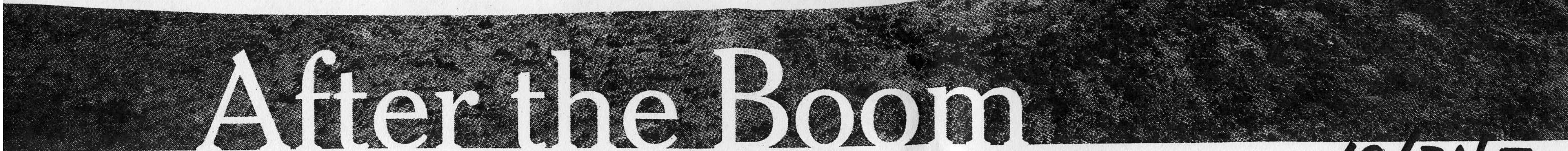

After the Boom In Natural Gas

NY times 10/21/12

Low prices for consumers, big profits for bankers and a gut punch to investors.

PHOTOGRAPHS BY MICHAEL STRAVATO FOR THE NEW YORK TIMES

A Chesapeake Energy drill rig, top, in DeSoto Parish, La. A natural gas glut and price plunge have hurt gas exploration companies — and their investors. Above, a sign at a car and truck dealership greeted shale gas field workers to the area this summer.

By CLIFFORD KRAUSS and ERIC LIPTON

EVELYN, La.

THE crew of workers fought off the blistering Louisiana sun, jerking their wrenches to tighten the fat hoses that would connect their cement trucks to the Chesapeake Energy drill rig — one of the last two rigs the company is still using to drill for natural gas here in the Haynesville Shale.

At its peak, Chesapeake ran 38 rigs in the region. All told, it has sunk more than 1,200 wells into the Haynesville, a gas-rich vein of dense rock that straddles Louisiana and Texas. Fed by a gold-rush mentality and easy money from Wall Street, Chesapeake and its competitors have done the same in other shale fields from Oklahoma to Pennsylvania.

For most of the country, the result has been cheaper energy. The nation is awash in so much natural gas that electric utilities, which burn the fuel in many generating plants, have curbed rate increases and switched more capacity to gas from coal, a dirtier fossil fuel.

THE ENERGY RUSH
The Making of a Glut

Companies and municipalities are deploying thousands of new gas-powered trucks and buses, curbing noxious diesel fumes and reducing the nation's reliance on imported oil.

And companies like fertilizer and chemical makers, which use gas as a raw material, are suddenly finding that the United States is an attractive place to put new factories, compared with, say, Asia, where gas is four times the price. Dow Chemical, which uses natural gas as a material for producing plastics, has assembled a list of 91 new manufacturing projects, representing $70 billion in potential investment and up to three million jobs, that various companies have proposed or begun because of cheap gas.

"The country has stumbled into a windfall on the backs of these entrepreneurs," said Edward Hirs, a finance professor at the University of Houston who contributed to a report that estimated that the nation's economy benefited by more than $100 billion last year alone from the lower gas prices.

But while the gas rush has benefited most Americans, it's been a money loser so far for many of the gas exploration companies and their tens of thousands of investors.

The drillers punched so many holes and extracted so much gas through

Continued on Page 4

After the Boom in Natural Gas

From Page 1

hydraulic fracturing that they have driven the price of natural gas to near-record lows. And because of the intricate financial deals and leasing arrangements that many of them struck during the boom, they were unable to pull their foot off the accelerator fast enough to avoid a crash in the price of natural gas, which is down more than 60 percent since the summer of 2008.

Although the bankers made a lot of money from the deal making and a handful of energy companies made fortunes by exiting at the market's peak, most of the industry has been bloodied — forced to sell assets, take huge write-offs and shift as many drill rigs as possible from gas exploration to oil, whose price has held up much better.

Rex W. Tillerson, the chief executive of Exxon Mobil, which spent $41 billion to buy XTO Energy, a giant natural gas company, in 2010, when gas prices were almost double what they are today, minced no words about the industry's plight during an appearance in New York this summer.

"We are all losing our shirts today," Mr. Tillerson said. "We're making no money. It's all in the red."

Like the recent credit bubble, the boom and bust in gas were driven in large part by tens of billions of dollars in creative financing engineered by investment banks like Goldman Sachs, Barclays and Jefferies & Company.

After the financial crisis, the natural gas rush was one of the few major profit centers for Wall Street deal makers, who found willing takers among energy companies and foreign financial investors.

Big companies like Chesapeake and lesser-known outfits like Quicksilver Resources and Exco Resources were able to supercharge their growth with the global financing, transforming the face of energy in this country. In all, the top 50 oil and gas companies raised and spent an annual average of $126 billion over the last six years on drilling, land acquisition and other capital costs within the United States, double their capital spending as of 2005, according to an analysis by Ernst & Young.

Now the gas companies are committed to spending far more to produce gas than they can earn selling it. Their stock prices and debt ratings have been hammered.

"We just killed more meat than we could drag back to the cave and eat," said Maynard Holt, co-president of Tudor Pickering Holt & Company, a Houston investment bank that has handled dozens of shale deals in the last four years. "Now we have a problem."

A Master Salesman

Aubrey K. McClendon, chief executive of Chesapeake Energy, had a secret, and he was anxious to share it.

He called Ralph Eads III, a fraternity buddy from Duke who had become his go-to banker. Mr. McClendon explained that he had quietly acquired leases on hundreds of thousands of acres somewhere in the southern United States — he would not say exactly where — that could become one of the world's biggest natural gas fields.

