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No consensus on natural gas

Investors like private equity firms have a great opportunity in the US to help boost the development and production of natural gas, but cooperation between industry, government and environmentalists is essential, writes Howard Newman.

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The US has won the shale gas lottery with estimates of US reserves ranging from “more than we’ll ever need” to “more than we’ll ever need forever.” The economic consequences of this sudden abundance are only beginning to be understood.

Consumers can look forward to a long period of stable power prices. Industries that use natural gas as a feedstock can be reestablished in the US. Gasoline prices may come under pressure as natural gas-fired vehicles become attractive or investments are made in “gas to liquids” projects that produce gasoline at competitive prices.

For these happy consequences to come about, however, industry, government and the environmental lobbies must change the way they deal with each other around regulation. Today, there is a great hue and cry being raised about “fracking” and politicians are responding with a bevy of proposed restrictions. For example, in February, a second New York judge reinforced the rights of towns and cities to ban fracking and other drilling practices.

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Given the superabundance of reserves, there will be no short term consequences to New York’s decision to ban fracking. The industry has responded by focusing its activities elsewhere. Starkly put, New York is free to decide it doesn’t want shale gas development and the jobs it will create. Its residents will buy their natural gas from states that take a different view on development.

The gas industry – and by extension, the private equity industry – is being shortsighted if it doesn’t acknowledge that there are real environmental and other issues associated with fracking and large scale development of shale resources. This is true of most investments—not just energy ones. The industry has to take the lead in developing a comprehensive set of solutions to address legitimate concerns.

Economists will tell you the cost of these environmental impacts should be included in the price consumers pay for natural gas. The good news is that a responsible environmental and regulatory charge would not be large enough to undo the economic benefits which low priced shale gas will bring to the US. Even the most stringent drilling and water treatment requirements are not likely to add significantly to the price of gas. In addition, once the rules have been established, it is very important the penalty for non-compliance be high. Firms that don’t play by the rules shouldn’t be in the game.

What will discourage investment in shale gas, however, is if the rules are constantly changed and the standards shift every time the political winds blow. Shale gas investments last for many years. How can those investments be made – especially in an environment where prices and margins are low – without both stability and certainty of the costs of doing business?

Investors like private equity firms are rightly concerned about rules changing after they have committed large amounts of capital. History has made them cautious, and they protect themselves by investing elsewhere, or by requiring very short payback periods for their investments. This behavior can only lead to unnecessarily higher prices, and possibly deny the US the benefits that responsible development can bring about.

Howard Newman is president and chief executive officer of Pine Brook.