using any of these three methods, Steven F. Leer or Robert G. Jones will vote your shares in the manner you indicate. You may specify whether your shares should be voted for all, some, or none of the nominees for director. If you vote by telephone or Internet and choose to vote with the recommendation of our board of directors, or if you vote by mail, sign your proxy card, and do not indicate specific choices, your shares will be voted FOR the election of all four nominees for director.

If any other matter is presented, your proxy will authorize Steven F. Leer or Robert G. Jones to vote in accordance with their best judgment. At the time this proxy statement was printed, we knew of no matters that needed to be acted on at the annual meeting other than those discussed in this proxy statement.

If you wish to give a proxy to someone other than Steven F. Leer or Robert G. Jones, you may strike out their names on the proxy card and write in the name of any other person, sign the proxy, and deliver it to the person whose name has been substituted.

**May I revoke my proxy?**

If you give a proxy, you may revoke it in any one of the following three ways:

Submit a valid, later-dated proxy;

Notify Robert G. Jones, our secretary, in writing before the annual meeting that you have revoked your proxy; or

Vote in person at the annual meeting.





**Table of Contents**

**How do I vote in person?**

If you are a stockholder of record, you may cast your vote in person at the annual meeting.

**If I hold shares in street name, how can I vote my shares?**

You can submit voting instructions to your bank, broker or other nominee. In most instances, you will be able to do this by telephone, over the Internet, or by mail. Please refer to the voting instruction card included with these materials by your bank, broker or other nominee.

**How do I vote my shares in the dividend reinvestment plan or the direct stock purchase plan?**

If you participate in our dividend reinvestment plan or our direct stock purchase plan, your proxy will also serve as an instruction to vote the whole shares you hold under those plans in the manner indicated on the proxy. If your proxy is not received, the shares you hold in those plans will not be voted.

**How do I vote my shares held in the Employee Thrift Plan or the Mingo Logan Savings Plan?**

If you are both a registered stockholder and a participant in our Employee Thrift Plan or the Mingo Logan Savings Plan, you will receive a single proxy card that covers shares of our common stock credited to your plan account as well as shares of record registered in exactly the same name. Accordingly, your proxy card also serves as a voting instruction for the trustee of the plan. If your plan account is not carried in exactly the same name as your shares of record, you will receive separate proxy cards for individual and plan holdings. If you own shares through one of these plans and you do not return your proxy by April 16, 2007, the trustee will vote your shares in the same proportion as the shares that are voted by the other participants in the plan. The trustee will also vote unallocated shares of our common stock held in the plan in direct proportion to the voting of allocated shares in the plan for which voting instructions have been received unless doing so would be inconsistent with the trustee's duties.

**Is my vote confidential?**

Yes. Voting tabulations are confidential except in extremely limited circumstances. Such limited circumstances include contested solicitation of proxies, when disclosure is required by law, to defend a claim against us or to assert a claim by us, and when a stockholder's written comments appear on a proxy or other voting material.

**What vote is required to approve each proposal?**

Election of four directors (Proxy Item No. 1)

The nominees who receive the most votes for the available positions will be elected. If you indicate withhold authority to vote for a particular nominee on your proxy card, your vote will not count either for or against the nominee. Abstentions are not counted in the election of directors and do not affect the outcome.

## **Table of Contents**

In order to have a valid stockholder vote, a stockholder quorum must exist at the annual meeting. A quorum will exist when stockholders holding a majority of the outstanding shares of our common stock are present at the meeting, either in person or by proxy.

Broker non-votes occur when brokers do not have discretionary voting authority to vote certain shares held in street name on particular proposals and the beneficial owner of those shares has not instructed the broker how to vote on those proposals. Under New York Stock Exchange rules, brokers who hold shares for the accounts of their clients and who have not received instructions from their clients do have discretion to vote in the election of directors. Accordingly, broker non-votes will have no effect on the election of directors.

### **Where can I find the voting results of the annual meeting?**

We intend to announce preliminary voting results at the annual meeting. We will publish the final results in our Quarterly Report on Form 10-Q for the first quarter of 2007, which we expect to file on or before May 10, 2007. You can obtain a copy of the Form 10-Q by logging on to our website at archcoal.com, by calling the Securities and Exchange Commission at (800) SEC-0330 for the location of the nearest public reference room, or through the EDGAR system at sec.gov. Information on our website does not constitute part of this proxy statement.

## **CORPORATE GOVERNANCE**

### **Overview**

We are dedicated to being a market-driven global leader in the coal industry and to creating superior long-term stockholder value. It is our policy to conduct our business with integrity and an unrelenting passion for providing the best value to our customers. All of our corporate governance materials, including the corporate governance guidelines, our code of conduct and board committee charters, are published under Corporate Governance in the Investors section of our website at archcoal.com. These materials are also available in print to any stockholder upon request. The board of directors continually reviews these materials, Delaware law, the rules and listing standards of the New York Stock Exchange and SEC regulations, as well as best practices suggested by recognized governance authorities, and modifies the materials as warranted.

### **Director Independence**

It is the board of director's objective to have an overwhelming majority of directors who are independent. We have adopted in our corporate governance guidelines the criteria established by the New York Stock Exchange for determining whether a director is independent. The board of directors has determined, in its judgment, that ten of the twelve members of the board of directors meet the New York Stock Exchange standards for independence. Other than Steven F. Leer and John W. Eaves, who are executive officers, each member of our board of directors satisfies the independence standards in the corporate governance guidelines. The independent members of the board meet regularly without any

## **Table of Contents**

members of management present. These sessions are normally held following or in conjunction with regular board meetings. Mr. James R. Boyd, chairman of the Nominating and Corporate Governance Committee and lead director, serves as the presiding director during executive sessions.

All members of our Audit, Nominating and Corporate Governance and Personnel and Compensation committees must be independent directors as defined by our corporate governance guidelines. Members of the Audit Committee must also satisfy a separate Securities and Exchange Commission independence requirement, which provides that they may not accept, directly or indirectly, any consulting, advisory or other compensatory fee from us or any of our subsidiaries other than their directors' compensation.

### **Code of Conduct**

All of our employees, including our chief executive officer, our chief financial officer and each of the other executive officers named in this proxy statement, and directors must act ethically at all times and in accordance with the policies comprising our code of conduct, which is published under "Corporate Governance" in the Investors section of our website at archcoal.com and available in print to any stockholder upon request. We intend to post amendments to or waivers from (to the extent applicable to one of our directors or executive officers) the code on our website.

### **Conflicts of Interest**

Our code of conduct reflects our policy that all of our employees, including the executive officers named in this proxy statement, and directors must avoid any activity that creates, or may create, a conflict of interest, that might interfere with the proper performance of their duties or that might be hostile, adverse or competitive with our business. In addition, each of our directors and executive officers is encouraged to notify our board of directors when confronted with any situation that may be perceived as a conflict of interest, even if the person does not believe that the situation would violate our code of conduct or corporate governance guidelines. Our board of directors will then determine, after consultation with counsel, whether a conflict of interest exists. Directors who have a material personal interest in a particular issue may not vote on any matters with respect to that issue.

### **Communicating with the Board of Directors**

Our board of directors has established procedures to enable anyone who has a concern about our conduct, or any employee who has a concern about our accounting, internal accounting controls or auditing matters, to communicate that concern directly to the board of directors, to the non-employee directors or to the Audit Committee. Such communications may be confidential or anonymous, and may be reported by phone to our confidential hotline at 1-866-519-1881 or by writing to the individual directors or group in care of Arch Coal, Inc., One CityPlace Drive, Suite 300, St. Louis, Missouri 63141, Attention: Vice President - Law, General Counsel and Secretary. All such communications are promptly communicated to our Director of Internal Audit and the chairman of the Audit Committee. It is our policy not to take any disciplinary or other retaliatory action against any employee for raising or helping to resolve an integrity concern.

**Table of Contents**

**ELECTION OF DIRECTORS**

**(PROXY ITEM NO. 1)**

**Structure of the Board of Directors**

Our certificate of incorporation and bylaws provide for a board of directors that is divided into three classes as equal in size as possible. The classes have three-year terms, and the term of one class expires each year in rotation at that year's annual meeting. The size of the board of directors can be changed by a two-thirds vote of its members and is currently set at twelve members. Vacancies on the board of directors may be filled by a majority of the remaining directors. A director elected to fill a vacancy, or a new directorship created by an increase in the size of the board of directors, serves for the remainder of the full term of the class of directors in which the vacancy or newly created directorship occurred. As a matter of policy, the board of directors will submit the nomination of a director elected to fill a vacancy to the vote of our stockholders at the next annual meeting.

In February 2006, as part of its succession planning process and upon the recommendation of the Nominating and Corporate Governance Committee, our board of directors increased the size of our board of directors to eleven and elected John W. Eaves, our President and Chief Operating Officer, to fill the vacancy created by the increase.

In July 2006, our board of directors increased the size of our board of directors to twelve and added Brian J. Jennings to fill the vacancy created by the increase. In searching for a new director, the Nominating and Corporate Governance Committee retained an executive search firm to identify potential candidates meeting certain qualifications established by the committee. The executive search firm then prepared a list of potential candidates and reviewed that list with the Nominating and Corporate Governance Committee. After interviewing several candidates, including Mr. Jennings, the Nominating and Corporate Governance Committee recommended to the full board of directors that Mr. Jennings be invited to join. Mr. Boyd, the chairman of the Nominating and Corporate Governance Committee, then contacted Mr. Jennings to extend an invitation to join the board of directors.

Our board of directors has nominated four individuals for election as directors for a three-year term that will expire in 2010: Brian J. Jennings, Steven F. Leer, Robert G. Potter and Theodore D. Sands. All nominees are currently serving as directors. The board of directors is not aware that any nominee named in this proxy statement will be unwilling or unable to serve as a director. All nominees have consented to be named in the proxy statement and to serve if elected. If, however, a nominee is unavailable for election, your proxy authorizes us to vote for a replacement nominee if the board of directors names one. As an alternative, the board of directors may reduce the number of directors to be elected at the meeting. Proxies may not be voted for a greater number of persons than the nominees identified below.

**Table of Contents**

The following is a list of our directors, their ages as of February 26, 2007, their occupation during the last five years and certain other biographical information:

**Nominees for a Three-Year Term That Will Expire in 2010**

*Brian J. Jennings*, 46, has been a director of Arch Coal since July 2006. From March 2004 to December 2006, Mr. Jennings served as Senior Vice President – Corporate Finance and Development and Chief Financial Officer of Devon Energy Corporation. Mr. Jennings served as Senior Vice President – Corporate Finance and Development from 2001 to March 2004. Mr. Jennings joined Devon in March 2000 as Vice President – Corporate Finance.

*Steven F. Leer*, 54, has been Chief Executive Officer and a director of Arch Coal since 1992. From 1992 to April 2006, Mr. Leer also served as our president. In April 2006, Mr. Leer became chairman of the board of directors. Mr. Leer also serves on the boards of the Norfolk Southern Corporation, USG Corp., the Western Business Roundtable and the University of the Pacific and is chairman of the Coal Industry Advisory Board. Mr. Leer is past chairman and continues to serve on the boards of the Center for Energy and Economic Development, the National Coal Council and the National Mining Association.

*Robert G. Potter*, 67, has been a director of Arch Coal since April 2001. Mr. Potter was Chairman and Chief Executive Officer of Solutia Inc., a producer and marketer of a variety of high performance chemical-based materials, from 1997 to his retirement in 1999. Mr. Potter served for 32 years with Monsanto Company prior to its spin-off of Solutia in 1997, most recently as the Chief Executive of its chemical businesses. Mr. Potter is a private investor and director of Stepan Company.

*Theodore D. Sands*, 61, has been a director of Arch Coal since 1999 and, since February 1999, has served as President of HAAS Capital, LLC, a private consulting and investment company. Mr. Sands is also a director of Protein Sciences Corporation and Terra Nitrogen Corporation. Mr. Sands served as Managing Director, Investment Banking for the Global Metals/Mining Group of Merrill Lynch & Co. from 1982 until February 1999.

**Your board of directors recommends a vote For these nominees.**

**Directors Whose Terms Will Expire in 2008**

*James R. Boyd*, 60, has been a director of Arch Coal since 1990. Mr. Boyd served as chairman of the board of directors from 1998 to April 2006, when he was appointed our lead director. Mr. Boyd served as Senior Vice President and Group Operating Officer of Ashland Inc., a multi-industry company with operations in chemicals, motor oil, car care products and highway construction, from 1989 until his retirement in January 2002. Mr. Boyd is also a director of Farmers Bancorp of Lynchburg, Tennessee and Halliburton Inc.

*John W. Eaves*, 49, has been a director of Arch Coal since February 2006. Mr. Eaves has been President and Chief Operating Officer since April 2006. From December 2002 to April 2006, Mr. Eaves served as our Executive Vice President and Chief Operating Officer. From February 2000 to December

**Table of Contents**

2002, Mr. Eaves served as our Senior Vice President Marketing and from September 1995 to December 2002 as President of our Arch Coal Sales Company, Inc. subsidiary. Mr. Eaves also served as our Vice President Marketing from July 1997 through February 2000. Mr. Eaves serves on the board of directors of ADA-ES, Inc.

*Douglas H. Hunt*, 54, has been a director of Arch Coal since 1995 and, since May 1995, has served as Director of Acquisitions of Petro-Hunt, LLC, a private oil and gas exploration and production company.

*A. Michael Perry*, 70, has been a director of Arch Coal since 1998. He served as Chairman of Bank One, West Virginia, N.A. from 1993 and as its Chief Executive Officer from 1983 to his retirement in June 2001. Mr. Perry is also a director of Champion Industries, Inc. and Portec Rail Products, Inc.

**Directors Whose Terms Will Expire in 2009**

*Frank M. Burke*, 67, has been a director of Arch Coal since September 2000. He has served as Chairman, Chief Executive Officer and Managing General Partner of Burke, Mayborn Company, Ltd., a private investment and consulting company since 1984. Mr. Burke is also a director of Crosstex Energy GP, LLC (general partner of Crosstex Energy, L.P.), Crosstex Energy, Inc. and Corrigan Investments, Inc., and is a member of the National Petroleum Council.

*Patricia F. Godley*, 58, has been a director of Arch Coal since 2004. Since 1998, Ms. Godley has been a partner with the law firm of Van Ness Feldman in Washington, D.C., practicing in the areas of economic and environmental regulation of electric utilities and natural gas companies. From 1994 until 1998, Ms. Godley served as the Assistant Secretary for Fossil Energy at the U.S. Department of Energy. Ms. Godley is also a director of the United States Energy Association.

*Thomas A. Lockhart*, 71, has been a director of Arch Coal since February 2003 and a member of the Wyoming State House of Representatives since 2000. Mr. Lockhart worked for PacifiCorp, an electric utility, for over 30 years and retired in 1998 as a Vice President. Mr. Lockhart is also a director of First Interstate Bank of Casper, Wyoming and Blue Cross Blue Shield of Wyoming.

