

September 13, 2012

The Honorable Richard Cordray  
Director  
U.S. Consumer Financial Protection Bureau  
1700 G Street, NW  
Washington, DC 20552

Re: Addressing the impact of oil and gas leases on U.S. property values and mortgages

Dear Director Cordray:

On behalf of the undersigned, the Environmental Working Group (EWG) would like to congratulate you on becoming director of the newly created U.S. Consumer Financial Protection Bureau (“Bureau”). As you develop the Bureau’s priorities, we ask you to give attention to the impact of deceptive oil and gas leasing practices on U.S. property values and mortgages, particularly as companies increasingly rely on the technology known as hydraulic fracturing.

Specifically, we ask the Bureau to:

- **Investigate the extent to which oil and gas companies misrepresent or fail to disclose the risks of drilling and hydraulic fracturing when they approach landowners to lease their land for drilling operations;**
- **Develop robust disclosure standards and other regulations that would prevent oil and gas companies from engaging in deceptive leasing practices and hold them accountable for representations made by their leasing agents; and**
- **Work with state regulators, the lending community, insurance companies and public interest groups to develop a campaign to educate the public about the ways that oil and gas leases may affect property values and mortgages.**

Taking these steps will ensure that oil and gas companies, eager to exploit U.S. oil and gas deposits, do not take advantage of unsuspecting property owners, potentially exposing them to significant losses and liabilities.

### **Inherent Risks of Drilling and Hydraulic Fracturing**

By drilling companies’ own admission, drilling and hydraulic fracturing are inherently risky activities. Oil and gas companies regularly send their shareholders and potential investors long lists of potential hazards incident to drilling. For example, XTO Energy Inc., a subsidiary of Exxon Mobil Corporation, the nation’s leading natural gas producer, has told its investors that:

“Our operations are subject to hazards and risks inherent in drilling for, producing and transporting oil and natural gas, such as:

- fires;
- natural disasters;
- explosions;
- pressure forcing oil or natural gas out of the wellbore at a dangerous velocity coupled with the potential for fire or explosion;
- weather, including hurricanes in the Gulf of Mexico;
- failure of oilfield drilling and service tools;
- changes in underground pressure in a formation that causes the surface to collapse or crater;
- pipeline ruptures or cement failures; and
- environmental hazards such as natural gas leaks, oil spills and discharges of toxic gases.”<sup>1</sup>

These risks are not hypothetical. As far back as 1987, the U.S. Environmental Protection Agency detailed dozens of cases of gas and oil drilling-related contamination in a report to Congress.<sup>2</sup> State officials in Colorado, Ohio, Pennsylvania and Wyoming have also documented water pollution attributed to oil and natural gas drilling.<sup>3</sup>

### **Potential Impact on Property Values and Mortgages**

Risks associated with drilling and hydraulic fracturing have implications not only for public health and the environment, but also for property owners and the lending community.

The number of oil and gas leases on mortgaged property is rising steeply. According to *The New York Times*, property owners have “signed millions of leases . . . in recent years.”<sup>4</sup> This comes as little surprise at a time when oil and gas companies such as scandal-tainted Chesapeake Energy Corporation<sup>5</sup> have “embarked on an aggressive lease

<sup>1</sup> XTO Energy Inc., Annual Report (form 10-K) (Feb. 25, 2010).

<sup>2</sup> Dusty Horwitt, Envntl. Working Group, Cracks in the Façade: 25 Years Ago, EPA Linked ‘Fracking’ to Water

Contamination (2011), [http://static.ewg.org/reports/2011/fracking/cracks\\_in\\_the\\_facade.pdf](http://static.ewg.org/reports/2011/fracking/cracks_in_the_facade.pdf).

<sup>3</sup> E.g., Ohio Dep’t of Natural Res., Report on the Investigation of the Natural Gas Invasion of Aquifers in Bainbridge Township of Geauga County, Ohio (2008); Settlement Agreement in re Windsor Energy (Wyo. Dep’t Env’tl. Quality Apr. 13, 2007),

[http://deq.state.wy.us/volremedi/downloads/Web%20Notices/Windsor%20Well\\_Clark/AR-M550N\\_20070419.pdf](http://deq.state.wy.us/volremedi/downloads/Web%20Notices/Windsor%20Well_Clark/AR-M550N_20070419.pdf).

<sup>4</sup> Ian Urbina & Jo Craven McGinty, Learning Too Late of the Perils in Gas Well Leases, N.Y. Times, Dec. 1, 2011, <http://www.nytimes.com/2011/12/02/us/drilling-down-fighting-over-oil-and-gas-well-leases.html?pagewanted=all> [hereinafter Urbana & McGinty, Learning Too Late].

