New York Times

New York Subpoenas Energy Firms

By IAN URBINA, Published: August 18, 2011

New York State's attorney general has sent subpoenas to three large energy companies as part of a broad investigation into whether they have accurately described to investors the prospects for their natural gas wells, according to several sources familiar with the inquiry.

The subpoenas focus on how the companies took advantage of federal rules, adopted in late 2008, that govern the way they report their oil and gas reserves to investors.

Investigators have requested documents relating to the formulas that companies use to predict how much gas their wells are likely to produce in the coming decades. The subpoenas, which were sent on Aug. 8, also request documents related to the assumptions that companies have made about drilling costs in their estimates of the wells' long-term profitability.

The investigation will be watched closely in the industry because the attorney general, Eric T. Schneiderman, is using a New York law called the Martin Act that gives him broad powers over businesses and allows him to obtain and publicly disclose an unusual amount of information.

Subpoenas were sent to the three companies — Range Resources, Cabot Oil and Gas, and Goodrich Petroleum — according to the sources, who have direct knowledge of the investigation. Mr. Schneiderman also broadened a continuing investigation by his office into a fourth company, Chesapeake Energy, asking it to respond to similar questions about its shale gas wells, they said.

The four companies were chosen because they are heavily involved in natural gas drilling and because New York State has more than $45 million of its pension money invested with them. If a company improperly reported to investors how its wells were likely to perform or failed to disclose the true costs of drilling, there could be repercussions for the state's financial portfolio.

Some legal experts consider the subpoenas an indication of Mr. Schneiderman's growing willingness to confront powerful interests. The action also opens a new front in an already heated debate in New York and other states over how much to allow companies to drill, and how they should be regulated.

The subpoenas come as New York's governor, Andrew M. Cuomo, seeks to end a de facto shale gas drilling moratorium caused by state regulators' extensive review of the environmental impact and the regulation of such drilling.

Under the Martin Act, which was passed in 1921, Mr. Schneiderman is empowered to subpoena virtually any document from any business operating in the state, and he can choose between civil or criminal charges.

Mr. Schneiderman does not have to prove that a company intended to defraud anyone, or that anyone actually was defrauded — or even that a transaction between two parties occurred.

The law helped raise Eliot Spitzer's profile as New York attorney general because he used it to investigate Wall Street firms, including Merrill Lynch and Salomon Smith Barney.

"The entire industry will pay attention to this because it shows that Schneiderman is taking a page straight from Spitzer's playbook," said Lloyd Constantine, who was chief of the antitrust division of the New York attorney general's office from 1980 to 1991 and who served as a senior adviser to Mr. Spitzer when he was governor. "The Martin Act is powerful if a prosecutor wants to make it that way, and Schneiderman is clearly choosing to do so."

Since he took office in January, Mr. Schneiderman has used the Martin Act to investigate major Wall Street banks involved in the mortgage-backed securities crisis and other accusations of financial impropriety.

Mr. Constantine said Mr. Spitzer was especially skilled at using the Martin Act to obtain damaging information, which he then released to the public as part of a strategy to win large settlements and avoid lengthy trials.

If Mr. Schneiderman finds damaging documents and releases them to the public, trial lawyers could use them as the basis for civil suits.

"The subpoenas are a big deal because they show how state scrutiny of shale gas has expanded beyond oil and gas producer states," said Kevin Book, director of research for ClearView Energy Partners, a research and consulting firm.

Despite limited data about how shale gas wells perform in the long term, responsible companies should have little to fear because current technology made their reserve estimates more accurate, Mr. Book said.

Mr. Schneiderman's office and the companies being investigated declined to comment. The subpoenas request documents relating to apparent discrepancies between what companies have told investors about gas well performance and costs and what is revealed in their federal filings, the sources said.

The subpoenas also require the companies to turn over information about the formulas used to predict how long the shale wells will produce gas before they dry up. The subpoenas were sent in response to documents made public by a series of articles in The New York Times, according to the three sources familiar with the investigation.

