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Gas Drillers' New York Hopes Fade on Paterson Woes (Update3)

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(Adds shares prices in ninth paragraph.)

By Jim Efstathiou Jr.

March 31 (Bloomberg) -- Chesapeake Energy Corp.'s bid to tap new sources of natural gas in New York state may be quashed by Governor David Paterson's political troubles.

Paterson is the most prominent state proponent of drilling in the Marcellus Shale, a formation extending from West Virginia to New York that has helped spur a boom in U.S. shale-gas production. Chesapeake, the second-biggest producer of natural gas in the U.S., is one of three companies that have filed a combined 58 applications for drilling permits in the state.

Paterson's Department of Environmental Conservation is completing rules for extracting the gas. Applicants had expected permits to be approved this year, said Dave Palmerton, an industry consultant. That was before the governor became the target of probes into allegations that he improperly contacted a woman who had accused an aide of domestic abuse and that he sought free tickets to baseball's World Series.

"Up until recently, he was in a position to push Marcellus drilling in New York state," said Palmerton, who is based in Syracuse. "Given the political pressures right now, I'm very concerned the DEC may be pressed to hold this up until after the election, or delay it for some indefinite period of time."

Oklahoma City-based Chesapeake, Calgary-based Talisman Energy Inc. and privately held Vertical Resources Inc., based in Sugar Grove, Pennsylvania, all want to drill in New York. More companies would follow, said Vertical President Steve Ford.

Not in My Watershed

Chesapeake trails only Fort Worth, Texas-based XTO Energy Inc., which agreed to be bought by Exxon Mobil Corp. for \$31 billion in December, in natural-gas production in the U.S.

Chesapeake dropped plans last year to drill in the part of the Marcellus Shale that lies beneath the New York City watershed after environmentalists and city officials said drilling would contaminate the water supply.

Jim Gipson, a Chesapeake spokesman, said it was a business decision not to drill in the city watershed. In an October statement, Chesapeake said it was "the most active driller" in the formation and expected to be the largest producer of gas from it.

Chesapeake rose 19 cents to \$23.63 at 4 p.m. in New York Stock Exchange composite trading. The shares have dropped 8.7 percent this year, compared with a 1.5 percent slide for the Standard & Poor's 500 Oil & Gas Exploration Index.

Playing Catch Up

Since 2007, discoveries of unconventional gas including that taken from shale have more than doubled the estimate of North American reserves to 3,000 trillion cubic feet, enough to meet 100 years of demand, according to energy consultants IHS Cambridge Energy Research Associates in Cambridge, Massachusetts. The Marcellus Shale alone may contain 50 trillion cubic feet of gas.

Paterson, 55, wants to tax shale gas and has anticipated revenue starting in the fiscal year that begins April 1, 2011, according to his budget proposal. The state Senate has proposed dropping the tax.

Drilling 300 wells would generate \$1.4 billion annually, including \$100 million in lease payments to landowners and \$32 million in tax revenue, according to the Independent Oil & Gas Association of New York, an industry group whose directors include representative of Chesapeake and Fort Worth, Texas-based oil and gas producer Range Resources Corp.

"Natural gas operators do not have their hands out," Brad Gill, executive director of the Lakeview, New York-based group, said in a March 26 statement. "We are only asking state lawmakers not to stand in the way of this economic opportunity."

The governor continues to support drilling "in an environmentally sensitive way" and expects the DEC to complete regulations this year, said spokesman Morgan Hook. "It could have huge economic implications for a region of the state that could really use it," Hook said.

In neighboring Pennsylvania, about 1,000 wells have been drilled in the Marcellus formation since 2005. State and local tax revenue from shale gas may more than double this year to \$871 million from \$400 million in 2009, according to a study by Pennsylvania State University in State College.

Not Running

Talisman Energy ended 2009 with 60 wells in Pennsylvania, said Mark Scheuerman, the company's general counsel.

Chesapeake recently drilled three wells in Pennsylvania, according to the company's Web site.

Paterson on Feb. 26 withdrew as a candidate for governor in November's election after the New York Times reported his role in the assault case. He has vowed to finish his term. Paterson moved up to governor from lieutenant governor in 2008, after Eliot Spitzer resigned.

"He was very anxious to have this drilling go forward," said U.S. Representative Maurice Hinchey, a Democrat whose district includes Broome County, where officials welcome drilling.

Paterson's lame-duck status may give additional momentum to critics who hope to block drilling in the New York City watershed, a network of 19 reservoirs that provide 1.3 billion gallons (4.9 billion liters) of water a day to the most populous U.S. city.

The 0.5% Factor

The objections stem from concerns that fracturing, or fracking, the method used to get gas from shale, may taint water supplies. Drillers use water, sand and chemicals to break up rock and allow gas to flow, Talisman's Scheuerman said.

Chemicals make up 0.5 percent of the mixture, he said. Some liquid returns to the surface and must be disposed of.

Hydraulic fracturing is on hold in New York while the DEC finishes rules for drillers. Kate Sinding, senior attorney with the New York-based Natural Resources Defense Council, called proposed regulations "severely" deficient.

"It slows down now because of Paterson's political situation," said Rick Capozza, a Syracuse-based attorney who represents oil and gas producers.

Chesapeake still believes it can produce shale gas "without adverse environmental impacts," Dave Spigelmyer, vice president of government relations, said in an e-mail.

The Syracuse watershed, like New York City's, has water so clear it is exempt from federal filtering requirements.

'Going Nowhere'

"We're concerned about human error," said Lee Macbeth, the city's watershed control coordinator. "No amount of regulation no matter how good it is can completely remove the risk."

Gas prices for now are too low to spur drilling, said Ben Dell, an analyst at Sanford C. Bernstein & Co. in New York.

Natural gas for May delivery fell 10.4 cents, or 2.6 percent, to \$3.869 per million British thermal units on the New York Mercantile Exchange. Prices need to reach \$7 to \$8 to make New York drilling attractive, Dell said.

"Most of the companies assume New York is going nowhere anytime quickly," Dell said. "They have more environmental regulation and more headaches."

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