<sup>5</sup> Sam Gustin, Fracked: Why Chesapeake Energy’s Aubrey McClendon is in Hot Water, Time, May 3, 2012, <http://business.time.com/2012/05/03/fracked-why-chesapeake-energys-aubrey-mcclendon-is-in-hot-water/>; Terry Macalister, SEC to Investigate Chesapeake Energy as Founder Steps Down as Chairman, The Guardian, May 4, 2012, <http://www.guardian.co.uk/business/2012/may/04/chesapeake-energy-sec-aubrey-mcclendon?newsfeed=true>.

acquisition program . . . referred to as the ‘gas shale land grab’ of 2006 through 2008 and the ‘unconventional oil land grab’ of 2009 and 2010.”<sup>6</sup> According to news reports, Chesapeake carried out this campaign in part by “plott[ing] with its top competitor [Encana Corporation] to suppress land prices.”<sup>7</sup>

This is not the only questionable tactic used by drillers to expand their operations.

A recent EWG investigation found that oil and gas companies frequently misrepresent or conceal the risks of drilling and hydraulic fracturing when seeking to persuade landowners to lease their land for drilling.<sup>8</sup> In interviews conducted with nearly two-dozen landowners, EWG was told repeatedly that representatives of these companies “never mentioned possible risks to their water supplies or health as they negotiated gas-drilling leases.”<sup>9</sup> In some cases, the risks were denied outright.<sup>10</sup> According to news reports, drilling industry representatives have been known to “show up in poorer areas shortly before the holidays, offering cash on the spot for signing a lease.”<sup>11</sup> Together, these practices result in thousands of property owners signing oil and gas leases with little or no understanding of how the leases can affect their property values and mortgages.

When owners accept up-front payouts from drillers for leasing their land, they potentially open themselves up to far greater losses and liabilities.<sup>12</sup> As with any lease, the fine print matters, and the terms of oil and gas leases depart from ordinary ones in several important respects. For one, they do not forbid dangerous activities or the use and storage of hazardous substances on the property.<sup>13</sup> Further, they typically do not require drillers to pay a security deposit to property owners or to name property owners on any insurance policies that cover damages caused by drilling operations.<sup>14</sup> Together, terms such as these could create a situation where property owners must pay exorbitant cleanup costs, with little recourse to hold oil and gas companies responsible.<sup>15</sup> That risk is compounded by the fact that property owners’ own insurance policies typically do not cover damages caused by drilling. For example, Nationwide Mutual Insurance Company recently announced that it does not cover property damage caused by hydraulic fracturing.<sup>16</sup>

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<sup>6</sup> Chesapeake Energy Corp., Annual Report (form 10-K) (Feb. 29, 2012).

<sup>7</sup> Brian Grow et al., Special Report: Chesapeake and Rival Plotted to Suppress Land Prices, Reuters, June 25, 2012, <http://www.reuters.com/article/2012/06/25/us-chesapeake-land-deals-idUSBRE8500EI20120625>.

<sup>8</sup> Dusty Horwitt, Env'tl. Working Group, Drilling Doublespeak: Gas Drillers Disclose Risks to Shareholders — But Not to Landowners (2011) [http://static.ewg.org/pdf/Drilling\\_Doublespeak.pdf](http://static.ewg.org/pdf/Drilling_Doublespeak.pdf) [hereinafter Horwitt, Drilling Doublespeak].

<sup>9</sup> Id. at 4.

<sup>10</sup> Id.

<sup>11</sup> Urbina & McGinty, Learning Too Late, *supra* note 4.

<sup>12</sup> Elisabeth N. Radow, Homeowners and Gas Drilling Leases: Boon or Bust?, N.Y. State B. Ass’n. J., Nov.-Dec. 2011, at 16.

<sup>13</sup> Id.

<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> Matthew Sturdevant, Possible Damage from ‘Fracking’ Not Covered by Standard Homeowner’s Policy, Hartford Courant, July 13, 2012, [http://articles.courant.com/2012-07-13/business/hc-fracking-insurance-coverage-20120713\\_1\\_hydraulic-fracking-property-casualty-insurers-liberty-mutual](http://articles.courant.com/2012-07-13/business/hc-fracking-insurance-coverage-20120713_1_hydraulic-fracking-property-casualty-insurers-liberty-mutual).

Hartford Financial Services Group, another insurance industry heavyweight, has announced that it is “aware of the increasing use of hydraulic fracking and is carefully evaluating its potential impact to [its] customers and business” as well.<sup>17</sup>

Other problems are more immediate. For example, properties subject to oil and gas leases can lose significant resale value. As a result, property owners end up trapped on their land, unable to move without incurring a serious financial loss.<sup>18</sup> Oil and gas leases also may cause property owners to unwittingly violate the terms of their mortgages.<sup>19</sup> Lenders often require property owners to obtain permission before allowing hazardous activities such as drilling on mortgaged property to ensure that the property retains its full value.<sup>20</sup> Otherwise, lenders might not be able to sell these mortgages to secondary lending companies such as Fannie Mae, which bundle individual mortgages and resell them to investors.<sup>21</sup> Individuals who sign oil and gas leases on mortgaged property without the permission of their lenders may have to pay off the full amount of their mortgage immediately or find themselves in foreclosure.<sup>22</sup> In addition, prospective buyers may have trouble securing loans or federal loan guarantees when they try to buy land already subject to an oil and gas lease.<sup>23</sup> In light of these potential consequences, property owners must have a better understanding of the inherent risks of drilling before they sign oil and gas leases, including how the leases can affect property values and mortgages. Federal and state regulators should require oil and gas companies to disclose these risks in a clear and conspicuous manner and ensure that their leasing agents do the same. Regulators also must limit the extent to which oil and gas companies include terms in their leases that prevent individuals from disclosing details about the leases themselves, or damage to their property or homes caused by drilling.

