

Chesapeake Energy Goes Bankrupt, Will It Spur The Industry To Police Its Own?

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Earlier in June, while trying to locate the successor to a longtime employee at Chesapeake Energy on behalf of a client, I asked a friend at another energy company if he knew whom I should contact. "I don't know," he responded, "I stay far away from Chesapeake."

That attitude said a lot about Chesapeake, which filed for Chapter 11 bankruptcy protection on Sunday. It also highlighted two problems that have bedeviled the shale companies since the industry's inception - an inability to work together and an inability to police its own.

There have been and will be many stories written about Chesapeake and its late founder, Aubrey McClendon. Possessing a combination of brilliance, daring and good luck, Chesapeake rose in the early 2000's to become a world leader and innovator in the shale industry. It was a major benefactor to Oklahoma City, whose NBA basketball team still plays in the Chesapeake Energy Arena.

Over time though, Chesapeake seemed to lose its way. The company piled up mountains of debt while acquiring new mineral rights, becoming dangerously exposed to the shale gas price crash that came in the early 2010's.

However, potentially more disturbing industry-wide was a sense that Chesapeake played loose with its figures. In Oklahoma and Texas, Chesapeake lost large litigation matters involving royalty calculations (full disclosure, I was attempting to reach Chesapeake on behalf of a client for the same issue). In at least one lawsuit in Pennsylvania, evidence showed that Chesapeake sent a landowner a royalty statement saying that the landowner actually owed Chesapeake money for the natural gas that Chesapeake extracted from the landowner's property.

These practices were not a secret to the other natural gas producers in Pennsylvania, and they badly hurt the image, if not the business, of the gas industry generally. Faced with massive and ever increasing pressure from the environmental movement, the last thing the industry needed was to allow this sort of thing from one of its major producers. But the industry never found a way to stop it.

Issues involving proper practice have not been restricted to Chesapeake. While my personal experience has been that the vast majority of companies and people in the natural gas industry in the Marcellus Shale Basin are honorable, try to follow the rules, and care as much about the environment as anyone claiming to be an "environmentalist", there are a few exceptions.

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Those exceptions often are known internally, but the industry has not been able to stamp them out. The result has been a black eye that follows the industry wherever it goes.

Part of this comes from the segmentation of the industry. Broadly speaking, the oil and gas industry is segmented into “Upstream” (the oil and gas producers themselves like Chesapeake), “Midstream” (the pipeline companies and others who transport the oil and gas), and “Downstream” (mainly the utilities who deliver the gas to the retail customer). Not only do companies within the same segment have difficulty coming together about issues of common interest, there is almost no coordination or even communication between the segments. While the public lumps it all together as the “fossil fuel industry”, internally it is much less homogeneous and it often is dysfunctional.

As the green movement grows, the natural gas industry, which has a substantial environmental case to make (having reduced CO2 emissions to levels not seen since the 1980’s), can’t even get that case out to the public. Some of this is due to our polarized society and to the mainstream press, but much is due also to the industry’s internal bickering.

Chesapeake may emerge from the bankruptcy court with a new lease on life. If so, hopefully it will avoid the constant royalty issues that plagued it for so long. More importantly, its story may very well become a cautionary tale to an industry that always must do its best to make sure that all of its participants follow the rules, and that they appreciate the public trust given the industry by the people where it works.