But to develop the wells, he needed billions of dollars.

"I can get the assets," Mr. McClendon told Mr. Eads, a vice chairman of Jefferies, according to three people who participated in that call, nearly five years ago. "You have to get the money."

Get it he did. Mr. Eads, a pitch artist who projects the unrestrained enthusiasm of a college football coach, traveled the world, ultimately raising an extraordinary $28 billion for Mr. McClendon's "secret" venture in the Haynesville Shale, as well as other Chesapeake drilling projects.

Other bankers working in the glass office towers of downtown Houston were equally busy. While the skyscrapers are home to global giants like Chevron and lesser-known companies like Plains Exploration and Production, they also house storefronts for Wall Street deal makers who play a vital, though less visible, role in the nation's surging energy production.

Mr. Eads, 53, a Texas native, is a prince of this world. His financial innovations helped feed the gas drilling boom, and he has participated in $159 billion worth of oil and gas deals since 2007.

A Sigma Alpha Epsilon fraternity brother of Mr. McClendon, he headed to Wall Street directly after Duke. He first earned a national profile in 2001, while working for the El Paso Corporation, a natural gas pipeline operator. Regulators accused El Paso of creating an artificial gas shortage in California in the previous year, contributing to a power crisis in the state. Although El Paso eventually settled the complaints for $1.7 billion, Mr. Eads said El Paso was guilty of nothing more than coming up with creative financial transactions.

"I wake up every day thinking about how to finance big things," he said.

His tall, lanky frame and bellowing voice make him hard to miss, even in a large crowd. And his deal radar is never off, as he works the room at dinner parties and charity events.

That is how he met Jim Flores, the chief executive of Plains Exploration, who eventually invited him on a duck hunt.

Overzealous drilling and complex financial deals resulted in a price tailspin.

After Mr. McClendon's urgent request for money, Mr. Eads put in a call to Mr. Flores to see if he might be willing to finance part of Chesapeake's Haynesville project.

"Aubrey and I have calculated it, and it might be the largest gas field in the world," Mr. Eads said he told Mr. Flores, noting early results from a single well that showed unprecedented gas flows.

The type of deal he pitched, nicknamed "cash and carry," was certainly aggressive and innovative. Plains would pay Chesapeake $1.7 billion to gain ownership of about one-third of the drilling rights that Chesapeake had leased in the Haynesville. Plains would also commit to paying out another $1.7 billion to cover half of Chesapeake's drilling costs, in return for part of the future profits.

"It's going to be a great investment," Mr. Flores said on the day the deal was announced in July 2008.

But the deal, like others later struck by Chesapeake, benefited Mr. Eads and Mr. McClendon and their companies far more than the people writing the big checks.

Chesapeake spent an average of $7,100 an acre on the drilling sites it had leased in the Haynesville. Plains paid Chesapeake the equivalent of $30,000 an acre.

Jefferies and the other firms involved in arranging the deal made an estimated $23 million on this transaction.

Much of the money that Mr. Eads raised for American gas drillers came from overseas oil and gas companies, like Total of France and Cnooc, the China National Offshore Oil Corporation. He told them the American shale revolution was an opportunity they simply could not afford to pass by.

"This is like owning the Empire State Building," Mr. Eads said, recalling one of his favorite lines. "It's not going to be repeated. You miss the boat, you miss the boat."

In China, he was in awe at just how much money was available to invest. One senior executive at a major Chinese oil company that Mr. Eads declined to identify, citing the confidential nature of the negotiations, explained that the country wanted to move as much as $750 billion from United States Treasury bonds into the North American energy business.

Mr. Eads was only happy to oblige, helping to secure $3.4 billion from the Chinese for Chesapeake through two deals.

Not everyone believed the story line of endless profits and opportunity. Mr. Eads said one oil company executive whom he would not identify had rejected his pitch, complaining, "The reason for the glut is you guys." The executive said he expected natural gas prices to plummet.

In private, Mr. Eads acknowledge that his pitches involved a bit of bluster

"Typically, we represent sellers, so want to persuade buyers that gas price are going to be as high as possible," M Eads said. "The buyers are big boys - they are giant companies with thou sands of gas economists who know wa more than I know. Caveat emptor."

Investment banking revenue at Jef feries reached $1.1 billion in 2011, record for the firm, up from $750 millio in 2007. Energy deals were cited amon the biggest drivers of that surge, which came despite major problems at th firm because of its exposure to European sovereign debt.

Mr. Eads would not say how much h had been compensated for this bonanza But Dealogic, a firm that tracks Wal Street transactions, estimated that Jef feries collected at least $124 million i fees from Chesapeake since 2007, a large share of its overall revenue on oil and gas deals, which ranged between $390 million and $700 million during the same period, according to two different industry estimates.

Even before the recent round of deals, Mr. Eads was a wealthy man. He lives in a sprawling, 11,000-square-foot lakefront mansion in Houston and has a wine cellar with 6,500 bottles. In 2010, he bought an $8.2 million home in the exclusive West End of Aspen, Colo., whose other homeowners have included Jack Nicholson and Mariah Carey.

Mr. Eads's success has produced no shortage of jealousy in Houston.

"A lot of people don't like him because he got ahead of everyone else," said Chip Johnson, chief executive of Carrizo Oil and Gas, who made two big deals in which Mr. Eads was involved. "He got

The Energy Rush

Articles in this series are examining th transformation of energy production i the United States.

Previous articles in the series:

nytimes.com/energy

Clifford Krauss reported from Evelyn, La., and Eric Lipton from Houston and Washington.