*Wesley M. Taylor*, 64, has been a director of Arch Coal since July 2005. Mr. Taylor was President of TXU Generation, a company engaged in electricity infrastructure ownership and management. Mr. Taylor served for 38 years at TXU prior to his retirement in 2004. Mr. Taylor is also a director of FirstEnergy Corporation.

**Board Meetings and Committees**

The board of directors has the following four committees: Nominating and Corporate Governance, Finance, Personnel and Compensation and Audit. The table below contains information concerning the membership of each of the committees and the number of times the board and each committee met during 2006. Each director attended at least 75% of the total number of meetings of the board and of the committees on which he or she serves. In addition, all directors are expected to attend the annual meeting

**Table of Contents**

of stockholders, and, except for Mr. Jennings who was elected after last year's annual meeting, all of them attended last year's annual meeting.

	<b>Board</b>	<b>Nominating and Corporate Governance</b>	<b>Finance</b>	<b>Personnel and Compensation</b>	<b>Audit</b>
Mr. Boyd		n			
Mr. Burke					n
Mr. Eaves					
Ms. Godley					
Mr. Hunt					
Mr. Jennings					
Mr. Leer	n				
Mr. Lockhart					
Mr. Perry					
Mr. Potter				n	
Mr. Sands			n		
Mr. Taylor					
Number of 2006 meetings	7	8	6	5	9
n Chair		Member			

***Audit Committee***

The Audit Committee is responsible for the following items:

monitoring the integrity of our consolidated financial statements, internal accounting, financial controls, disclosure controls and financial reporting processes;

confirming the qualifications and independence of our independent registered public accounting firm;

evaluating the performance of our internal audit function and our independent registered public accounting firm; and

reviewing our compliance with legal and regulatory requirements.

The Audit Committee is directly responsible for the appointment, compensation and oversight of the work of our independent registered public accounting firm. The board of directors has determined, in its judgment, that the Audit Committee is composed entirely of independent directors as defined in the New York Stock Exchange listing standards and Rule 10A-3 of the Securities Exchange Act of 1934 and operates under a written charter adopted by the board of directors, a copy of which is published under Corporate Governance in the Investors section of our website at archcoal.com and is available in print to any stockholder upon request.

The board of directors has also determined, in its judgment, that Mr. Burke and Mr. Jennings are audit committee financial experts and that each member of the Audit Committee is financially literate. Our corporate governance guidelines do not currently restrict the number of audit committees of public





**Table of Contents**

companies on which members of our Audit Committee may serve. The board of directors has determined that none of the members of the Audit Committee currently serves on the audit committees of more than three public companies. The report of the Audit Committee can be found beginning on page 12 of this proxy statement.

***Finance Committee***

The Finance Committee reviews and approves fiscal policies relating to our financial structure, including our debt, cash and risk management policies. The Finance Committee also reviews and recommends to the board appropriate action with respect to significant financial matters, including dividends on our capital stock, major capital expenditures and acquisitions, and funding policies of our employee benefit plans.

***Nominating and Corporate Governance Committee***

The Nominating and Corporate Governance Committee is responsible for the following items:

- identifying individuals qualified to become directors and recommending candidates for membership on the board of directors and its committees;
- developing and recommending the corporate governance guidelines to the board of directors;
- reviewing and recommending compensation of non-employee directors; and
- reviewing the effectiveness of board governance.

The Nominating and Corporate Governance Committee regularly reviews the appropriate size and composition of the board of directors and anticipates future vacancies and needs of the board. In the event the Nominating and Corporate Governance Committee recommends an increase in the size of the board of directors or a vacancy occurs, the committee may consider nominees submitted by several sources, including current directors, management, director search firms and stockholders. A candidate for director should possess the highest personal and professional ethics, integrity and values and be committed to representing the long-term interests of our stockholders. In evaluating the suitability of individual nominees, the Nominating and Corporate Governance Committee will also take into account, among other things, the person's strength of character, practical wisdom, mature judgment and ability to respect and maintain adherence to the corporate governance guidelines. In the past, the Nominating and Corporate Governance Committee has, from time to time, retained an executive search firm to identify potential candidates to fill vacancies on the board of directors or as part of the board of director's succession planning. The Nominating and Corporate Governance Committee will consider candidates recommended by stockholders. Stockholder recommendations should be submitted in writing to Robert G. Jones, our secretary and should include the candidate's name, home and business contact information, detailed biographical data, relevant qualifications for membership on the board of directors and any other information required under our bylaws. Individuals recommended by stockholders in accordance with these procedures will receive the same consideration received by individuals identified to the Nominating and Corporate Governance Committee through other means.

**Table of Contents**

The Nominating and Corporate Governance Committee periodically reviews the compensation structure and amounts for our non-employee directors. Our human resources department supports the Nominating and Corporate Governance Committee by researching the structures and amounts of compensation programs sponsored by other similarly-sized public companies and compiling the results of that research for the committee. From time to time, the Nominating and Corporate Governance Committee may engage an independent compensation consultant to provide survey or proxy data on the structure and amount of director compensation for other companies.

The board of directors has determined, in its judgment, that the Nominating and Corporate Governance Committee is composed entirely of independent directors as defined in the New York Stock Exchange listing standards and operates under a written charter adopted by the board of directors, a copy of which is published under Corporate Governance in the Investors section of our website at archcoal.com and is available in print to any stockholder upon request.

***Personnel and Compensation Committee***

The Personnel and Compensation Committee is responsible for the following items:

- reviewing and recommending to the board of directors our compensation programs;
- reviewing and recommending to the board of directors the participation of executives and other key management employees in the various compensation plans; and
- monitoring our succession planning and management development practices.

Each year, the Personnel and Compensation Committee reviews the history of and proposals for total compensation of each of our executive officers, including the portions of total compensation comprised of cash and equity-based components. Our Chairman and Chief Executive Officer and Vice President Human Resources assist the Personnel and Compensation Committee by recommending base salaries and targeted payout amounts under our annual cash incentive program and certain of our long-term incentive plans for each of the other executive officers based on the executive officer's level of responsibility and ability to impact our future financial and operating performance. Neither our Chairman and Chief Executive Officer nor our Vice President Human Resources recommends his or her own base salary or targeted payout amounts under our annual cash incentive program or our long-term incentive plans. The Personnel and Compensation Committee also uses survey and proxy data for our peer group provided by Watson Wyatt, an independent compensation consultant retained by the committee for those purposes. The compensation consultant is engaged by, and reports directly to, the Personnel and Compensation Committee.

The board has determined, in its judgment, that the Personnel and Compensation Committee is composed entirely of independent directors as defined in the New York Stock Exchange listing standards and operates under a written charter adopted by the entire board, a copy of which is published under Corporate Governance in the Investors section of our website at archcoal.com and is available in print to any stockholder upon request. The report of the Personnel and Compensation Committee can be found on page 13 of this proxy statement.

**Table of Contents**

**Audit Committee Report**

The Audit Committee oversees our financial reporting process on behalf of the board of directors. Management is primarily responsible for the financial statements and reporting process, including the systems of internal controls, while the independent registered public accounting firm is responsible for performing an independent audit of our financial statements in accordance with auditing standards generally accepted in the United States and expressing an opinion on the conformity of those financial statements with accounting principles generally accepted in the United States.

In this context, the Audit Committee has reviewed our audited consolidated financial statements and has met with and held discussions with management, our internal auditors and with Ernst & Young, LLP, our independent registered public accounting firm, to discuss those financial statements and related matters. The Audit Committee reviewed with our internal and independent auditors the overall scope and plans for their respective audits. The Audit Committee also met, at least quarterly, with the auditors, with and without management present, to discuss the results of their examinations, their evaluations of our internal controls and the overall quality of our financial reporting. The Audit Committee also reviewed with the independent auditors their judgment as to the quality and the appropriateness of our accounting principles and financial controls and such other matters as are required to be discussed with the Audit Committee under auditing standards generally accepted in the United States.

Our independent registered public accounting firm also provided to the Audit Committee the written disclosures required by the Independence Standards Board Standards No. 1 (Independence Discussions with Audit Committees), and the Audit Committee discussed with the independent auditors that firm's independence, including those matters required to be discussed by Statement on Auditing Standards No. 61, as amended by Statement on Auditing Standards No. 90. The Audit Committee considered whether the performance by Ernst & Young LLP of non-audit services was compatible with their independence.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the board of directors, and the board of directors approved, including the audited consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2006 for filing with the Securities and Exchange Commission. The Audit Committee has retained Ernst & Young LLP as our independent registered public accounting firm for 2007.

**Table of Contents**

While the Audit Committee has the responsibilities and powers set forth in its charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that our financial statements are complete and accurate or are in accordance with generally accepted accounting principles. This is the responsibility of management and the independent auditor.

**AUDIT COMMITTEE**

Frank M. Burke, Chairman

James R. Boyd

Patricia F. Godley

Brian J. Jennings

Thomas A. Lockhart

A. Michael Perry

**Personnel and Compensation Committee Report**

The Personnel and Compensation Committee is comprised entirely of independent directors and has the responsibility for reviewing and recommending changes in our executive compensation policies and programs to the board of directors. The committee also reviews and makes recommendations for all compensation payments to our chief executive officer and other executive officers, which are approved by the board of directors as a whole.

The Personnel and Compensation Committee has reviewed and met with management to discuss the disclosures contained in the section entitled "Compensation Discussion and Analysis" beginning on page 19 of this proxy statement. Based on that review and discussions with management, the Personnel and Compensation Committee recommended to the board of directors, and the board of directors approved, including the disclosures contained in the section entitled "Compensation Discussion and Analysis" in this proxy statement and, by incorporating that section by reference, in the Annual Report on Form 10-K for the year ended December 31, 2006 for filing with the Securities and Exchange Commission.

**PERSONNEL AND COMPENSATION COMMITTEE**

Robert G. Potter, Chairman

Frank M. Burke

Douglas H. Hunt

Thomas A. Lockhart

Theodore D. Sands

Wesley M. Taylor

**Table of Contents****Compensation Committee Interlocks and Insider Participation**

None of the directors who served on the Personnel and Compensation Committee during 2006 has been an officer or employee of ours. None of our executive officers has served on the board of directors or compensation committee of any other entity that has or has had one or more executive officers serving as a member of our board of directors or compensation committee.

**Director Compensation for the Year Ended December 31, 2006**

The following table sets forth compensation paid to each non-employee director during 2006. Messrs. Leer and Eaves do not receive separate retainers or attendance fees for their services as directors.

Name	Fees Earned or Paid in Cash(1)	All Other Compensation (\$) (2)	Total (\$)
James R. Boyd	\$ 171,250	\$ 9,167	\$ 180,417
Frank M. Burke	131,250	6,441	137,691
Patricia F. Godley	102,500	919	103,419
Brian J. Jennings	78,750(3)		78,750
Douglas H. Hunt	97,500	6,816	104,316
Thomas A. Lockhart	102,500	900	103,400
A. Michael Perry	106,250	4,835	111,085
Robert G. Potter	105,000	441	105,441
Theodore D. Sands	102,500	4,485	106,985
Wesley M. Taylor	97,500	2,382	99,882

- (1) Amounts shown include amounts that the directors elected to defer, on a discretionary basis, pursuant to our deferred compensation plan for non-employee directors described below.
- (2) Amounts shown represent contributions under our director matching gift program and reimbursement of spousal travel expenses incurred in connection with their attendance at an out-of-town board meeting. We determined the aggregate incremental cost of spousal travel expenses by reference to our actual out-of-pocket costs for such benefits or a prorated portion of our actual out-of-pocket costs in the event such costs were not separately identifiable.
- (3) Amount includes a new director fee of \$30,000.

*Director Compensation.* Our director compensation program is designed to compensate our non-employee directors, through a simple and understandable structure, for the amount of work required for a company of our size and scope and to align the interests of our non-employee directors with the long-term interests of our stockholders. The key elements of our director compensation program include the following:

an annual retainer of \$75,000, paid quarterly;

a board and committee attendance fee of \$1,250 for each meeting attended;

an additional annual retainer for our lead director of \$15,000;

an additional annual retainer for the chairperson of each committee of \$5,000, except that the chairman of our Audit Committee is paid an additional annual retainer of \$30,000 and, until

**Table of Contents**

April 2007 when Mr. Leer was elected chairman, the chairman of the board of directors was paid an additional annual retainer of \$100,000; and

a new director fee of \$30,000.

*Deferred Compensation Plan.* Our board of directors has adopted a deferred compensation plan for non-employee directors. Under the plan, non-employee directors may choose to defer receipt of any or all of the compensation paid to them in a cash account that mirrors the gains and/or losses of a number of different investment funds, one of which is a hypothetical investment in shares of our common stock. Under the plan, we credit each non-employee director's account with the number of units equal to the number of shares or units that the non-employee director could purchase or receive with the amount of compensation deferred under the plan on the date we credit the non-employee director's account, based upon the fair market value of the underlying investment on that date. When a director terminates his or her service as a director, we will pay the amount of compensation deferred under the plan to the director (or to his or her designated beneficiary in the event of death) in annual installments or in a lump sum, at the director's election. The amount we pay will be based on the number of units credited to each director's account, valued on the basis of the fair market value of an equivalent number of shares or units of the underlying investment on the date payment occurs. We may also pay a director the amount of compensation deferred under the plan prior to the termination of a director's service as a director if the board determines that the director has a demonstrated financial hardship.

*Other Compensation Arrangements.* In addition to the annual retainers and meeting attendance fees described above, we sponsor a director matching gift program. Under our matching gift program, we donate \$2.00 for each dollar contributed by a director to accredited institutions of higher education up to a maximum of \$6,000 each year. We have included the matching gifts paid on behalf of each of our non-employee directors for 2006 in the table above. We have included the matching gifts paid on behalf of Mr. Leer in the table on page 27 of this proxy statement. During 2006, we did not pay any matching gifts on behalf of Mr. Eaves. We reimburse each director for their travel expenses incurred in connection with attendance at board and committee meetings and other matters related to service on our board and for the costs of attending continuing education seminars. We also pay the premiums for directors' liability insurance and travel accident insurance for each director. These amounts are not included in the table above since they are deemed to be business-related payments and not perquisites. We do not maintain a directors' retirement plan, and non-employee directors do not participate in our health, welfare or benefit plans.

*Stock Ownership Guidelines.* In order to more closely align the interests of our non-employee directors with the long-term interests of our stockholders, our board of directors has adopted stock ownership guidelines for non-employee directors that establish a goal for each of our non-employee directors to own a number of shares of our common stock equal in value to five times the annual retainer for non-employee directors. Each non-employee director is expected to satisfy this goal by April 27, 2011 or, if elected after April 27, 2006, within five years of becoming a director. As of December 31, 2006, each of the non-employee directors who has been on our board of directors for at least five years satisfied the stock ownership goal adopted by the board of directors.