In recent years, a technique known as hydraulic fracturing, or fracking, which involves injecting water and chemicals deep underground, has been increasingly used to release natural gas trapped in shale formations.

The process has been especially controversial in New York, areas of which lie atop a large shale formation, mostly because of concern over its environmental impact.

This is not Mr. Schneiderman's first foray into the fracking issue.

On May 31, his office sued several federal agencies, including the Environmental Protection Agency, in an effort to require additional review before fracking is allowed at more than 15,000 gas wells that are planned for the Delaware River watershed.

This watershed supplies drinking water to more than seven million New York City residents.

In June, Mr. Schneiderman also sent subpoenas to five large shale gas companies as part of a Martin Act inquiry into whether the companies had accurately disclosed the environmental risks from fracking to investors.

The federal Securities and Exchange Commission has also begun increasing its oversight of the industry. Last month, the agency sent subpoenas to several shale gas companies.

The commission has said it is considering whether to revise rule changes like those that allow companies to conceal details about how they calculate reserve estimates and to avoid third-party audits of these estimates.

The commission also has asked some oil and gas companies over the past month to reduce the number of years they predict their shale gas wells will produce, according to two industry consultants informed of the requests.

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Regulators Seek Records on Claims for Gas Wells

By IAN URBINA
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WASHINGTON — The Securities and Exchange Commission sent subpoenas this week to energy companies asking them for documents about how they calculate and publicly disclose the performance of their shale gas wells, according to oil and gas industry lawyers.

The subpoenas reflect the regulators' interest in determining whether companies are overstating how their gas wells perform and how much gas these companies can profitably extract over the long term.

It is not clear how many subpoenas were sent. John Nester, a spokesman for the commission, declined to comment.

"The use of subpoenas makes clear that the S.E.C. is taking a formal, not a casual, look at the matter," said a market research report on Thursday by Robert W. Baird & Co., an international financial services firm. The report also noted that subpoenas do not mean that the commission intends to take action against any particular company, and that estimating reserves is not an exact science.

In a separate note, Gerard G. Pecht, a lawyer with Fulbright & Jaworski, told clients that the subpoenas were focused on the actual performance of shale gas wells compared with how companies were projecting their performance, according to an article on FuelFix.com, an energy news Web site. Mr. Pecht did not respond to messages seeking comment.

The subpoenas also request documents related to discrepancies between what companies are telling investors about the costs of shale gas versus what they are reporting in federal filings.

Large natural gas companies, including Chesapeake Energy, EOG Resources and the Petrohawk Energy Corporation, did not return calls seeking comment. Alan T. Jeffers, a spokesman for Exxon Mobil, the largest natural gas producer in the country, said the company had not received a subpoena.

One oil and gas industry consultant said that he was called to a meeting in mid-June with investigators from the Fort Worth office of the S.E.C. The investigators, he said, wanted to discuss a range of shale gas companies, and discrepancies between data reported to federal officials and what these companies had told investors about profit and well performance. The consultant asked not to be identified, to avoid alienating the energy companies that are his clients.

According to several oil and gas industry lawyers, the subpoenas are in response to articles published in June in The New York Times, which showed that a range of industry and federal officials had questioned whether shale gas companies might be playing down costs or inflating their predictions about well performance.

Some federal agencies have also begun discussing concerns about the long-term productivity of shale gas wells.

For example, the 2011 summer newsletter of the National Energy Technology Laboratory, a research arm of the Department of Energy, says that technology needs to improve in the Barnett shale in Texas, and in other shale gas areas, for these shale gas wells to be more economically viable.

Shale gas wells often decline sharply after their first year, but many in the industry had remained optimistic about the wells' ability to produce at a slow but steady rate for decades. Others have doubted these assumptions, which may not be holding up.

"A crucial challenge for the industry today," the newsletter said, is that only a "fraction" — a third or less — of wells show "sustained long-term production," which makes it difficult for companies to make money on this drilling.

The newsletter added that many of the wells produce poorly and others drop in production sharply after an early period of heavy production.