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Natural-Gas Firms Seek Outlet for Growing Supplies

Industry Tries to Lift Demand to Keep Production Strong

By **BEN CASSELMAN**
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As major oil companies search for more oil to meet growing global demand, U.S. natural-gas companies face the opposite problem: what to do with all the gas they soon will be producing.

U.S. natural-gas production is soaring, thanks to high energy prices and new technologies that have unlocked reserves considered too difficult or expensive to tap in earlier eras. Production is up 8% this year, according to government data, and the growth is expected to continue as companies drill thousands of wells in Texas, Louisiana and Oklahoma, and look at massive new reserves in Appalachia and Canada.

Demand is growing, too, but more slowly. Total U.S. natural-gas consumption is up 5.5% this year through May, spurred largely by a gradual shift from coal power plants to cleaner-burning gas-fired ones. Consumption actually fell slightly between 2003 and 2006.

As some analysts have begun to toss around terms like "gas glut," natural-gas futures have tumbled 9.2% in the past two weeks, and they have brought producers' stocks down with them. Shares of large natural-gas producers [Chesapeake Energy Corp.](#), [XTO Energy Inc.](#) and [EOG Resources Inc.](#) are all down 30% or more from their recent highs in late June and early July. By comparison, oil-focused [Exxon Mobil Corp.](#) is down 17% from its recent high May 20.

"I think that supply growth has become the 800-pound gorilla in the North American gas investing equation," said Dan Pickering of Tudor Pickering Holt & Co., an energy-focused investment bank.

For consumers, increased supplies of natural gas could mean lower heating and cooling bills, as the fuel generates a fifth of the nation's electricity and heats half of the U.S.'s homes. But any relief is likely to be limited. Analysts say that if natural-gas prices settle below \$8 per million British thermal units, producers will cut back production -- which will tighten supplies and drive prices up again.

"It'll be essentially a self-correcting mechanism," EOG Chief Executive Mark Papa said.

Cutbacks in production could spell trouble for producers and their investors. Unlike Big Oil, most independent producers aren't using their cash to buy back stock or pay big dividends. They have been plowing it back into drilling, because Wall Street values the companies on their growth potential. If lower prices force producers to slow their drilling, their growth will slow, too.

To prevent that, the industry in recent months has cranked up its lobbying to boost long-term

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demand for natural gas. In television ads and congressional testimony, the industry has been touting natural gas as cheaper than oil, cleaner than coal and domestically produced.

"Find me the congressman or find me the policy maker who's against cleaner energy, cheaper energy and American energy," Chesapeake Chief Executive Aubrey McClendon said in an interview.

Mr. McClendon, whose company expects to become the nation's top natural-gas producer by the end of the year, is especially aggressive. Late last month he lobbied Washington lawmakers to promote compressed natural gas.

In an interview, Mr. McClendon said he wants to make lawmakers and the public aware of the potential of shale gas. "You can only produce what the market wants ... We're not going to expand if the market doesn't want it," he added.

Other producers acknowledge they are concerned about supply outstripping demand. EOG's Mr. Papa said that if shale discoveries prove as successful as companies expect, the industry will need to promote natural gas for use in trucks and other transportation.

"It's going to change the dynamics of the gas markets," Mr. Papa said.

The new supplies could pose problems for importers of liquefied natural gas. U.S. LNG imports are currently low because higher prices in Asia and Europe have attracted shipments to those markets. If new U.S. supplies are as plentiful and comparatively low, LNG imports are unlikely to rise.

The U.S. natural-gas industry has a history of booms and busts. Last fall, producers cut back production because a warm winter drove prices to below \$6 per million BTUs.

But experts say the current situation is different. Instead of a single big discovery or a weather-related temporary rise in supplies, the industry has found a completely new resource -- shale -- that could provide a steady stream of gas.

Shale -- or dense rock formations that are common in many parts of the country and around the world -- can hold natural gas. But production was impractical because the rock isn't porous enough for the gas to flow.