**Table of Contents****OWNERSHIP OF ARCH COAL COMMON STOCK****Ownership by Directors and Executive Officers**

The following table sets forth, as of February 26, 2007, information concerning the beneficial ownership of our common stock by each director, each of the executive officers named in this proxy statement and all current directors and executive officers as a group. Under rules of the Securities and Exchange Commission, persons who have power to vote or dispose of securities, either alone or jointly with others, are deemed to be the beneficial owners of such securities. Each person reflected in the table below has both sole voting and investment power with respect to the shares included in the table, except as described in the footnotes below.

Name of Beneficial Owner	Number of Actual Shares	Options	Amount and		Other	Total
	Owned	Exercisable	Nature of Beneficial	Percent of Class	Stock- Based	Stock- Based
	Directly or Indirectly (1)	Within 60 Days (2)	Ownership		Items (3)	Ownership
James R. Boyd, Director (4)	67,372		67,372	*	66,336	133,708
Frank M. Burke, Director (4)	100,000		100,000	*	35,041	135,041
John W. Eaves, President, Chief Operating Officer and Director	100,540	235,000	335,540	*	211,864	547,404
Patricia F. Godley, Director				*	11,818	11,818
Douglas H. Hunt, Director (4)	281,354		281,354	*	39,811	321,165
Brian J. Jennings, Director				*	1,585	1,585
Steven F. Leer, Chairman and Chief Executive Officer (4)	293,161	771,200	1,064,361	*	188,200	1,252,561
Thomas A. Lockhart, Director	200		200	*	10,478	10,678
A. Michael Perry, Director	12,558		12,558	*	21,423	33,981
Robert G. Potter, Director(4)	21,000		21,000	*	35,879	56,879
Theodore D. Sands, Director	50,000		50,000	*	52,932	102,932
Wesley M. Taylor, Director	15,103		10,086	*	5,329	20,432
C. Henry Besten, Jr., Senior Vice President Strategic Development	24,774	28,100	52,874	*	29,181	82,055
Robert G. Jones, Vice President Law, General Counsel and Secretary	31,635	156,900	188,535	*	25,398	213,913
Robert J. Messey, Senior Vice President and Chief Financial Officer	84,496	34,248	118,744	*	80,498	199,242



All of our directors and  
 executive officers as a group  
 (20 persons)

1,175,063	1,325,578	2,500,641	1.8%	961,503	3,462,144
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\* Less than one percent of the outstanding shares.

(1) Includes, for executive officers, shares of restricted stock, including shares that the executive officers have elected to defer under our deferred compensation plan for executive officers, and indirect interests in shares of our common stock held under our defined contribution plan.

**Table of Contents**

- (2) Represents shares of our common stock that could be acquired by exercising stock options through April 30, 2007.
- (3) Includes, for directors, indirect interests in shares of our common stock held under our deferred compensation plan for non-employee directors. Includes, for executive officers, unvested restricted stock units and performance-contingent phantom stock awarded to executive officers under our equity-based compensation plans and indirect interests in shares of our common stock held under our deferred compensation plan for executive officers. We have included performance-contingent phantom stock awards at their maximum payout amounts. While restricted stock units, performance-contingent phantom stock and indirect interests in shares of our common stock under our deferred compensation plans may not be voted or transferred, we have included them in the table as they represent an economic interest in our common stock that is subject to the same market risk as ownership of actual shares of our common stock.
- (4) Includes, for Mr. Boyd, 2,090 shares and, for Mr. Leer, 2,020 shares held jointly with such person's spouse and for which such person shares voting and investment power. Includes, for Mr. Burke, 40,000 shares held by Burke, Mayborn Co., Ltd. for which Mr. Burke has voting and investment power and 60,000 shares held in Mr. Burke's SEP-IRA account for which Mr. Burke has sole voting and investment power. Includes, for Mr. Hunt, 259,354 shares held by the Lyda Hunt-Herbert Trusts—Douglas Herbert Hunt under which Mr. Hunt is a beneficiary but for which Mr. Hunt has no voting or investment power. Includes, for Mr. Potter, 20,000 shares held by the Robert G. Potter Trust dated 11/05/92, Robert G. Potter, as trustee, for which Mr. Potter has voting and investment power and 1,000 shares held by Mr. Potter's spouse.

**Ownership by Others**

The following table shows all persons or entities that we know were beneficial owners of more than five percent of our common stock on February 26, 2007.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
FMR Corp. 82 Devonshire Street Boston, Massachusetts 02109	16,795,026(1)	11.8%
Neuberger Berman Management Inc. Neuberger Berman, LLC 605 Third Avenue New York, New York 10158	15,223,386(2)	10.7%
Capital Group International, Inc. 11100 Santa Monica Boulevard Los Angeles, California 90025	8,286,640(3)	5.8%
Capital Research and Management Company 333 South Hope Street Los Angeles, California 90071	7,800,000(4)	5.5%

**Table of Contents**

- (1) Based on its filings with the Securities and Exchange Commission, Fidelity Management & Research Company, a subsidiary of FMR Corp. and an investment adviser registered under Section 203 of the Investment Advisors Act of 1940, is the beneficial owner of 15,979,548 shares of our common stock as a result of acting as investment advisor to various investment companies registered under the Investment Company Act of 1940. The ownership of one investment company, Magellan Fund, amounted to 9,652,548 shares of our common stock. Edward C. Johnson 3d and FMR Corp., through its control of Fidelity Management & Research Company, each has sole power to dispose of 15,979,548 shares of common stock. Neither FMR Corp. nor Edward C. Johnson 3d has the sole power to vote or direct the voting of the shares owned directly by the funds, which power resides with the funds' board of trustees.

Fidelity International Limited and various foreign-based subsidiaries of FMR Corp. provide investment advisory and management services to a number of non-U.S. investment companies and certain institutional investors. Fidelity International Limited is the beneficial owner of 815,400 shares of our common stock. Partnerships controlled predominantly by members of the family of Edward C. Johnson 3d, or trusts for their benefit, own shares of voting stock of Fidelity International Limited with the right to cast approximately 47% of the total votes which may be cast by all such holders.

- (2) Based on its filings with the Securities and Exchange Commission, Neuberger Berman Management Inc. and Neuberger Berman, LLC may be deemed the beneficial owners of 15,223,386 shares of our common stock since they both have shared power to make decisions whether to retain or dispose of and vote the shares. Neuberger Berman Management Inc. and Neuberger Berman, LLC each has the sole power to vote 10,498,968 shares of common stock and shares the power to vote 4,020,936 shares of common stock and to dispose of 15,223,386 shares of common stock.
- (3) Based on its filings with the Securities and Exchange Commission, Capital Group International, Inc. is the holding company of a group of investment management companies that provide investment advisory and management services for their respective clients. These investment management companies may be deemed to beneficially own the shares of common stock held of record by their clients. Capital Group International, Inc. has the sole power to vote 6,578,340 shares of common stock and the sole power to dispose of 8,286,640 shares of common stock.
- (4) Based on its filings with the Securities and Exchange Commission, Capital Research and Management Company, an investment adviser registered under Section 203 of the Investment Advisors Act of 1940, is the beneficial owner of 7,800,000 shares of our common stock as a result of acting as investment advisor to various investment companies registered under the Investment Company Act of 1940. Capital Research and Management Company has the sole power to vote 3,000,000 shares of common stock and the sole power to dispose of 7,800,000 shares of common stock.

**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires our directors, executive officers and any persons beneficially holding more than ten percent of our common stock to report their ownership of

**Table of Contents**

common stock and any changes in that ownership to the Securities and Exchange Commission and the New York Stock Exchange. The Securities and Exchange Commission has established specific due dates for these reports, and we are required to report in this proxy statement any failure to file by these dates. Based solely on a review of the copies of the reports furnished to us and written representations that no other such statements were required, we believe that all such reports of our directors and executive officers were filed on a timely basis, except that a Form 4 reporting one transaction was filed on behalf of Mr. Potter after the due date of the report and a Form 3 was filed on behalf of Mr. Jennings after the due date of the report.

**COMPENSATION OF EXECUTIVE OFFICERS**

**Compensation Discussion and Analysis**

***Our Compensation Philosophy***

Our Personnel and Compensation Committee believes that an effective compensation program should encompass the following fundamental objectives:

*Compensation should be competitive* We focus on attracting and retaining our executive officers by providing them with compensation that is competitive with other similarly-sized public companies. Our Personnel and Compensation Committee regularly reviews each element of compensation and compares those elements to similar elements collected from proxy disclosures and survey results for our peer group and for the S&P Midcap 400 Index provided by the independent compensation consultant retained by the committee. For 2006, our peer group consisted of several similarly-sized public companies, including several coal companies. The Personnel and Compensation Committee periodically reviews and updates the peer group used for these purposes to ensure that the companies included are the most representative for our business.

*Compensation should be performance-based* We reinforce our strategic objective of being a leader in stockholder return, safety performance and environmental stewardship by tying executive compensation to the achievement of our financial and operating performance targets. We motivate our key employees, including the executive officers named in this proxy statement, by providing them with opportunities to receive payouts under short- and long-term incentive awards upon the achievement of these objectives. In general, performance below our targets results in lower total compensation, and performance above our targets results in greater total compensation.

*Compensation should be stockholder-focused* We align the interests of our executive officers with those of our stockholders by requiring that a portion of total compensation paid to our executive officers consist of equity or otherwise be tied to long-term stock price appreciation. In addition, our board of directors has adopted stock ownership guidelines for our executive officers that require our executive officers to own specified amounts of our common stock determined as a multiple of base salary. The Personnel and Compensation Committee believes that these programs align the interests of our executive

**Table of Contents**

officers with the long-term interests of our stockholders and provide an appropriate balance against the cash components of our compensation program.

*Elements of Our Compensation Program*

We use a variety of compensation elements to achieve our overall compensation objectives. These elements include the following:

- base salary;
- short- and long-term incentive opportunities;
- restricted stock, restricted stock units and stock option awards; and
- certain limited perquisites.

Each of our executive officers, including the executive officers named in this proxy statement, is eligible to participate in the same health and welfare plans as our other eligible employees. These plans include medical and dental insurance, life, travel and accidental death and dismemberment insurance, short- and long-term disability coverage and participation in our qualified defined benefit pension plan, our supplemental retirement plan and our qualified defined contribution plan. In addition, each of our executive officers receives an employment agreement and is eligible to participate in our deferred compensation plan.

In general, a large percentage of total compensation depends on our performance in accordance with the compensation philosophy described above. There is no pre-established policy or target for the allocation between either cash and non-cash or short- and long-term incentive compensation. Instead, the Personnel and Compensation Committee considers data collected from proxy disclosures and survey results for our peer group provided by a compensation consultant to determine the appropriate level and mix of incentive compensation. The Personnel and Compensation Committee intends for the level and mix of compensation to provide a meaningful method by which to promote successful short- and long-term decision-making.

We generally seek to maximize the tax deductibility of all elements of compensation. When reviewing executive compensation and our compensation programs, our Personnel and Compensation Committee considers the anticipated tax treatment to our company and to our employees. The Personnel and Compensation Committee retains the ability to evaluate the performance of our employees and to recommend that the board of directors approve compensation, even if a portion of it may not be deductible. The Personnel and Compensation Committee retains discretion to recommend to the board of directors certain payouts that are above or below the performance levels for the relevant performance period. For purposes of determining the amount of a payout to recommend to the board of directors, the Personnel and Compensation Committee may also consider infrequent or non-recurring items that are not reflective of ongoing operations or the effects of major corporate transactions or other items that the committee determines, in its judgment, significantly distort the comparability of our performance levels against the performance targets selected at the beginning of the performance period.

**Table of Contents**

We have included a description of each key element of our compensation program below:

*Base salary* We provide each of our executive officers with an annual base salary. With the recommendation of the Personnel and Compensation Committee, the board of directors sets base salaries for our executive officers at levels designed to attract and retain experienced management talent. The Personnel and Compensation Committee reviews base salaries for our executive officers annually. Base salaries for our executive officers depend on the scope of their responsibilities, competitive market compensation paid by other companies for similar positions and salaries paid to the executives' peers within the company.

The Personnel and Compensation Committee believes that a greater percentage of total compensation for those employees with the ability to influence the achievement of our objectives should be variable and, therefore, subject to greater risk. In general, as the position and amount of responsibility for a key employee increase, a greater percentage of that employee's total compensation will be variable. As a result, the executive officers with the highest level and amount of responsibility generally have the lowest percentage of their total compensation fixed as base salary and the highest percentage of their total compensation dependent upon short- or long-term incentive awards. The salaries of the executive officers named in this proxy statement for 2006 are shown in the table on page 27 of this proxy statement.

*Annual cash incentive awards* Through an annual cash incentive program, we provide approximately 245 key employees, including the executive officers named in this proxy statement, an opportunity to earn additional cash compensation. Early each year, the Personnel and Compensation Committee considers whether an annual cash incentive program should be established for that year and, if so, recommends to the board of directors the group of employees eligible to participate in the plan for that year. The annual cash incentive program includes various incentive levels based on the participant's accountability and impact on our financial and operating performance, with target opportunities established as a percentage of base salary. For 2006, the target opportunities available to the executive officers named in this proxy statement as a percentage of their base salaries ranged from 50% to 83%.

For 2006, payouts under the annual cash incentive program depended upon our earnings before interest, taxes, depreciation and amortization (EBITDA), our safety and environmental performance and, for some employees, our earnings per share or operating costs per ton. In general, we must achieve an acceptable level of EBITDA performance before any other portions of the annual cash incentive awards will be paid. Some or all of these performance measures may be used for our regional or other operational employees, and the performance measures may differ for various groups or classifications of employees. By identifying meaningful performance measures and by assigning certain measures greater weight, compensation is more closely aligned with the achievement of those business objectives over which particular employees have the greatest impact.

In order to create an incentive for superior performance above the targets that it sets and to acknowledge certain levels of performance below the targets that it sets, the annual cash incentive program includes minimum, target and maximum levels for each performance measure. Payment of awards under the annual cash incentive plan depends upon the achievement of such objectives. For the executive officers

**Table of Contents**

named in this proxy statement for 2006, the threshold performance level equaled 25% of the target, and the maximum performance level equaled 200% of the target. Payouts under the annual cash incentive awards may be prorated for performance levels that fall within these ranges.

The performance targets are based upon our annual financial budgets as reviewed and approved by the board of directors and, in some cases, on our prior performance history. In the past, the board of directors has approved performance targets that the Personnel and Compensation Committee considers challenging based on prevailing market conditions at the time and on our prior performance history. Over the past five years, we have paid amounts to the executive officers named in this proxy statement under the annual cash incentive plan above the target levels in only one year.