### **Greater Consumer Protection Needed**

The debate over drilling and hydraulic fracturing has largely focused on whether it can be done safely, without compromising water supplies. However, we cannot afford to ignore its serious spillover effects, including how drilling operations affect property values and mortgages. We believe this is an area where the U.S. Consumer Financial Protection Bureau should be taking the lead to protect the public, especially when no other

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<sup>17</sup> Id.

<sup>18</sup> E.g., Horwitt, Drilling Doublespeak, supra note 8.

<sup>19</sup> Tompkins County NY Council of Gov'ts Gas Drilling Task Force, Gas and Oil Leases: Impact on Residential Lending (Mar. 24, 2011 & as rev. Nov. 15, 2011), [http://www.tompkins-co.org/tccog/Gas\\_Drilling/Focus\\_Groups/LandValues\\_Assessment.html](http://www.tompkins-co.org/tccog/Gas_Drilling/Focus_Groups/LandValues_Assessment.html) [hereinafter Tompkins County, Oil and Gas Leases]; Ian Urbina, Rush to Drill for Natural Gas Creates Conflicts with Mortgages, N.Y. Times, Oct. 19, 2011, <http://www.nytimes.com/2011/10/20/us/rush-to-drill-for-gas-creates-mortgage-conflicts.html?pagewanted=all> [hereinafter Urbina, Rush to Drill].

<sup>20</sup> Id.

<sup>21</sup> Tompkins County, Oil and Gas Leases, supra note 19, at 2-3; Urbina, Rush to Drill, supra note 19.

<sup>22</sup> Id.

<sup>23</sup> See Tompkins County, Oil and Gas Leases, supra note 19, at 2; Ian Urbina, Mortgages for Drilling Properties May Face Hurdle, N.Y. Times, Mar. 18, 2012, <http://www.nytimes.com/2012/03/19/us/drilling-property-mortgages-may-get-closer-look-from-agriculture-dept.html?pagewanted=all> (USDA considered requiring “extensive environmental review before issuing mortgages to people who have leased their land for oil and gas drilling.”).

regulatory agency appears to have the ability to address this issue on a comprehensive, national scale.

That is why we again call on the Bureau to:

- Investigate the extent to which oil and gas companies misrepresent or fail to disclose the risks of drilling and hydraulic fracturing when they approach landowners to lease their land for drilling operations;
- Develop robust disclosure standards and other regulations that would prevent oil and gas companies from engaging in deceptive leasing practices and hold companies accountable for representations made by their leasing agents; and
- Work with state regulators, the lending community, insurance companies, and public interest groups to develop a campaign that would educate the public about the ways that oil and gas leases may affect property values and mortgages.

Thank you for taking these recommendations under consideration. The debate over drilling and hydraulic fracturing cuts across many federal regulatory jurisdictions. However, this is one issue that we cannot afford to let slip through the cracks. Doing so could have serious repercussions for thousands of households and ultimately jeopardize the nation's fragile economic recovery.

Sincerely,

Kenneth A. Cook, President  
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*Center for Health, Environment & Justice*

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Gwen B. Fischer, Representative  
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Cc: The Honorable Edward J. DeMarco, Acting Director, Federal Housing Finance Agency  
The Honorable Dustin McDaniel, Attorney General, State of Arkansas  
The Honorable Kamala D. Harris, Attorney General, State of California  
The Honorable John W. Suthers, Attorney General, State of Colorado  
The Honorable George Jepsen, Attorney General, State of Connecticut  
The Honorable Lisa Madigan, Attorney General, State of Illinois  
The Honorable Douglas F. Gansler, Attorney General, State of Maryland  
The Honorable Martha Coakley, Attorney General, Commonwealth of Massachusetts  
The Honorable Bill Schuette, Attorney General, State of Michigan  
The Honorable Steve Bullock, Attorney General, State of Montana  
The Honorable Jeffrey S. Chisea, Attorney General, State of New Jersey  
The Honorable Gary K. King, Attorney General, State of New Mexico  
The Honorable Eric T. Schneiderman, Attorney General, State of New York  
The Honorable Roy Cooper, Attorney General, State of North Carolina  
The Honorable Mike DeWine, Attorney General, State of Ohio  
The Honorable Linda Kelly, Attorney General, Commonwealth of Pennsylvania  
The Honorable Robert E. Cooper, Jr., Attorney General, State of Tennessee  
The Honorable Greg Abbott, Attorney General, State of Texas  
The Honorable Kenneth T. Cuccinelli, II, Attorney General, Commonwealth of Virginia  
The Honorable Darrell McGraw, Attorney General, State of West Virginia  
The Honorable Gregory A. Phillips, Attorney General, State of Wyoming