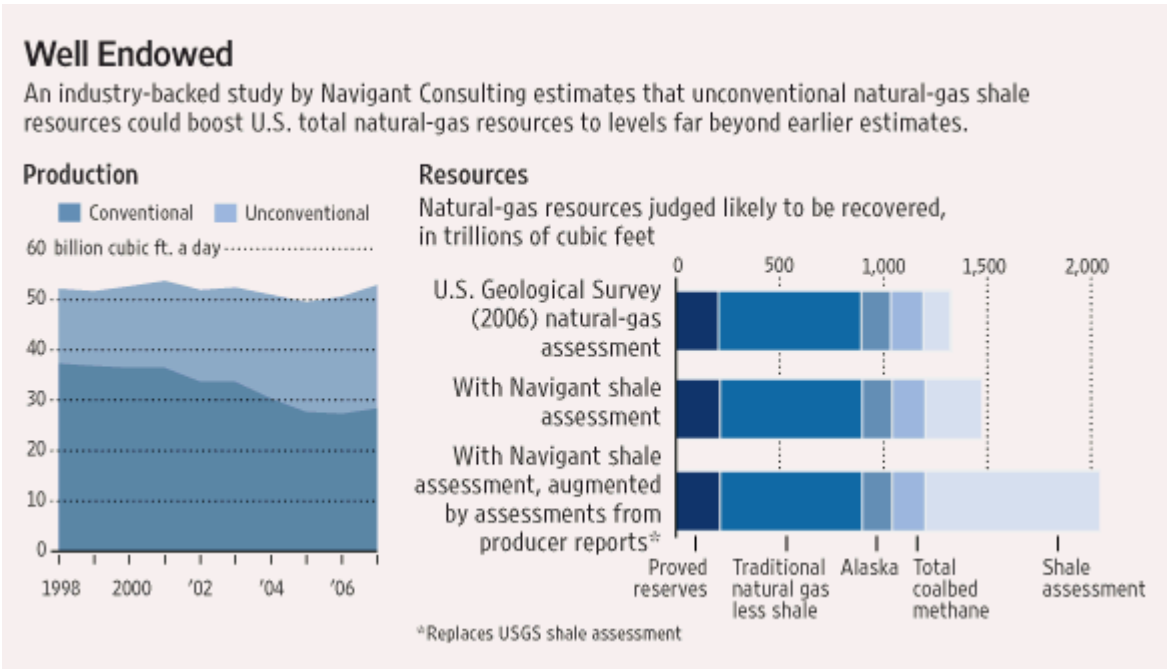
In the 1990s, however, companies figured out how to crack the shale using pressurized water, releasing the gas. The technique in the Barnett Shale, a massive shale-gas field around Fort Worth, Texas, that now produces about 1 billion cubic feet per day of natural gas, 6.5% of total U.S. production and quadruple what it produced in 2004.

The success of the Barnett set off a frantic search for new shale fields, some of them staggeringly large. The Haynesville Shale in northwest Louisiana and East Texas has by some estimates 250 trillion cubic feet of gas, 10 times as much gas as the Barnett. The massive Marcellus Shale formation in Appalachia could be even larger. Some geologists believe the plays could hold as much as 840 trillion cubic feet of gas by one industry estimate -- the equivalent of 10 years of oil, more than half the proven reserves of Saudi Arabia.

It is still early, and the actual amounts produced could be lower. Nor will all that gas be available to consumers. Limited availability of drilling equipment, pipeline capacity, as well as environmental and regulatory constraints, will restrict how fast production can ramp up.

But the recent discoveries have put natural-gas producers in a fundamentally different position from what they were in 2004. Many gas producers are promising double-digit production growth next year. Meanwhile, [Chevron's](#) oil production fell 3.4%, and Exxon's oil production fell 2% in the second quarter from a year earlier, excluding unusual

"There's very little doubt that you can bring this much gas supply on. The reserves are there," Creighton said. "The issue is, does that amount of gas push the price down?"



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