In early 2007, upon the recommendation of the Personnel and Compensation Committee, the board of directors approved payouts under the annual cash incentive plan for 2006 at levels that were slightly lower than the target levels based on our performance. Payouts under the annual cash incentive plan for 2006 for the executive officers named in this proxy statement are shown in the table on page 27 of this proxy statement. The threshold, target and maximum annual cash incentives awarded to the executive officers named in this proxy statement in 2006 are shown in the table on page 29 of this proxy statement.

*Restricted stock* From time to time, upon the recommendation of the Personnel and Compensation Committee, the board of directors may grant restricted stock to certain of our executive officers. Restricted stock awards generally cliff vest at the end of a specified period or, in some cases, may vest ratably over a specified period of time, subject to the executive's continued employment. Holders of unvested restricted stock receive dividends in the same amounts and on the same record dates established by our board of directors for payment of common stock dividends.

*Restricted stock units* In 2006, upon the recommendation of the Personnel and Compensation Committee, the board of directors granted restricted stock units to each of our executive officers to retain and motivate them, to promote long-term stock price appreciation and to reinforce stock ownership levels. The board of directors has generally used restricted stock units rather than restricted stock because the executive officers may elect to defer receipt of the restricted stock and the associated taxes upon vesting of restricted stock units. Restricted stock unit awards generally vest over a three-year period, with one-third vesting on each anniversary of the grant date, subject to the executive's continued employment. The number of shares of our common stock held by an executive officer has not been a factor considered by the Personnel and Compensation Committee in recommending subsequent awards of restricted stock units to the board of directors. We pay dividend equivalent amounts in cash to each of the executive officers based on the number of unvested restricted stock units held by the executive officers on the record dates established by our board of directors for payment of common stock dividends. Dividend equivalents are paid on unvested restricted stock units at the same rate as the cash dividends we pay on our outstanding common stock.

The number of restricted stock units and the grant date fair value of restricted stock units awarded to the executive officers named in this proxy statement for 2006 are shown in the table on page 29 of this

**Table of Contents**

proxy statement. For 2007, the Personnel and Compensation Committee has determined to replace restricted stock units with stock options, which we discuss in greater detail below.

*Performance units* In 2006, upon the recommendation of the Personnel and Compensation Committee, the board of directors awarded performance units to approximately 50 key employees, including the executive officers named in this proxy statement, to motivate them to focus on our performance over a longer period than our annual cash incentive award program. Performance units provide an opportunity for the executive officers named in this proxy statement to earn additional compensation ranging from 25% to 35% of their targeted total compensation depending upon the successful achievement of performance objectives over a three-year performance period. Each performance unit represents the right to receive \$1.00 per unit, which may be paid in cash, stock or a combination of cash and stock.

For the 2006-2008 performance period, payouts under the performance units will depend upon the relationship of the compound annual growth rate of our EBITDA to that of a peer group and the percentage improvement in our safety and environmental performance, with a greater weight given to the achievement of the EBITDA objective. In order to create an incentive for superior performance above the targets that it sets and to acknowledge certain levels of performance below the targets that it sets, the performance units include threshold, target and maximum levels for each performance measure. For the executive officers named in this proxy statement for the performance units awarded in 2006, the threshold performance level for the achievement of EBITDA growth equals 25% of the target, and the maximum performance level equals 200% of the target. The threshold performance level for the achievement of the safety and environmental objectives equals 100% of the target, and the maximum performance level equals 200% of the target. Payouts within these ranges depend upon our performance relative to the targets.

The performance targets are based upon our long-term financial budgets as reviewed and approved by the board of directors and on our prior performance history. Because payouts under the performance units will depend upon our performance relative to a peer group, the Personnel and Compensation Committee considers the objectives used for performance units to be challenging since higher payouts require us to outperform our peer group over an extended period of time.

In early 2007, upon the recommendation of the Personnel and Compensation Committee, the board of directors approved a cash payout of the performance units awarded in 2004 above the target level. While the EBITDA growth objective fell slightly short of target, the board of directors considered our performance in several areas, including safety, environmental and financial performance and concluded that significant long-term financial and operating objectives had been accomplished. Payouts for performance units awarded to the executive officers named in this proxy statement in 2004 are shown in the table on page 27 of this proxy statement. The threshold, target and maximum payouts in future periods for performance units awarded to the executive officers named in this proxy statement in 2006 are shown in the table on page 29 of this proxy statement. For 2007, the Personnel and Compensation Committee has determined to replace performance unit awards with stock options, which we discuss in greater detail below.



**Table of Contents**

*Stock options* Prior to 2003, we used stock options as an element of compensation intended to align the interests of our key employees with the long-term interests of our stockholders by providing additional compensation for stock price appreciation. In 2002, upon the recommendation of the Personnel and Compensation Committee, the board of directors awarded stock options to certain employees, including the executive officers named in this proxy statement, that were intended to apply to 2002 and to 2003. From 2003 to 2006, we did not grant stock options to our executive officers.

In 2007, upon the recommendation of the Personnel and Compensation Committee, the board of directors determined to replace the value of restricted stock units and performance units with stock options. The Personnel and Compensation Committee believes that long-term stock price appreciation is reflective of our achievement of the long-term performance objectives established by our board of directors. Our policy is to issue stock options on the dates on which the awards are approved and to set the exercise prices of these stock option awards equal to the closing market price of our common stock on the dates on which the awards are approved.

*Performance-contingent phantom stock* From time to time, upon the recommendation of the Personnel and Compensation Committee, our board of directors has awarded our executive officers with performance-contingent phantom stock in order to provide the executive officers with an opportunity to receive additional compensation ranging from 15% to 40% of their targeted total compensation for exceptional long-term financial performance. Target payouts under the performance-contingent phantom stock awards are based on the extent to which each executive officer has the ability to impact our long-term financial performance. In order to align the interests of our executive officers with the long-term interests of our stockholders, payouts under the performance-contingent phantom stock awards depend upon the attainment of a sustained average closing price of our common stock and the achievement of a minimum EBITDA over the trailing 12-month period. Because payouts under the performance-contingent phantom stock awards depend upon long-term stock price appreciation, the Personnel and Compensation Committee considers the objectives used for these awards to be challenging since higher payouts require stock price appreciation to be attributable, in part, to our achievement of specified levels of EBITDA instead of appreciation in the broader equity market or coal industry generally.

Under the 2005 performance-contingent phantom stock awards, our executive officers can earn one-half of the performance-contingent phantom stock awards if the average closing price of our common stock for a period of 20 consecutive trading days meets or exceeds \$35.00, subject to the achievement of the EBITDA component of the award. The other half of the performance-contingent phantom stock awards can be earned if the average closing price of our common stock for a period of 20 consecutive trading days meets or exceeds \$40.00, subject to the achievement of the EBITDA component of the award. Payouts under the performance-contingent phantom stock awards depend on the extent to which the compound annual growth rate of our EBITDA for the preceding 12 months, with a starting value equal to a target EBITDA established at the time the award was granted, falls within certain ranges.

We will pay one-half of any payout amount that an executive officer elects not to defer in the form of cash and the other one-half in shares of our common stock. We will pay the amount that an executive

**Table of Contents**

officer elects to defer in shares of our common stock. We did not award any performance-contingent phantom stock to our executive officers in 2006.

*Perquisites and other benefits* We provide some of our executive officers with other benefits that are not tied to any formal performance objectives. In particular, we pay for the cost of the following items for certain of our executive officers:

financial and tax planning services;

annual dues associated with social and professional club memberships;

annual physical examinations;

spousal travel in connection with out-of-town board meetings; and

tax gross-up amounts attributable to such benefits.

The perquisites paid to the executive officers named in this proxy statement in 2006 are shown in the table on page 27 of this proxy statement.

*Supplemental pension plan benefits* We sponsor a defined benefit pension plan covering all of our eligible employees, including our executive officers. The Internal Revenue Code limits the amount of qualified retirement benefits we may provide for certain employees. As a result, we sponsor a supplemental retirement plan that provides eligible employees, including the executive officers named in this proxy statement, with additional retirement benefits that would otherwise be available under our defined benefit pension plan but for the limitations contained in the Internal Revenue Code. For more information about our defined benefit pension plan and our supplemental retirement plan, including the accumulated benefits attributable to the executive officers named in this proxy statement, you should see Pension Benefits beginning on page 33 of this proxy statement.

*Deferred compensation plan* We sponsor a tax-qualified defined contribution plan covering all of our eligible employees, including the executive officers named in this proxy statement. Under this plan, eligible employees may contribute up to 50% of their base salaries to the plan, subject to certain limitations contained in the Internal Revenue Code. We contribute one dollar for each dollar contributed by our employees, up to a maximum of 6% of employees base salaries. The Internal Revenue Code limits the amount certain of our employees may contribute to our defined contribution plan in any tax year. As a result, we sponsor a deferred compensation plan that allows eligible employees, including the executive officers named in this proxy statement, to defer receipt of a portion of their base salaries and annual cash and long-term incentive awards. The deferred compensation plan provides higher-paid employees with the full company matching contribution to which they would otherwise be entitled under our defined contribution plan but for the limitations contained in the Internal Revenue Code. For more information about our deferred compensation plan, including information about amounts attributable to the executive officers named in this proxy statement, you should see Non-Qualified Deferred Compensation beginning on page 34 of this proxy statement.

**Table of Contents**

*Employment agreements* In order to induce certain key employees, including the executive officers named in this proxy statement, to remain employed with us and to provide them with some financial security in the event their employment with us is terminated without cause, we provide those employees with employment agreements that provide for cash payments in the event their employment with us is terminated under certain circumstances. The Personnel and Compensation Committee believes that the employment agreements we maintain with our key employees provide a meaningful mechanism by which to retain those individuals who are most capable of affecting our future financial and operating performance. For more information about the employment agreements with the executive officers named in this proxy statement, you should see *Potential Payments Upon Termination of Employment or Change-in-Control* beginning on page 35 of this proxy statement.

*Stock ownership guidelines* Our board of directors has adopted stock ownership guidelines for our executive officers that are intended to link the interests of our executive officers with the long-term interests of our stockholders. These guidelines specify a number of shares of our common stock, including unvested restricted stock, unvested restricted stock units, shares held through our defined contribution plan and hypothetical shares of our common stock held through the deferred compensation plan described above, that our executive officers must accumulate by January 1, 2009 or, if elected after January 1, 2004, within five years of becoming an executive officer. The specific share holding requirements are determined based on a multiple of base salary ranging from one to three times, with the higher multiples applicable to the executive officers having the highest levels of responsibility. As of December 31, 2006, each of our executive officers who has been an executive officer for at least five years satisfied the stock ownership goal adopted by the board of directors.

**Table of Contents****Summary Compensation Table**

The following table is a summary of compensation information for our chief executive officer, our chief financial officer and each of the other three most highly compensated executive officers for 2006:

Name and Principal Position	Year	Salary \$(1)	Bonus (\$)	Stock Awards \$(2)	Option Awards \$(2)	Non- Equity Incentive	Change in Pension Value and Nonqualified Deferred Compensation	All Other Compen- sation \$(5)	Total (\$)
						Plan Compen- sation \$(3)	Earnings \$(4)		
Steven F. Leer, Chairman and Chief Executive Officer	2006	\$ 750,000		\$ 2,999,550	\$ 152,011	\$ 1,433,200	\$ 190,858	\$ 89,853	\$ 5,615,472
Robert J. Messey, Senior Vice President and Chief Financial Officer	2006	335,000		1,432,161	47,568	582,800	52,982	51,765	2,502,276
J. Henry Westen, Jr., Senior Vice President Strategic Development	2006	265,000		414,187	39,027	589,850	91,685	33,560	1,433,309
John W. Eaves, President, Chief Operating Officer and Director	2006	450,000		2,197,614	49,929	811,200	83,273	78,971	3,670,987
Robert G. Jones, Vice President Law, General Counsel and Secretary	2006	300,000		479,244	40,555	680,798	49,364	38,997	1,588,958

(1) Amounts shown include amounts that the executive officers named in this proxy statement elected to defer, on a discretionary basis, pursuant to our deferred compensation plan. You should see the section entitled Non-Qualified Deferred Compensation beginning on page 34 of this proxy statement for more information about our deferred compensation plan.

- (2) Amounts shown represent the compensation cost we recognized in our consolidated financial statements for 2006 as a result of certain stock or stock option awards in 2006 and prior years. We have determined the compensation cost in accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*. The compensation cost is subject to certain estimates and assumptions described in Note 17 to our consolidated financial statements for the year ended December 31, 2006 and under the heading *Stock-Based Compensation* in the section entitled *Critical Accounting Policies* included in our Annual Report on Form 10-K for the year ended December 31, 2006. Amounts shown do not necessarily represent the actual amount of compensation received by the executive officers in 2006.
- (3) Amounts shown include payouts under our annual cash incentive awards for 2006 of \$523,200 for Mr. Leer, \$155,800 for Mr. Messey, \$123,300 for Mr. Besten, \$251,200 for Mr. Eaves and \$139,600 for Mr. Jones and payouts under performance unit awards granted in 2004 of \$910,000 for Mr. Leer, \$427,000 for Mr. Messey, \$466,550 for Mr. Besten, \$560,000 for Mr. Eaves and \$541,198 for Mr. Jones. You should see the information under the heading *Elements of Our Compensation Program* in the section entitled *Compensation Discussion and Analysis* beginning on page 19 of this proxy statement for more information about these awards. Amounts shown include amounts that the executive officers named in this proxy statement elected to defer, on a discretionary basis, pursuant to our deferred compensation plan. You should see the section entitled *Non-Qualified Deferred Compensation* beginning on page 34 of this proxy statement for more information about our deferred compensation plan.
- (4) Amounts shown represent the changes in the actuarial present value of the accumulated benefits for the executive officers named in this proxy statement under our defined benefit pension plans, including our supplemental retirement plan, computed in accordance with Statement of Financial Accounting

**Table of Contents**

Standards No. 87, *Employer's Accounting for Pensions*. The present value of accumulated benefits is subject to certain actuarial assumptions described in Note 14 to our consolidated financial statements for the year ended December 31, 2006 and under the heading "Employee Benefit Plans" in the section entitled "Critical Accounting Policies" included in our Annual Report on Form 10-K for the year ended December 31, 2006. For more information about our defined benefit pension plans, including the accumulated benefits attributable to the executive officers named in this proxy statement, you should see "Pension Benefits" beginning on page 33 of this proxy statement.

