InvestmentNews

# Fracking: Investment Opportunity With Plenty of Risk

## *Lax disclosure one of the problems keeping investors at bay*

Jeff Benjamin | Nov. 26, 2013

The rapid expansion of hydraulic fracturing techniques for mining oil and natural gas has spawned a new growth cycle for energy exploration and production companies. But for investors and financial advisers interested in the fast-growing and sometimes misunderstood fracking space, extreme caution still might be the most prudent move.

John Fenton stands next to an Encana Corp. gas well near his home in Pavillion, Wyo. The EPA has said water in this area is contaminated from hydraulic fracturing. Photo: Bloomberg News

While fracking has been around in some form since the late 1940s, the recent popularity is illustrated in the more than 82,000 new fracking wells that have come on line since 2005. The widespread expansion and advancements of techniques involving horizontal drilling and the use of pressurized water and chemicals to help facture rock is creating new concerns that the industry is outpacing any efforts at adequate regulatory oversight.

Wall Street and investors generally likes the fracking industry, as the performance of the some of the most highly-recommended names with exposure to the space shows.

Through Nov. 26, shares of Cabot Oil & Gas Corp. (COG) are up 38.6% this year, EOG Resources (EOG) is up nearly 41%, and Chesapeake Energy Corp. (CHK) is up 60.4%.

Opposition to fracking has grown almost in proportion to the techniques, with well-documented claims of contaminated wastewater and polluted air among the most common byproducts.

Socially responsible and activist investor groups have been applying pressure to try to force exploration and production companies to embrace even a self-imposed form of compliance, but so far the major fracking industry participants have been slow to adopt standards that could go a long way toward saving the golden goose.

Earlier this month, a report by a consortium of activist investor organizations and asset management firms showed that the biggest problem facing the fracking space is transparency with regard to reporting guidelines, which are only loosely acknowledged and barely followed.

The study evaluated 24 major fracking companies based on 32 separate indicators of disclosure practices and found that none of the companies disclosed information on even half of the indicators.

**INCREASED RISK FACTOR**

Some of the top-performing stocks are also some of the most lax companies when it comes to disclosing risk factors.

Cabot and Chesapeake each met just five of the 32 reporting criteria, while EOG met six.

Encana Corp. (ECA) was the shining standout, having met the disclosure requirements on 14 of the 32 indicators. Apache Corp. (APA) and Ultra Petroleum Corp. (UPL) also managed to reach the double-digit level of reporting with 10 indicators each.

Beyond that, the study showed the range of reporting went from eight indicators for Hess Corp. (HES) down to just one for QEP Resources Inc. (QEP).

The 32 reporting indicators range from disclosures on how water is transported to whether executive compensation is linked to health, environment and safety performance.

The researchers were quick to point out that a lack of reporting doesn't automatically mean a company is doing anything illegal in any area of the fracking business.

But from an investor's perspective, this pattern of lax disclosure increasingly will be interpreted as an increased risk factor.

“In a lot of cases, these companies are just hiding their light under a bushel, because there are some well-managed companies that are just not disclosing,” said Paul Bugala, a senior sustainability analyst at Calvert Investments.

“This is material information, both in terms of how a company manages risk and how competitive the company is, but the industry has grown so quickly there is a lack of awareness that investors need this information,” he added. “This is an incredibly competitive industry and this kind of information gives us information on whether one company is managing its business better than others.”

The push for better disclosure in the fracking business first started to gain momentum in 2009 when institutional investors began pressing for more information.

“With the boom in natural gas drilling, there have been significant impacts on the environment, and as investors, we want to know that companies are addressing and mitigating those risks,” said Lucia von Reusner, a shareholder advocate at Green Century Capital Management.

The various environmental effects can include contaminated surface water, damaged roads, methane leaks and a general influx of industrial activity in areas that previously had none.

Green Century helped produce the 32-point industry score card along with Boston Common Asset Management, Investor Environmental Health Network, and shareholder activist foundation As You Sow.

“At this point, the industry has received such a bad reputation from a few bad actors that absent disclosure from companies, the communities will continue to assume the worst,” Ms. Von Reusner said. “This score card seeks to benchmark companies that are most transparent about efforts to mitigate the risks.”

An October report by Environment America claimed that the fracking industry generated 280 billion gallons of toxic wastewater in 2012, and that, since 2005, the industry has directly damaged 360,000 acres of land.

“The ultimate goal is to reduce the impact on the environment,” said Danielle Fugere, president of As You Sow.

“Right now, the industry appears to be all over the board in terms of disclosure and there's definitely room for improvement,” she said. “We're hoping the industry will adopt the best practices, because there is fear and concern out there and companies can't just tell people they're doing a great job and expect people to believe that. We're saying companies need to disclose measurable impacts and how they are trying to reduce any impacts that are occurring.”