

Dallas' Inaction On Fracking Regs Driving Away Drillers

By Jess Davis

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XTO Energy Inc. shelved its plans to drill for natural gas in Dallas last week, saying the city's indecision on how to regulate urban drilling has made it impossible to move forward, and experts say continued rulemaking delays add to an already bleak picture for fracking in the city.

Dallas raked in more than \$33 million in bonus payments in 2008, when it leased the mineral rights under some city land to XTO, an ExxonMobil Corp. subsidiary, and to Trinity East Energy LLC, an affiliate of Keystone Exploration Ltd. But it hasn't granted either of the companies a permit to begin drilling, and now it is embroiled in a politically charged debate about new safety regulations for fracking inside city limits.



XTO said Sunday it had notified the city it was pulling its permit application for the drilling project because it couldn't plan around the city council's wavering.

This delay in finalizing fracking regulations and issuing permits to companies with mineral leases will likely chill future production from the Barnett Shale inside Dallas, experts say. An uncertain regulatory environment, on top of the economic challenges of drilling in the city, is likely to keep oil and gas producers at bay in the short term, they say.

Stuart Hollimon of Andrews Kurth LLP, who has done work for XTO in the past but isn't involved in this lease, said that until a regulatory framework is in place, operators will be unable to evaluate the risks of projects in the city and whether it makes economic sense to invest in them.

"The delay will have a chilling effect on operators that would have an interest otherwise in developing and drilling here," Hollimon said. "That may not be what the city council intends, but it's going to be the logical consequence."

The city council's inaction is forcing operators who've already signed mineral leases in Dallas to reconsider whether they can move forward prudently, he said.

XTO spokesman Jeffrey Neu said the company was confident it could drill for natural gas in a safe and environmentally responsible way, but decided to pull its permit application after the city refused its request to extend its lease, which will expire in August.

“Without clarity on the regulations, we are unable to evaluate drilling in Dallas,” Neu said in a statement.

A task force commissioned by the city council has twice briefed the city on its suggestions for new rules, which include a 1,000-foot setback between drilling sites and protected ones like homes and schools. But the council has not yet proposed or voted on an official ordinance.

Deep divides on the council have pitted members who say the city should let its residents earn income from their mineral rights against those who say the city has to stringently protect the public health from industrial threats.

Political resistance to drilling seems to have ushered in an "informal moratorium" that will stand until the city finalizes new rules, according to Charles Sartain of Looper Reed & McGraw PC. Without knowing what the regulations will be, no company will want to pay for new leases, given the trouble XTO and Trinity East have had getting permits to drill, he said.

“The message from the city is, ‘We don’t want people drilling gas wells in Dallas, and we’re going to make it hard,’” Sartain said.

Even if the city enacts the task force’s recommendations, oil and gas operators will face tough restrictions, he said. The proposed setback leaves “precious few spots” to place a well within the city, and companies would face higher costs, as saltwater byproducts would have to be trucked out of the city rather than disposed in injection wells, Sartain said.

Years of delay may have left a lingering bad taste in the mouth of energy companies, which can turn to other locations with friendlier rules and cheaper gas, he said.

“Enacting an ordinance would help, but people will for a long time be mindful that the political situation is such that even with an easy ordinance, you can’t get a permit to drill,” Sartain said.

Larry Nettles of Vinson & Elkins LLP said he believes Dallas will eventually come around to the idea of urban fracking and pass rules similar to those in neighboring Fort Worth, Texas, where natural gas production is booming at the heart of the Barnett Shale.

But in the meantime, energy companies will focus their time and money on other shale plays and oil reserves, like the Eagle Ford in south Texas, the Niobrara in Colorado and Wyoming, or the Utica in Ohio, that can turn a quicker profit, he said.

“Any time there is delay and uncertainty, that encourages operators to take their rigs and go elsewhere,” Nettles said. “The longer they delay, the more they incentivize companies to move.”

As the efficiency of horizontal drilling improves, companies want to be able to get their drilling rigs to areas where they can produce more easily, he said. It’s unclear if the economic window has closed on fracking in Dallas, but with natural gas prices staying low and supply increasing, the delays could make the city an untenable option for companies focused on the bottom line, he said.

Part of the problem is that the Barnett Shale under Dallas is unproven — nobody's sure how much oil and gas it could produce, and probably won't be until some drilling gets under way, according to Hollimon. The risk assessment oil and gas operators have placed on the area remains unclear, adding to the economic uncertainty facing exploration and production companies who might be eyeing it, he said.

“If the rules the city council ultimately enacts are so stiff and difficult to deal with that it increases the cost of getting the product out of the ground, that would make a project that perhaps the operator already isn't thrilled with drop below that operator's threshold,” Hollimon said.

Some say that at the end of the day, it's the economics more than the politics that is driving companies away from Dallas. Exploration and production companies are typically experienced negotiators used to operating in difficult political environments like the Middle East, according to David Ammons of Diamond McCarthy LLP.

“If they thought the economic upside was here, they might be willing to deal with the difficult politics,” Ammons said.

The Dallas city planning commission is set to vote Feb. 7 on permits that would allow Trinity East to drill, after having previously denied the application. The city council would have final say on the permits.