(5) Amounts shown include the following:

matching contributions to our thrift plan of \$11,513 for Mr. Leer, \$13,200 for Mr. Messey, \$11,058 for Mr. Besten, \$12,645 for Mr. Eaves and \$6,034 for Mr. Jones;

credits under our deferred compensation plan of \$31,895 for Mr. Leer, \$6,294 for Mr. Messey, \$4,494 for Mr. Besten, \$13,520 for Mr. Eaves and \$8,633 for Mr. Jones;

dividend equivalent payouts on unvested restricted stock units of \$9,687 for Mr. Leer, \$6,441 for Mr. Messey, \$2,214 for Mr. Besten, \$27,901 for Mr. Eaves and \$2,558 for Mr. Jones;

financial and tax planning services of \$9,150 for Mr. Leer, \$8,600 for Mr. Messey, \$10,320 for Mr. Besten, \$9,040 for Mr. Eaves and \$12,270 for Mr. Jones;

reimbursement of social and professional club membership dues of \$7,620 for Mr. Leer, \$7,620 for Mr. Messey and \$7,020 for Mr. Eaves;

reimbursement of the costs of annual physical examinations for Messrs. Leer, Besten, Eaves and Jones;

reimbursement of spousal travel expenses incurred in connection with their attendance at an out-of-town board meeting;

contributions under our director matching gift program of \$6,000 for Mr. Leer; and

tax reimbursements on the perquisites listed above of \$13,057 for Mr. Leer, \$8,382 for Mr. Messey, \$5,125 for Mr. Besten, \$8,082 for Mr. Eaves and \$7,065 for Mr. Jones.

We determined the aggregate incremental cost of financial planning services, social and professional club membership dues, annual physical examinations and spousal travel expenses by reference to our actual out-of-pocket costs for such benefits or a prorated portion of our actual out-of-pocket costs in the event such costs were not separately identifiable.

Table of Contents**Grants of Plan-Based Awards for the Year Ended December 31, 2006**

The following table shows information relating to the grants of certain equity and non-equity awards made to the executive officers named in this proxy statement during 2006:

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)(1)	Grant Date  Fair Value of Stock and Option Awards(2)
		Threshold(\$)	Target(\$)	Maximum(\$)		
Steven F. Leer	02/23/06	\$ 140,625(3)	\$ 562,500(3)	\$ 1,125,000(3)		
	02/23/06	112,500(4)	750,000(4)	1,500,000(4)		
	02/23/06				6,300	\$ 237,920
Robert J. Messey	02/23/06	41,875(3)	167,500(3)	335,000(3)		
	02/23/06	50,250(4)	335,000(4)	670,000(4)		
	02/23/06				2,900	109,519
C. Henry Besten, Jr.	02/23/06	33,125(3)	132,500(3)	265,000(3)		
	02/23/06	52,987(4)	353,245(4)	706,490(4)		
	02/23/06				2,300	86,860
John W. Eaves	02/23/06	67,500(3)	270,000(3)	540,000(3)		
	02/23/06	67,500(4)	450,000(4)	900,000(4)		
	02/23/06				3,800	143,507
Robert G. Jones	02/23/06	37,500(3)	150,000(3)	300,000(3)		
	02/23/06	59,985(4)	399,900(4)	799,800(4)		
	02/23/06				2,600	98,189

(1) Amounts represent the number of restricted stock units we granted to the executive officers named in this proxy statement during 2006. We have adjusted the number of units for the two-for-one stock split on May 15, 2006. You should see the information under the heading *Elements of Our Compensation Program* in the section entitled *Compensation Discussion and Analysis* beginning on page 19 of this proxy statement for more information about our restricted stock unit awards.

(2) Amounts represent the grant date fair value of the restricted stock units we awarded to the executive officers named in this proxy statement for 2006 determined, in accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, by reference to the closing price for our common stock on the date on which such awards were approved by our board of directors.

- (3) Amounts represent the potential amounts payable to the executive officers named in this proxy statement under the annual cash incentive awards for 2006 assuming threshold, target and maximum levels of performance. Amounts paid to the executive officers named in this proxy statement under our annual cash incentive awards for 2006 have been included under the column entitled "Non-Equity Incentive Plan Compensation" in the table on page 27 of this proxy statement. You should see the information under the heading "Elements of Our Compensation Program" in the section entitled "Compensation Discussion and Analysis" beginning on page 19 of this proxy statement for more information about our annual cash incentive awards.
- (4) Amounts represent the potential amounts payable in 2009 to the executive officers named in this proxy statement under performance units awarded in 2006 assuming threshold, target and maximum levels of performance for the 2006-2008 performance period. You should see the information under the heading



**Table of Contents**

Elements of Our Compensation Program in the section entitled Compensation Discussion and Analysis beginning on page 19 of this proxy statement for more information about our performance unit awards.

**Outstanding Equity Awards at December 31, 2006**

The following table shows information relating to the equity awards previously made to the executive officers named in this proxy statement which remain outstanding at December 31, 2006. We have adjusted the amounts reported in prior years for the two-for-one stock split on May 15, 2006.

Option Awards			Stock Awards			Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested
Number of Securities Underlying Unexercised Options (#)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)(1)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)
		\$ 13.94	07/23/07		\$	\$
		11.44	07/22/08			
		5.34	02/25/09			
		10.98	02/22/11			
		9.08	02/28/12			
		11.30	04/25/12			
				4,742(8)	142,402	
				23,788(9)	714,354	
				9,200(10)	276,276	
				6,300(11)	189,189	
						45,200(12)
						45,200(12)
		9.08	02/28/12			

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11.30	04/25/12			2,226(8)	66,847		
				11,162(9)	335,195		
				3,932(10)	118,078		
				2,900(11)	87,087		
						19,300(12)	579,579
						19,300(12)	579,579
9.08	02/28/12			1,824(8)	54,775		
11.30	04/25/12			2,738(9)	82,222		
				3,200(10)	96,096		
				2,300(11)	69,069		
						4,800(12)	144,144
						4,800(12)	144,144
13.94	07/23/07					(1.46)	(0.77)
(0.23)	(1.80)	(3.19)	(3.81)	(2.70)	(1.45)		
(1.11)	(10.28)	(9.95)	4.23	(1.12)	4.07		
\$ 4.27	\$ 5.38	\$ 15.66	\$ 25.61	\$ 21.38	\$ 22.50		
\$ 4.04	\$ 3.80	\$ 14.52	\$ 24.74	\$ 19.24	\$ 20.62		
14.21%	58.62%	27.49%	39.55%	8.27%	32.15%		
14.70% <sup>c</sup>	68.42%	30.40%	49.81%	6.32%	25.05%		

See accompanying notes to financial statements.

## COHEN &amp; STEERS QUALITY INCOME REALTY FUND, INC.

## FINANCIAL HIGHLIGHTS (Unaudited) (Continued)

Ratios/Supplemental Data:	For the Six	For the Year Ended December 31,					
	Months Ended	2009	2008	2007	2006	2005	2004
Net assets applicable to common shares, end of period (in millions)	June 30, 2009	\$ 167.7	\$ 210.9	\$ 609.1	\$ 995.3	\$ 830.9	\$ 874.2
Ratio of expenses to average daily net assets applicable to common shares (before expense reduction) <sup>e</sup>		4.48% <sup>f</sup>	2.11%	1.52%	1.47%	1.54%	1.51%
Ratio of expenses to average daily net assets applicable to common shares (net of expense reduction) <sup>e</sup>		4.22% <sup>f</sup>	1.76%	1.14%	1.00%	1.06%	1.04%
Ratio of expenses to average daily net assets applicable to common shares (net of expense reduction and excluding interest expense) <sup>e</sup>		3.96% <sup>f</sup>	1.72%				
Ratio of net investment income to average daily net assets applicable to common shares (before expense reduction) <sup>e</sup>		4.91% <sup>f</sup>	6.36%	3.73%	4.06%	3.71%	4.74%
Ratio of net investment income to average daily net assets applicable to common shares (net of expense reduction) <sup>e</sup>		5.16% <sup>f</sup>	6.71%	4.12%	4.53%	4.19%	5.20%
Ratio of expenses to average daily managed assets (before expense reduction) <sup>e,g</sup>		2.47% <sup>f</sup>	1.20%	1.02%	1.01%	1.02%	1.03%
Ratio of expenses to average daily managed assets (net of expense reduction) <sup>e,g</sup>		2.33% <sup>f</sup>	1.00%	0.76%	0.69%	0.70%	0.71%
Portfolio turnover rate		48% <sup>c</sup>	23%	26%	18%	11%	3%
Preferred Shares/Revolving Credit Agreement:							
Liquidation value, end of period (in 000's)		\$ 71,825	\$ 120,825	\$ 434,000	\$ 434,000	\$ 434,000	\$ 434,000
Total shares outstanding (in 000's)		3	5	17	17	17	17
		517%	3,786%				

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Asset coverage ratio for revolving credit agreement						
Asset coverage per \$1,000 for revolving credit agreement	\$ 5,166	\$ 37,859				
Asset coverage ratio for auction market preferred shares <sup>h</sup>	230%	262%	240%	329%	291%	301%
Asset coverage per share for auction market preferred shares <sup>h</sup>	\$ 57,500	\$ 65,500	\$ 60,088	\$ 82,333	\$ 72,863	\$ 75,359
Liquidation preference per share	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000
Average market value per share <sup>i</sup>	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000

<sup>a</sup> Amount is less than \$0.005.

<sup>b</sup> Total market value return is computed based upon the New York Stock Exchange market price of the Fund's shares and excludes the effects of brokerage commissions. Total net asset value return measures the changes in value over the period indicated, taking into account dividends as reinvested. Dividends and distributions, if any, are assumed for purposes of these calculations, to be reinvested at prices obtained under the Fund's dividend reinvestment plan.

<sup>c</sup> Not annualized.

<sup>d</sup> Reflects adjustments in accordance with accounting principles generally accepted in the United States of America and as such, the net asset value for financial reporting purposes and the returns based upon those net asset values differ from the net asset value and returns reported on December 31, 2008.

<sup>e</sup> Ratios do not reflect dividend payments to preferred shareholders.

<sup>f</sup> Annualized.

<sup>g</sup> Average daily managed assets represent net assets applicable to common shares plus liquidation preference of preferred shares and the outstanding balance of the revolving credit agreement.

<sup>h</sup> Includes the effect of the outstanding borrowings from the revolving credit agreement.

<sup>i</sup> Based on weekly prices.

See accompanying notes to financial statements.



**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

NOTES TO FINANCIAL STATEMENTS (Unaudited)

Note 1. Significant Accounting Policies

Cohen & Steers Quality Income Realty Fund, Inc. (the Fund) was incorporated under the laws of the State of Maryland on August 22, 2001 and is registered under the Investment Company Act of 1940, as amended, as a nondiversified, closed-end management investment company. The Fund's investment objective is high current income.

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The policies are in conformity with accounting principles generally accepted in the United States of America (GAAP). The preparation of the financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

*Portfolio Valuation:* Investments in securities that are listed on the New York Stock Exchange are valued, except as indicated below, at the last sale price reflected at the close of the New York Stock Exchange on the business day as of which such value is being determined. If there has been no sale on such day, the securities are valued at the mean of the closing bid and asked prices for the day or, if no asked price is available, at the bid price. Exchange traded options are valued at their last sale price as of the close of options trading on applicable exchanges. In the absence of a last sale, options are valued at the average of the quoted bid and asked prices as of the close of business. Over-the-counter options quotations are provided by the respective counterparty.

Securities not listed on the New York Stock Exchange but listed on other domestic or foreign securities exchanges or admitted to trading on the National Association of Securities Dealers Automated Quotations, Inc. (Nasdaq) national market system are valued in a similar manner. Securities traded on more than one securities exchange are valued at the last sale price on the business day as of which such value is being determined as reflected on the tape at the close of the exchange representing the principal market for such securities.

Readily marketable securities traded in the over-the-counter market, including listed securities whose primary market is believed by Cohen & Steers Capital Management, Inc. (the investment manager) to be over-the-counter are valued at the official closing prices as reported by Nasdaq, the Pink Sheets, or such other comparable sources as the Board of Directors deem appropriate to reflect their fair market value. If there has been no sale on such day, the securities are valued at the mean of the closing bid and asked prices for the day, or if no asked price is available, at the bid price. However, certain fixed-income securities may be valued on the basis of prices provided by a pricing service when such prices are believed by the Board of Directors to reflect the fair market value of such securities. Where securities are traded on more than one exchange and also over-the-counter, the securities will generally be valued using the quotations the Board of Directors believes most closely reflect the value of such securities. Interest rate swaps are valued utilizing quotes received from an outside pricing service.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

Portfolio securities primarily traded on foreign markets are generally valued at the closing values of such securities on their respective exchanges or if after the close of the foreign markets, but prior to the close of business on the day the securities are being valued, market conditions change significantly, certain foreign securities may be fair valued pursuant to procedures established by the Board of Directors.

Securities for which market prices are unavailable, or securities for which the investment manager determines that bid and/or asked price does not reflect market value, will be valued at fair value pursuant to procedures approved by the Fund's Board of Directors. Circumstances in which market prices may be unavailable include, but are not limited to, when trading in a security is suspended, the exchange on which the security is traded is subject to an unscheduled close or disruption or material events occur after the close of the exchange on which the security is principally traded. In these circumstances, the Fund determines fair value in a manner that fairly reflects the market value of the security on the valuation date based on consideration of any information or factors it deems appropriate. These may include recent transactions in comparable securities, information relating to the specific security and developments in the markets.

The Fund's use of fair value pricing may cause the net asset value of Fund shares to differ from the net asset value that would be calculated using market quotations. Fair value pricing involves subjective judgments and it is possible that the fair value determined for a security may be materially different than the value that could be realized upon the sale of that security.

Short-term debt securities, which have a maturity date of 60 days or less, are valued at amortized cost, which approximates value.

The Fund adopted Financial Accounting Standards Board Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"), effective January 1, 2008. In accordance with FAS 157, fair value is defined as the price that the Fund would receive to sell an investment or pay to transfer a liability in an orderly transaction with an independent buyer in the principal market, or in the absence of a principal market the most advantageous market for the investment or liability. FAS 157 establishes a single definition of fair value, creates a three-tier hierarchy as a framework for measuring fair value based on inputs used to value the Fund's investments, and requires additional disclosure about fair value. The hierarchy of inputs is summarized below.

Level 1 quoted prices in active markets for identical investments

Level 2 other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)

Level 3 significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The Fund adopted Financial Accounting Standards Board Statement of Financial Accounting Standards Staff Position No. 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP 157-4"), effective June 15, 2009.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

## NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

FSP 157-4 provides additional guidance for estimating fair value in accordance with FAS 157, when the volume and level of activity for the asset or liability have significantly decreased as well as guidance on identifying circumstances that indicate a transaction is not orderly.

