

January 4, 2010
KUFM/KGPR
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The Decision to Lease the Otter Creek Coal Tracts: What Does It Mean?

On December 21st, the Montana Land Board, a board made up of all five of the Montana officials chosen in statewide elections, voted to offer the state-owned Otter Creek coal tracts for lease. The development of that coal has been heatedly debated ever since the state got ownership of it from the federal government a decade ago.

That Land Board decision, however, does not necessarily mean that the coal will be developed or that a new coalmine in the Tongue River Valley is just around the corner. There remain significant economic barriers to that coal ever being mined.

The Land Board, itself, created one of those barriers when it established a relatively high minimum “bonus bid” that has to be paid upfront by the winning coal company whether or not a single ton of coal ever is mined. The minimum acceptable bonus bid set by the Land Board is over \$143 million. It was based on 25 cents for each ton of recoverable coal.

Earlier this fall the company that owns the alternating sections of coal intermingled with the state’s Otter Creek tracts leased its share of the coal for only 10 cents per ton. One of the nation’s largest coal companies, Arch Coal, leased those private coal tracts and was expected to bid on the State of Montana’s share of that coal too. With the state demanding two and a half times as much, Arch Coal and other coal companies may choose not to bid at all.

The market for coal does not seem very bright right now. The Great Recession has shuttered a lot of factories and reduced the demand for electricity and the coal that

fuels much of the nation's electric generation. As a result, stockpiles of coal have been growing to towering heights at electric generating stations despite the reduction in coal production that has already taken place during the recession. As a result, coal production is likely to be cut still further in the coming year and coal prices are likely to be pushed lower.

In addition to these short-term downward pressures on the coal industry due to the recession, there are also long-term downward pressures. First, there is the impending regulation of carbon dioxide emissions to protect our climate. Coal is the most carbon-intensive of the fossil fuels and will be penalized the most by limits on carbon emissions. Second, the long-term supply of natural gas appears to be much larger than the most optimistic of previous forecasts. Vast new supplies close to eastern population and economic centers are in the process of being brought into production. The result has been that natural gas prices have fallen dramatically and are now expected to stay relatively low well into the future.

The combination of low natural gas prices, a projected plentiful natural gas supply, and the 40 percent lower carbon emissions associated with burning natural gas has led electric utilities, even those that had previously been heavily committed to coal, to reconsider their reliance on coal and begin to shift from coal-fired to natural gas-fired electric generation. Progress Energy, an electric utility serving North and South Carolina and Florida, announced in December that it was planning to phase out 11 of its coal-fired power plants and replace them primarily with natural gas-fired generation. Many other utilities have put their plans for coal-fired generation on hold while they reconsider

what the future least-cost sources of electricity will be in an increasingly carbon-constrained world.

The world's largest oil company, Exxon Mobil Corporation, also announced in December that it putting up \$30 billion to buy one of the natural gas companies that has pioneered the development of the new shale natural gas supplies. This will now make Exxon Mobil the nation's largest producer of natural gas. Exxon also sees a shift from coal to natural gas taking place as well as the possibility of liquefied and compressed natural gas being substituted for diesel and gasoline for truck and automobile fuel.

Then there are the economic problems specific to the Otter Creek Coal. First, there is no railroad serving the mine. An expensive railroad will have to be built before the coal can be marketed. The Otter Creek Coal is also high in sodium, making it unsuitable for use in most electric plants. Either boilers have to be built specifically for that coal or the coal has to be washed to remove the sodium.

The combination of all of these negative economic factors makes it unlikely that the Otter Creek Coal will be developed any time soon. Whether Arch Coal will be willing to put up the \$143 million the Montana Land Board is demanding is unclear. Arch recently bought a huge coalmine and its associated coal reserve adjacent to Arch's existing Black Thunder mine in Wyoming, making it the nation's second-largest coal producer.

This makes Arch Coal, like all of Wyoming coal, a competitor for the coal markets Montana currently serves along the northern tier of states. Arch may be hoping that the leasing of the Otter Creek coal will lead to the Tongue River Railroad being built, giving Arch a short cut to get at Montana's markets in North Dakota, Minnesota, Michigan,

Washington, and Oregon. Arch may simply want to sit on the Otter Creek coal while carrying its own Wyoming coal right on by.

The State Land Board has tried to demand that any coal company that wants to lease Montana's share of the Otter Creek coal has to assure that the State of Montana gets something significant out of it. We will have to wait and see if that ploy works or whether Arch Coal will simply smile and choose not to bid anything for the Montana coal now that Arch's lease of the other half of that coal already gives it an effective veto over the development of Otter Creek. In effect, Arch already may have relatively cheaply taken a potentially competitive coal source, namely the Otter Creek coal, off the market. The struggle over the Otter Creek coal remains a high stakes craps shoot.

In any case, a new coal boom is not about to hit Eastern Montana.