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

The following is a summary of the inputs used as of June 30, 2009 in valuing the Fund's investments carried at value:

	Total	Fair Value Measurements at June 30, 2009 Using		
		Quoted Prices In Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Common Stock	\$ 205,817,047	\$ 205,817,047	\$	
Preferred Securities \$25 Par Value				
Shopping Center Community Center	15,697,654	13,609,534	2,088,120	
Preferred Securities \$25 Par Value				
Other Industries	62,208,499	62,208,499		
Preferred Securities Capital Securities	3,715,168		3,715,168	
Corporate Bonds	3,042,621		3,042,621	
Money Market Funds	8,004,341		8,004,341	
	\$ 298,485,330	\$ 281,635,080	\$ 16,850,250	
Other Financial Instruments*	\$ (3,270,861)		\$ (3,270,861)	

\* Other financial instruments are interest rate swap contracts.

Included in the table above are \$1,851,762 of corporate bonds which were fair valued pursuant to the Fund's fair value procedures. The fair value price considered current day transaction prices, transaction volume and comparability of transaction. The volume and level of activity had not decreased significantly and therefore, the transactions were deemed to be orderly.

*Security Transactions and Investment Income:* Security transactions are recorded on trade date. Realized gains and losses on investments sold are recorded on the basis of identified cost. Interest income is recorded on the accrual basis. Discounts are accreted and premiums are amortized over the life of the respective securities. Dividend income is recorded on the ex-dividend date except for certain dividends on foreign securities, which are recorded as soon as the Fund is informed after the ex-dividend date. The Fund records distributions received in excess of income from underlying investments as a reduction of cost of investments and/or realized gain. Such



**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

amounts are based on estimates if actual amounts are not available, and actual amounts of income, realized gain and return of capital may differ from the estimated amounts. The Fund adjusts the estimated amounts of the components of distributions (and consequently its net investment income) as an increase to unrealized appreciation/(depreciation) and realized gain/(loss) on investments as necessary once the issuers provide information about the actual composition of the distributions.

*Options:* The Fund may write covered call options on an index or a security. When a Fund writes (sells) an option, an amount equal to the premium received by the Fund is recorded in the Statement of Assets and Liabilities as a liability. The amount of the liability is subsequently marked-to-market to reflect the current market value of the option written. When an option expires, the Fund realizes a gain or loss on the option to the extent of the premiums received. Premiums received from writing options which are exercised or are closed, are added to or offset against the proceeds or amount paid on the transaction to determine the realized gain or loss. The Fund, as writer of an option, bears the market risk of an unfavorable change in the price of the underlying index or security. Other risks include the possibility of an illiquid options market or the inability of the counterparties to fulfill their obligations under the contract.

*Foreign Currency Translations:* The books and records of the Fund are maintained in U.S. dollars as follows: (1) the foreign currency market value of investment securities, other assets and liabilities and foreign currency contracts are translated at the exchange rates prevailing at the end of the period; and (2) purchases, sales, income and expenses are translated at the exchange rates prevailing on the respective dates of such transactions. The resultant exchange gains and losses are recorded as realized and unrealized gain/loss on foreign exchange transactions. Pursuant to U.S. federal income tax regulations, certain foreign exchange gains/losses included in realized and unrealized gain/loss are included in or are a reduction of ordinary income for federal income tax purposes. The Fund does not isolate that portion of the results of operations arising as a result of changes in the foreign exchange rates from the changes in the market prices of the securities.

*Foreign Securities:* The Fund may directly purchase securities of foreign issuers. Investing in securities of foreign issuers involves special risks not typically associated with investing in securities of U.S. issuers. The risks include possible revaluation of currencies, the ability to repatriate funds, less complete financial information about companies and possible future adverse political and economic developments. Moreover, securities of many foreign issuers and their markets may be less liquid and their prices more volatile than those of securities of comparable U.S. issuers.

*Interest Rate Swaps:* The Fund uses interest rate swaps in connection with the sale of preferred shares and borrowing under its credit agreement. The interest rate swaps are intended to reduce the risk that an increase in short-term interest rates could have on the performance of the Fund's common shares as a result of the floating rate structure of the preferred shares and the credit agreement. In these interest rate swaps, the Fund agrees to pay the other party to the interest rate swap (which is known as the counterparty) a fixed rate payment in exchange

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

for the counterparty agreeing to pay the Fund a variable rate payment that is intended to approximate the Fund's variable rate payment obligation on the preferred shares and the credit agreement. The payment obligation is based on the notional amount of the swap. Depending on the state of interest rates in general, the use of interest rate swaps could enhance or harm the overall performance of the common shares. The market value of interest rate swaps is based on pricing models that consider the time value of money, volatility, the current market and contractual prices of the underlying financial instrument. Unrealized appreciation is reported as an asset and unrealized depreciation is reported as a liability on the Statement of Assets and Liabilities. The change in value of swaps, including the accrual of periodic amounts of interest to be paid or received on swaps, is reported as unrealized appreciation or depreciation in the Statement of Operations. A realized gain or loss is recorded upon payment or receipt of a periodic payment or termination of swap agreements. Swap agreements involve, to varying degrees, elements of market and counterparty risk, and exposure to loss in excess of the related amounts reflected in the Statement of Assets and Liabilities. The Fund's maximum risk of loss from counterparty credit risk is the discounted net value of the cash flows to be received from or paid to the counterparty over the contract's remaining life, to the extent that such amount is positive.

For each swap counterparty, the Fund entered into an International Swap Dealers Association Inc. Master Agreement and related annexes thereto ("ISDAs") which sets forth the general terms and conditions of the Fund's swap transactions. During 2008, the Fund notified Merrill Lynch Derivatives Product AG ("MLDP") and UBS AG ("UBS") that it breached certain terms and conditions of its ISDAs. On November 21, 2008, UBS granted a conditional waiver to the Fund stating that UBS did not intend to presently exercise its rights under the ISDA.

At June 30, 2009, the Fund continues to operate under the existing terms of all of its various ISDAs, including those with MLDP and UBS. However, MLDP and UBS reserve any and all rights to take any future action with respect to such events, including termination of outstanding swap transactions; termination or renegotiation of the ISDAs; posting of collateral in the form of cash or U.S. Treasury securities representing the unrealized depreciation on outstanding interest rate swap transactions or continuation under the current terms of the ISDAs. Any action resulting in the early termination of an interest rate swap transaction would cause the Fund to realize any market depreciation that existed on such transaction. In addition to realizing such losses, the early termination of a swap transaction may generate additional expenses for the Fund.

*Dividends and Distributions to Shareholders:* Dividends from net investment income and capital gain distributions are determined in accordance with U.S. federal income tax regulations, which may differ from GAAP. Dividends from net investment income are declared and paid quarterly. Net realized capital gains, unless offset by any available capital loss carryforward, are typically distributed to shareholders at least annually. Dividends and distributions to shareholders are recorded on the ex-dividend date and are automatically reinvested in full and fractional shares of the Fund unless the shareholder has elected to have them paid in cash.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

Distributions paid by the Fund are subject to recharacterization for tax purposes. Based upon the results of operations for the six months ended June 30, 2009, the investment manager considers it likely that a portion of the dividends to common shareholders will be reclassified to return of capital upon the final determination of the Fund's taxable income for the year.

Series M7, Series T, Series TH and Series F preferred shares pay dividends based on a variable interest rate set at auctions, normally held every seven days. The dividends are declared and recorded for the subsequent seven day period on the auction date. In most instances, dividends are payable every seven days, on the first business day following the end of the dividend period.

Series M28 and Series W preferred shares pay dividends based on a variable interest rate set at auctions, normally held every 28 days. The dividends are declared and recorded for the subsequent 28 day period on the auction date. In most instances, dividends are payable every 28 days, on the first business day following the end of the dividend period.

*Income Taxes:* It is the policy of the Fund to continue to qualify as a regulated investment company, if such qualification is in the best interest of the shareholders, by complying with the requirements of Subchapter M of the Internal Revenue Code applicable to regulated investment companies, and by distributing substantially all of its taxable earnings to its shareholders. Accordingly, no provision for federal income or excise tax is necessary. The Fund has adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position must meet before being recognized in the financial statements. An assessment of the Fund's tax positions has been made and it has been determined that there is no impact to the Fund's financial statements. Each of the Fund's federal tax returns for the prior three fiscal years remains subject to examination by the Internal Revenue Service.

Note 2. Investment Management Fees, Administration Fees and Other Transactions with Affiliates

*Investment Management Fees:* The investment manager serves as the Fund's investment manager pursuant to an investment management agreement (the investment management agreement). Under the terms of the investment management agreement, the investment manager provides the Fund with day-to-day investment decisions and generally manages the Fund's investments in accordance with the stated policies of the Fund, subject to the supervision of the Board of Directors.

For the services under the investment management agreement, the Fund pays the investment manager an investment management fee, accrued daily and paid monthly, at an annual rate of 0.85% of the Fund's average daily managed asset value. Managed asset value is the net asset value of the common shares plus the liquidation preference of the preferred shares and/or the amount of any loan outstanding.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

## NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

The investment manager has contractually agreed to waive its investment management fee in the amount of 0.14% of average daily managed asset value in 2009, 0.08% of average daily managed asset value in 2010 and 0.02% of average daily managed asset value in 2011.

*Administration Fees:* The Fund has entered into an administration agreement with the investment manager under which the investment manager performs certain administrative functions for the Fund and receives a fee, accrued daily and paid monthly, at the annual rate of 0.02% of the Fund's average daily managed asset value. For the six months ended June 30, 2009, the Fund incurred \$26,995 in administration fees. Additionally, the Fund pays State Street Bank and Trust Company as sub-administrator under a fund accounting and administration agreement.

*Directors' and Officers' Fees:* Certain directors and officers of the Fund are also directors, officers, and/or employees of the investment manager. The Fund does not pay compensation to any affiliated directors and officers except for the Chief Compliance Officer, who received \$2,067 from the Fund for the six months ended June 30, 2009.

## Note 3. Purchases and Sales of Securities

Purchases and sales of securities, excluding short-term investments, for the six months ended June 30, 2009, totaled \$133,432,391 and \$127,077,538, respectively.

Transactions in options written during the six months ended June 30, 2009 were as follows:

	Number of Contracts	Premium
Options outstanding at December 31, 2008		\$
Options written	444,679	596,102
Options expired	(442,605)	(381,166)
Options terminated in closing transactions	(1,360)	(168,640)
Options exercised	(714)	(46,296)
Options outstanding at June 30, 2009		\$

## Note 4. Income Tax Information

As of June 30, 2009, the federal tax cost and net unrealized depreciation on securities were as follows:

Gross unrealized appreciation	\$ 11,257,253
Gross unrealized depreciation	(79,889,150)
Net unrealized depreciation	\$ (68,631,897)
Cost for federal income tax purposes	\$ 367,117,227

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

As of December 31, 2008, the Fund had a net capital loss carryforward of \$91,551,930, which will expire on December 31, 2016. This carryforward may be used to offset future capital gains to the extent provided by regulations.

Note 5. Capital Stock

The Fund is authorized to issue 100 million shares of common stock at a par value of \$0.001 per share.

During the six months ended June 30, 2009 and the year ended December 31, 2008, the Fund issued 0 and 352,497 shares of common stock, respectively, for the reinvestment of dividends.

On June 12, 2008, the Board of Directors approved the delegation of its authority to management to effect repurchases, pursuant to management's discretion and subject to market conditions and investment considerations, of up to 10% of the Fund's outstanding common shares ("Share Repurchase Program") through the fiscal year ended December 31, 2008. On December 17, 2008, the Board of Directors authorized the continuation of the Share Repurchase Program through fiscal year ending December 31, 2009. During the six months ended June 30, 2009 and the year ended December 31, 2008, the Fund did not effect any repurchases.

The Fund's articles of incorporation authorize the issuance of Fund preferred shares, par value \$0.001 per share, in one or more classes or series, with rights as determined by the Board of Directors, by action of the Board of Directors without the approval of the common shareholders.

Preferred shares are senior to the Fund's common shares and will rank on a parity with shares of any other series of preferred shares, and with shares of any other series of preferred stock of the Fund, as to the payment of dividends and the distribution of assets upon liquidation. If the Fund does not timely cure a failure to (1) maintain a discounted value of its portfolio equal to the preferred shares basic maintenance amount, (2) maintain the 1940 Act preferred shares asset coverage, or (3) file a required certificate related to asset coverage on time, the preferred shares will be subject to a mandatory redemption at the redemption price of \$25,000 per share plus an amount equal to accumulated but unpaid dividends thereon to the date fixed for redemption. To the extent permitted under the 1940 Act and Maryland Law, the Fund at its option may without consent of the holders of preferred shares, redeem preferred shares having a dividend period of one year or less, in whole, or in part, on the business day after the last day of such dividend period upon not less than 15 calendar days and not more than 40 calendar days prior to notice. The optional redemption price is \$25,000 per share plus an amount equal to accumulated but unpaid dividends thereon to the date fixed for redemption.

The Fund's common shares and preferred shares have equal voting rights of one vote per share and vote together as a single class, except in certain circumstances regarding the election of directors. In addition, the affirmative vote of the holders of a majority, as defined in the 1940 Act, of the outstanding preferred shares shall be required to (1) approve any plan of reorganization that would adversely affect the preferred shares and (2) approve any matter that materially and adversely affects the rights, preferences, or powers of that series.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

## NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

The following table reflects the preferred shares issued and outstanding in the amount of \$71,825,000 as of June 30, 2009, along with the range of dividend rates paid during the six months ended June 30, 2009:

	Value	Range
Auction market preferred shares, Series M7, (\$25,000 liquidation value, \$0.001 par value, 621 shares issued and outstanding)	\$ 15,525,000	0.14%-1.73%
Auction market preferred shares, Series M28, (\$25,000 liquidation value, \$0.001 par value, 396 shares issued and outstanding)	\$ 9,900,000	0.38%-0.77%
Auction market preferred shares, Series T, (\$25,000 liquidation value, \$0.001 par value, 464 shares issued and outstanding)	\$ 11,600,000	0.12%-1.73%
Auction market preferred shares, Series W, (\$25,000 liquidation value, \$0.001 par value, 464 shares issued and outstanding)	\$ 11,600,000	0.44%-0.68%
Auction market preferred shares, Series TH, (\$25,000 liquidation value, \$0.001 par value, 464 shares issued and outstanding)	\$ 11,600,000	0.11%-0.53%
Auction market preferred shares, Series F, (\$25,000 liquidation value, \$0.001 par value, 464 shares issued and outstanding)	\$ 11,600,000	0.17%-1.73%

The Articles Supplementary (the "Articles") creating each series of Auction Market Preferred Shares ("AMPS") provide for dividends to be paid at either the rate set in the current auction, or at the maximum rate as defined in the Articles if sufficient clearing bids for the AMPS are not received in the current auction. Beginning on February 13, 2008, sufficient clearing bids were not received for the auctions for the AMPS series of the Fund, and therefore, the maximum rates were declared on the respective AMPS series. Based upon the current ratings of the AMPS, the maximum rate for shares of a series will be 150% of the applicable commercial paper rate.

An existing owner of AMPS may sell, transfer or dispose of AMPS only in an auction, pursuant to a bid or sell order in accordance with the auction procedures, or outside an auction, to or through a broker-dealer. Existing holders will be able to sell all of the AMPS that are the subject of their submitted sell orders only if there are bidders willing to purchase those AMPS in the auction. An auction fails when there is an insufficient number of bidders. A failed auction is not a default. Dividends continue to be paid on the AMPS at the maximum rate rather than an auction rate. Broker-dealers, which have been appointed by the Fund to serve as dealers for the auctions, may submit a bid in an auction to avoid an auction failure, but are not obligated to do so. Due to liquidity concerns in the market, most broker-dealers have decided not to submit bids to purchase AMPS.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

## NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

The AMPS continue to be rated Aaa by Moody's Investor Services and AAA by Standard & Poor's. In addition, the Fund continues to meet certain specified asset coverage tests required by the rating agencies as well as the 200% asset coverage test with respect to AMPS set forth in the Investment Company Act of 1940, as amended.

During the six months ended June 30, 2009 and the year ended December 31, 2008, the Fund redeemed \$49,000,000 and \$313,175,000, respectively, of its outstanding preferred shares at a redemption price of \$25,000 per share plus accrued but unpaid dividends. The partial redemption of the preferred shares was made on a pro rata basis across all preferred series. Redemptions were allocated among participating broker/dealers by the Depository Trust Company using a predetermined methodology and each broker/dealer allocated the redeemed shares to the underlying beneficiaries according to its own procedures.

The redemption amount and details for the six months ended June 30, 2009 are:

Series	Shares Outstanding 12/31/08	Number of Shares Redeemed	Shares Outstanding 06/30/09	Total Value 12/31/08	Amount Redeemed	Total Value 06/30/09
M7	1,045	424	621	\$ 26,125,000	\$ 10,600,000	\$ 15,525,000
M28	668	272	396	16,700,000	6,800,000	9,900,000
T	780	316	464	19,500,000	7,900,000	11,600,000
W	780	316	464	19,500,000	7,900,000	11,600,000
TH	780	316	464	19,500,000	7,900,000	11,600,000
F	780	316	464	19,500,000	7,900,000	11,600,000
				\$ 120,825,000	\$ 49,000,000	\$ 71,825,000

The redemption amount and details for the year ended December 31, 2008 are:

Series	Shares Outstanding 12/31/07	Number of Shares Redeemed	Shares Outstanding 12/31/08	Total Value 12/31/07	Amount Redeemed	Total Value 12/31/08
M7	3,760	2,715	1,045	\$ 94,000,000	\$ 67,875,000	\$ 26,125,000
M28	2,400	1,732	668	60,000,000	43,300,000	16,700,000
T	2,800	2,020	780	70,000,000	50,500,000	19,500,000
W	2,800	2,020	780	70,000,000	50,500,000	19,500,000
TH	2,800	2,020	780	70,000,000	50,500,000	19,500,000
F	2,800	2,020	780	70,000,000	50,500,000	19,500,000
				\$ 434,000,000	\$ 313,175,000	\$ 120,825,000

On June 30, 2009 the Fund announced the redemption of the balance of its outstanding preferred shares.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

## NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

The redemption amount and details are:

Series	Number of Shares Redeemed	Amount Redeemed	Redemption Date
T	464	\$ 11,600,000	July 22, 2009
TH	464	\$ 11,600,000	July 24, 2009
F	464	\$ 11,600,000	July 20, 2009
W	464	\$ 11,600,000	July 24, 2009
M28	396	\$ 9,900,000	July 24, 2009
M7	621	\$ 15,525,000	July 21, 2009

## Note 6. Borrowings

On September 23, 2008 the Fund entered into a \$250,000,000 revolving credit agreement (the credit agreement) with BNP Paribas Prime Brokerage Inc. (BNPP). On July 15, 2009 the credit agreement was amended to reduce the maximum commitment to \$150,000,000. The Fund pays a facility fee of 0.95% per annum on the unused portion of the credit agreement. The credit agreement has a 270-day rolling term that resets daily; however, if the Fund exceeds certain net asset value triggers, the credit agreement may convert to a 60-day rolling term that resets daily. The Fund is required to segregate portfolio securities as collateral in an amount up to two times the loan balance outstanding and has granted a security interest in the securities segregated to, and in favor of, BNPP as security for the loan balance outstanding. If the Fund fails to meet certain requirements, or maintain other financial covenants required under the credit agreement, the Fund may be required to repay immediately, in part or in full, the loan balance outstanding under the credit agreement necessitating the sale of portfolio securities at potentially inopportune times. The credit agreement also permits, subject to certain conditions, BNPP to re-hypothecate portfolio securities segregated by the Fund up to the amount of the loan balance outstanding. The Fund will receive a portion of the fees earned by BNPP in connection with the re-hypothecation of portfolio securities.

As of June 30, 2009 the Fund has outstanding borrowings of \$57,500,000. During the six months ended June 30, 2009, the Fund borrowed an average daily balance of \$33,571,141 at a weighted average borrowing cost of 1.44%.

## Note 7. Derivative Investments

The Fund has adopted the provisions of Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (FAS 161). This new standard requires funds to disclose information intended to enable financial statement users to understand how and why the Fund uses derivative instruments, how derivative instruments are accounted for under FAS 133 and how derivative instruments affect the



**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

## NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

company's financial position, results of operations, and cash flows. All changes to disclosure have been made in accordance with FAS 161 and incorporated for the current period as part of the Notes to Financial Statements.

Fair Values of Derivative Instruments as of June 30, 2009:

## Statement of Assets and Liabilities

Derivatives	Assets		Liabilities	
	Location	Fair Value	Location	Fair Value
Interest Rate Swaps	Unrealized appreciation		Unrealized depreciation	\$ 3,270,861

## Statement of Operations

Derivatives	Location	Realized Gain/(Loss)	Change in Unrealized Appreciation/ (Depreciation)
Interest Rate Swaps	Net Realized and Unrealized Gain (Loss)	\$ (2,290,341)	\$ 3,454,205
Written Options	Net Realized and Unrealized Gain (Loss)	455,797	
		\$ (1,834,544)	\$ 3,454,205

## Note 8. Other

In the normal course of business, the Fund enters into contracts that provide general indemnifications. The Fund's maximum exposure under these arrangements is dependent on claims that may be made against the Fund in the future and, therefore, cannot be estimated; however, based on experience, the risk of material loss from such claims is considered remote.

## Note 9. Merger

On June 10, 2009, the Boards of Directors of the Fund and each of Cohen & Steers Premium Income Realty Fund, Inc. ("RPF"), Cohen & Steers Advantage Income Realty Fund, Inc. ("RLF") and Cohen & Steers Worldwide Realty Income Fund, Inc. ("RWF" and collectively with RLF and RPF, the "Acquired Funds") approved a merger, subject to approval by the Fund's shareholders, in which RPF, RLF and RWF would merge with and into the Fund in accordance with Maryland General Corporation Law. If each fund's shareholders approve the mergers, shareholders of RPF, RLF and RWF would become shareholders of the Fund. In connection with the mergers, all of RPF's, RLF's and RWF's assets and liabilities will be combined with the Fund, and each shareholder of RPF, RLF and RWF will receive a number of shares of the Fund in exchange for their shares of RPF, RLF and RWF having an aggregate net asset value equal to the aggregate net asset value of RPF's, RLF's and RWF's shares held as of the close of business of the New York Stock Exchange on the closing date of the mergers. Each merger is subject to approval

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

of the shareholders of each of RPF, RLF, RWF and the Fund and shareholders of RPF, RLF and RWF will vote separately on the merger involving their respective fund. Shareholders of the Fund must also approve an amendment to the Fund's charter to increase the number of authorized common shares. Additionally, the merger of RWF with and into the Fund is conditioned on the approval of the merger of RPF with and into the Fund or on the approval of the merger of RLF with and into the Fund. If shareholders approve the mergers and if the shareholders of the Fund approve an increase in the number of authorized common shares, the closing date of the mergers is expected to be on or about December 18, 2009.

If the Fund's shareholders do not approve the amendment to the Fund's charter to increase the number of authorized shares, but the proposals approving the mergers are approved, the Fund will not have sufficient authorized but unissued common shares to issue to all of RPF's, RLF's and RWF's shareholders, and will not be able to consummate all of the mergers. Should this occur, the Funds' Boards of Directors reserve the right to consummate the mergers of only one or two of the Acquired Funds with and into the Fund and will publicly announce prior to the closing date which mergers will be consummated.

Merger related expenses, which will be borne by the Fund, are estimated to be approximately \$311,000.

Note 10. Subsequent Events

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 165, Subsequent Events (FAS 165), effective for interim or annual periods ending after June 15, 2009. The FASB has established general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued.

Note 5 discloses the subsequent AMPS redemptions which were announced on June 30 and Note 6 discloses the subsequent reduction of the Fund's line of credit. With regard to the Fund's financial statements, subsequent to June 30, 2009 and through August 18, 2009, there have been no recognized subsequent events (subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet) nor have there been any nonrecognized subsequent events (subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet but before the financial statements are issued or are available to be issued), except for those noted above.



**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

PROXY RESULTS (Unaudited)

Cohen & Steers Quality Income Realty Fund shareholders voted on the following proposals at the annual meeting held on April 30, 2009. The description of each proposal and number of shares voted are as follows:

Common Shares

	Shares Voted For	Authority Withheld
To elect Directors		
George Grossman	34,627,005	1,667,251
Robert H. Steers	34,637,492	1,656,763
C. Edward Ward, Jr.	34,705,253	1,589,002

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

AVERAGE ANNUAL TOTAL RETURNS

(periods ended June 30, 2009) (Unaudited)

Based on Net Asset Value			Based on Market Value		
One Year	Five Years	Since Inception (02/28/02)	One Year	Five Years	Since Inception (02/28/02)
62.23%	13.19%	3.62%	67.51%	12.38%	4.75%

*The performance data quoted represent past performance. Past performance is no guarantee of future results. The investment return will vary and the principal value of an investment will fluctuate and shares, if sold, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance results reflect the effect of leverage resulting from the issuance of preferred shares and borrowings under a credit agreement.*

REINVESTMENT PLAN

We urge shareholders who want to take advantage of this plan and whose shares are held in 'Street Name' to consult your broker as soon as possible to determine if you must change registration into your own name to participate.

OTHER INFORMATION

A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities is available (i) without charge, upon request, by calling 800-330-7348, (ii) on our Web site at [cohenandsteers.com](http://cohenandsteers.com) or (iii) on the Securities and Exchange Commission's Web site at <http://www.sec.gov>. In addition, the Fund's proxy voting record for the most recent 12-month period ended June 30 is available (i) without charge, upon request, by calling 800-330-7348 or (ii) on the SEC's Web site at <http://www.sec.gov>.

The Fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The Fund's Forms N-Q are available (i) without charge, upon request by calling 800-330-7348, or (ii) on the SEC's Web site at <http://www.sec.gov>. In addition, the Forms N-Q may be reviewed and copied at the SEC's Public Reference Room in Washington, DC. Information on the operation of the Public Reference Room may be obtained by calling 800-SEC-0330.

Please note that the distributions paid by the Fund to shareholders are subject to recharacterization for tax purposes. The Fund may also pay distributions in excess of the Fund's net investment company taxable income and this excess would be a tax-free return of capital distributed from the Fund's assets. To the extent this occurs, the Fund's shareholders of record will be notified of the estimated amount of capital returned to shareholders for each such distribution and this information will also be available at [cohenandsteers.com](http://cohenandsteers.com). The final tax treatment of all distributions is reported to shareholders on their 1099-DIV forms, which are mailed after the close of each calendar year. Distributions of capital decrease the Fund's total assets and, therefore, could have the effect of increasing the Fund's expense ratio. In addition, in order to make these distributions, the Fund may have to sell portfolio securities at a less than opportune time.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

The Board of Directors, at its June 9-10, 2009 meeting, approved that the Fund may, but is not required to, use, without limit, various strategic transactions described below to seek to generate return, facilitate portfolio management and mitigate risks. Although the investment manager may seek to use these kinds of transactions to further the Fund's investment objectives, no assurance can be given that they will achieve this result. The Fund may enter into exchange-listed and over-the-counter put and call options on securities (including securities of investment companies and baskets of securities), indicies, and other financial instruments; purchase and sell financial futures contracts and options thereon; enter into various interest rate transactions, such as swaps, caps, floors or collars or credit transactions; equity index, total return and credit default swaps; forward contracts; and structured investments. In addition, the Fund may enter into various currency transactions, such as forward currency contracts, currency futures contracts, currency swaps or options on currency or currency futures. The Fund also may purchase and sell derivative instruments that combine features of these instruments. The Fund may invest in other types of derivatives, structured and similar instruments which are not currently available but which may be developed in the future. Collectively, all of the above are referred to as "Derivatives Transactions."

Derivatives Transactions can be highly volatile and involve various types and degrees of risk, depending upon the characteristics of the particular derivative, including the imperfect correlation between the value of such instruments and the underlying assets, the possible default of the other party to the transaction and illiquidity of the derivative instruments. Derivatives Transactions may entail investment exposures that are greater than their cost would suggest, meaning that a small investment in derivatives could have a large potential impact on the Fund's performance, effecting a form of investment leverage on the Fund's portfolio. In certain types of Derivatives Transactions the Fund could lose the entire amount of its investment; in other types of Derivatives Transactions the potential loss is theoretically unlimited.

The market for many derivatives is, or suddenly can become, illiquid. Changes in liquidity may result in significant, rapid and unpredictable changes in the prices for Derivatives Transactions. The Fund could experience losses if it were unable to liquidate its position because of an illiquid secondary market. Successful use of Derivatives Transactions also is subject to the ability of the investment manager to predict correctly movements in the direction of the relevant market and, to the extent the transaction is entered into for hedging purposes, to ascertain the appropriate correlation between the transaction being hedged and the price movements of the derivatives. Derivatives Transactions entered into to seek to manage the risks of the Fund's portfolio of securities may have the effect of limiting gains from otherwise favorable market movements. The use of Derivatives Transactions may result in losses greater than if they had not been used (and a loss on a Derivatives Transaction position may be larger than the gain in a portfolio position being hedged), may require the Fund to sell or purchase portfolio securities at inopportune times or for prices other than current market values, may limit the amount of appreciation the Fund can realize on an investment, or may cause the Fund to hold a security that it might otherwise sell. Amounts paid by the Fund as premiums and cash or other assets held as collateral with respect to Derivatives Transactions may not otherwise be available to the Fund for investment purposes.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

The use of currency transactions can result in the Fund incurring losses as a result of the imposition of exchange controls, political developments, government intervention or failure to intervene, suspension of settlements or the inability of the Fund to deliver or receive a specified currency.

Structured notes and other related instruments carry risks similar to those of more traditional derivatives such as futures, forward and option contracts. However, structured instruments may entail a greater degree of market risk and volatility than other types of debt obligations.

The Fund will be subject to credit risk with respect to the counterparties to certain Derivatives Transactions entered into by the Fund. Derivatives may be purchased on established exchanges or through privately negotiated transactions referred to as over-the-counter ("OTC") derivatives. Exchange-traded derivatives generally are guaranteed by the clearing agency which is the issuer or counterparty to such derivatives. However, many futures exchanges and boards of trade limit the amount of fluctuation permitted in futures contract prices during a single trading day and once the daily limit has been reached in a particular contract no trades may be made that day at a price beyond that limit or trading may be suspended. There also is no assurance that sufficient trading interest to create a liquid secondary market on an exchange will exist at any particular time and no such secondary market may exist or may cease to exist. Each party to an OTC derivative bears the risk that the counterparty will default. OTC derivatives are less liquid than exchange-traded derivatives because the other party to the transaction may be the only investor with sufficient understanding of the derivative to be interested in bidding for it. If a counterparty becomes bankrupt or otherwise fails to perform its obligations under a derivative contract due to financial difficulties, the Fund may experience significant delays in obtaining any recovery under the derivative contract in bankruptcy or other reorganization proceeding. The Fund may obtain only a limited recovery or may obtain no recovery in such circumstances.

The Fund will not be a commodity pool (*i.e.*, a pooled investment vehicle which trades in commodity futures contracts and options thereon and the operator of which is registered with the Commodity Futures Trading Commission). In addition, the Fund has claimed an exclusion from the definition of commodity pool operator and, therefore, is not subject to registration or regulation as a pool operator under the Commodity Exchange Act.

The Board of Directors, at its June 29, 2009 meeting, approved amendments to certain non-fundamental investment policies of the Fund. The Directors voted to eliminate the requirement to invest at least 90% of its total assets in common stocks (including REIT shares), preferred stocks, and other equity securities issued by real estate companies, such as "real estate investment trusts" ("REITs"). Although the Fund, under normal market conditions, will invest at least 80% of its total assets in income producing equity securities issued by high quality REITs, the Directors approved revisions to the definition of high quality, noting that high quality REITs are companies that, in the opinion of the Investment Manager, offer prospects for above average revenue and earnings growth and to determine whether a company is of high quality, the Investment Manager generally looks to the company's record of earnings growth, as well as to a company's current ratio of debt to capital and the quality of its management. In addition, the Directors voted to (i) increase the fund's 20% limit on investments in foreign securities to 25% of

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

the Fund's total assets, of which 15% may be invested in emerging markets; (ii) expand the types of permitted investments for temporary defensive measures to include short-term debt instruments, government securities, cash or cash equivalents (currently only investment grade debt securities); (iii) remove the 10% limitation on investments in mortgage and hybrid REITs; and (iv) remove the restriction that REIT investments will have a market cap greater than \$100 million.

**APPROVAL OF INVESTMENT MANAGEMENT AGREEMENT**

The Board of Directors of the Fund, including a majority of the directors who are not parties to the Fund's investment management agreement (the "Investment Management Agreement"), or interested persons of any such party ("Independent Directors"), has the responsibility under the 1940 Act to approve the Fund's Investment Management Agreement for its initial two year term and its continuation annually thereafter at a meeting of the Board of Directors called for the purpose of voting on the approval or continuation. At a meeting held in person on March 17-18, 2009, the Investment Management Agreement was discussed and was unanimously continued for a one-year term by the Fund's Board of Directors, including the Independent Directors. The Independent Directors were represented by independent counsel who assisted them in their deliberations during the meeting and executive session.

In considering whether to continue the Investment Management Agreement, the Board of Directors reviewed materials provided by the Fund's investment manager (the "Investment Manager") and Fund counsel which included, among other things, fee, expense and performance information compared to peer funds ("Peer Funds") prepared by an independent data provider; supplemental performance and summary information prepared by the Investment Manager; and memoranda outlining the legal duties of the Board of Directors. The Board of Directors also spoke directly with representatives of the independent data provider and met with investment management personnel. In addition, the Board of Directors considered information provided from time to time by the Investment Manager throughout the year at meetings of the Board of Directors, including presentations by portfolio managers relating to the investment performance of the Fund and the investment strategies used in pursuing the Fund's objective. In particular, the Board of Directors considered the following:

*(i) The nature, extent and quality of services to be provided by the Investment Manager:* The Board of Directors reviewed the services that the Investment Manager provides to the Fund, including, but not limited to, making the day-to-day investment decisions for the Fund, and generally managing the Fund's investments in accordance with the stated policies of the Fund. The Board of Directors also discussed with officers and portfolio managers of the Fund the amount of time the Investment Manager dedicates to the Fund and the types of transactions that were being done on behalf of the Fund. Additionally, the Board of Directors took into account the services provided by the Investment Manager to its other funds, including those that invest substantially in real estate securities and have investment objectives and strategies similar to the Fund.

The Board of Directors next considered the education, background and experience of the Investment Manager's personnel, noting particularly that the favorable history and reputation of the portfolio managers for



**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

the Fund, has had, and would likely continue to have, a favorable impact on the Fund. The Board of Directors further noted the Investment Manager's ability to attract quality and experienced personnel. The Board of Directors then considered the administrative services provided by the Investment Manager, including compliance and accounting services. After consideration of the above factors, among others, the Board of Directors concluded that the nature, quality and extent of services provided by the Investment Manager are adequate and appropriate.

*(ii) Investment performance of the Fund and the Investment Manager:* The Board of Directors considered the investment performance of the Fund compared to Peer Funds and compared to a relevant benchmark. The Board of Directors noted that the Fund outperformed the medians of the Peer Funds for the one-, three- and five-year periods ended December 31, 2008. The Board of Directors also noted that the Fund underperformed its benchmark for the same periods. The Board of Directors engaged in discussions with the Investment Manager regarding the Fund's most recent absolute and relative performance, which was hampered by extreme market volatility during 2008 as a result of the recession and credit crisis, and by leverage. The Board of Directors also considered supplemental performance data provided by the Investment Manager, including a narrative summary of various factors affecting performance, and the Investment Manager's performance in managing other real estate funds. The Board of Directors then determined that Fund performance, in light of all considerations noted above, was satisfactory.

*(iii) Cost of the services to be provided and profits to be realized by the Investment Manager from the relationship with the Fund:* Next, the Board of Directors considered the management fees and administrative fees payable by the Fund, as well as total expense ratios. As part of their analysis, the Board of Directors gave substantial consideration to the fee and expense analyses provided by the independent data provider. The Board of Directors considered the Fund's actual and contractual management fees, and the Fund's net expense ratios at managed and common asset levels compared to the medians of the Peer Funds, ranking the Fund in the first or third quintiles across most categories. The Board of Directors also noted that the Investment Manager continues to waive a portion of its management fee for the next three years. The Board of Directors noted that the Fund pays an affiliated administration fee of 0.02% of the average daily managed assets to the Investment Manager. The Board of Directors concluded that the Fund's current expense structure is competitive in the peer group.

The Board of Directors also reviewed information regarding the profitability to the Investment Manager of its relationship with the Fund. The Board of Directors considered the level of the Investment Manager's profits and whether the profits were reasonable for the Investment Manager. The Board of Directors took into consideration other benefits to be derived by the Investment Manager in connection with the Investment Management Agreement, noting particularly the research and related services, within the meaning of Section 28(e) of the Securities Exchange Act of 1934, as amended, that the Investment Manager receives by allocating the Fund's brokerage transactions. The Board of Directors also considered the fees received by the Investment Manager from its administrative relationship with the Fund, but noted the significant services received, such as operational services and furnishing office space and facilities for the Fund, and providing persons satisfactory to the Board of Directors to serve as officers of the Fund, and that these services were beneficial to the Fund. The Board of Directors concluded

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

that the profits realized by the Investment Manager from its administrative relationship with the Fund were reasonable and consistent with fiduciary duties.

*(iv) The extent to which economies of scale would be realized as the Fund grows and whether fee levels would reflect such economies of scale:* The Board of Directors noted that as a closed-end fund, the Fund would not be expected to have inflows of capital that might produce increasing economies of scale. The Board of Directors determined that, given the Fund's closed-end structure, shareholders appropriately benefited from economies of scale.

*(v) Comparison of services rendered and fees paid to those under other investment management contracts, such as contracts of the same and other investment managers or other clients:* As discussed above in (i) and (iii), the Board of Directors compared both the services rendered and the fees paid under the Investment Management Agreement to those under other investment management contracts of other investment managers managing Peer Funds. The Board of Directors also compared the services rendered and fees paid under the Management Agreement to the Investment Manager's other fund management agreements, as well as the profitability under the Management Agreement to the Investment Manager's other management contracts with institutional and other clients with similar investment mandates. The Board of Directors determined that on a comparative basis the fees under the Investment Management Agreement were reasonable in relation to the services provided.

No single factor was cited as determinative to the decision of the Board of Directors. Rather, after weighing all of the considerations and conclusions discussed above, the Board of Directors, including the Independent Directors, unanimously approved the continuation of the Investment Management Agreement.



**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

*Meet the Cohen & Steers family of open-end funds:*

**COHEN & STEERS  
GLOBAL REALTY SHARES**

Designed for investors seeking total return, investing primarily in global real estate equity securities

Symbols: CSFAX, CSFBX, CSFCX, CSSPX

**COHEN & STEERS  
INSTITUTIONAL GLOBAL REALTY SHARES**

Designed for institutional investors seeking total return, investing primarily in global real estate securities

Symbol: GRSIX

**COHEN & STEERS  
REALTY SHARES**

Designed for investors seeking total return, investing primarily in REITs

Symbol: CSRSX

**COHEN & STEERS  
INSTITUTIONAL REALTY SHARES**

Designed for institutional investors seeking total return, investing primarily in REITs

Symbol: CSRIX

**COHEN & STEERS  
REALTY INCOME FUND**

Designed for investors seeking maximum total return, investing primarily in real estate securities with an emphasis on both income and capital appreciation

Symbols: CSEIX, CSBIX, CSCIX, CSDIX

**COHEN & STEERS  
INTERNATIONAL REALTY FUND**

Designed for investors seeking total return, investing primarily in international real estate securities

Symbols: IRFAX, IRFCX, IRFIX

**COHEN & STEERS  
ASIA PACIFIC REALTY SHARES**

Designed for investors seeking total return, investing primarily in real estate securities located in the Asia Pacific region

Symbols: APFAX, APFCX, APFIX

**COHEN & STEERS  
GLOBAL INFRASTRUCTURE FUND**

Designed for investors seeking total return, investing primarily in global infrastructure securities

Symbols: CSUAX, CSUBX, CSUCX, CSUIX

**COHEN & STEERS  
DIVIDEND VALUE FUND**

Designed for investors seeking high current income and long-term growth of income and capital appreciation, investing primarily in dividend paying common stocks and preferred stocks

Symbols: DVFAX, DVFCX, DVFIX

*Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing. A prospectus containing this and other information can be obtained by calling 800-330-7348 or by visiting [cohenandsteers.com](http://cohenandsteers.com). Please read the prospectus carefully before investing.*

Cohen & Steers Securities, LLC, Distributor

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

OFFICERS AND DIRECTORS

Robert H. Steers  
Director and co-chairman

Martin Cohen  
Director and co-chairman

Bonnie Cohen  
Director

George Grossman  
Director

Richard E. Kroon  
Director

Richard J. Norman  
Director

Frank K. Ross  
Director

Willard H. Smith Jr.  
Director

C. Edward Ward, Jr.  
Director

Adam M. Derechin  
President and chief executive officer

Joseph M. Harvey  
Vice president

William F. Scapell  
Vice president

Thomas N. Bohjalian  
Vice president

Yigal D. Jhirad  
Vice president

Francis C. Poli  
Secretary

James Giallanza  
Treasurer and chief financial officer

Lisa D. Phelan  
Chief compliance officer

KEY INFORMATION

Investment Manager

Cohen & Steers Capital Management, Inc.  
280 Park Avenue  
New York, NY 10017  
(212) 832-3232

Fund Subadministrator and Custodian

State Street Bank and Trust Company  
One Lincoln Street  
Boston, MA 02111

Transfer Agent - Common Shares

The Bank of New York Mellon  
480 Washington Boulevard  
Jersey City, NJ 07310  
(866) 227-0757

Legal Counsel

Stroock & Stroock & Lavan, LLP  
180 Maiden Lane  
New York, NY 10038

New York Stock Exchange Symbol: RQI

Web site: [cohenandsteers.com](http://cohenandsteers.com)

This report is for shareholder information. This is not a prospectus intended for use in the purchase or sale of Fund shares. Past performance is of course no guarantee of future results and your investment may be worth more or less at the time you sell.





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NEW YORK, NY 10017

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**JUNE 30, 2009**

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**Item 2. Code of Ethics.**

Not applicable.

**Item 3. Audit Committee Financial Expert.**

Not applicable.

**Item 4. Principal Accountant Fees and Services.**



Not applicable.

**Item 5. Audit Committee of Listed Registrants.**

Not applicable.

**Item 6. Schedule of Investments.**

Included in Item 1 above.

**Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.**

Not applicable.

**Item 8. Portfolio Managers of Closed-End Management Investment Companies.**

Not applicable.

**Item 9. Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers.**

None.

**Item 10. Submission of Matters to a Vote of Security Holders.**

None.

**Item 11. Controls and Procedures.**

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(a) The registrant's principal executive officer and principal financial officer have concluded, based upon their evaluation of the registrant's disclosure controls and procedures as conducted within 90 days of the filing date of this report, that these disclosure controls and procedures provide reasonable assurance that material information required to be disclosed by the registrant in the report it files or submits on Form N-CSR is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms

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and that such material information is accumulated and communicated to the registrant's management, including its principal executive officer and principal financial officer, as appropriate, in order to allow timely decisions regarding required disclosure.

(b) There were no changes in the registrant's internal control over financial reporting that occurred during the second fiscal quarter of the period covered by this report that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting.

**Item 12. Exhibits.**

(a)(1) **Not applicable.**

(a) (2) Certifications of principal executive officer and principal financial officer as required by Rule 30a-2(a) under the Investment Company Act of 1940.

(a)(3) Not applicable.

(b) Certifications of principal executive officer and principal financial officer as required by Rule 30a-2(b) under the Investment Company Act of 1940.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**COHEN & STEERS QUALITY INCOME REALTY FUND, INC.**

By: /s/ Adam M. Derechin  
**Name: Adam M. Derechin**  
Title: President and Chief Executive Officer

Date: August 28, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Adam M. Derechin  
**Name: Adam M. Derechin**  
Title: President and Chief Executive Officer  
(principal executive officer)

By: /s/ James Giallanza  
Name: James Giallanza  
Title: Treasurer  
(principal financial officer)

Date: August 28, 2009

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