

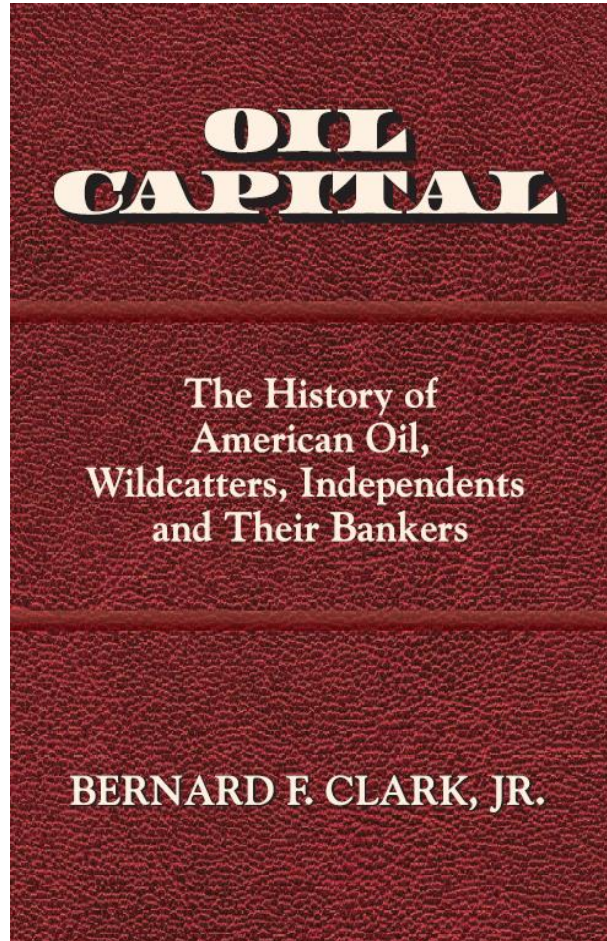


SOUTH TEXAS COLLEGE OF LAW  
ENERGY LAW INSTITUTE:

# HISTORY AND FUTURE OF BANKING IN THE OIL PATCH

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August 28, 2019  
Houston Texas

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# In Search of the Holy Grail

# HISTORICAL FOUNDATION OF U.S. OIL & GAS INDUSTRY

- Plentiful Oil and Gas Resource
- Private Ownership of Minerals
- Rule of Law
- Access to Capital

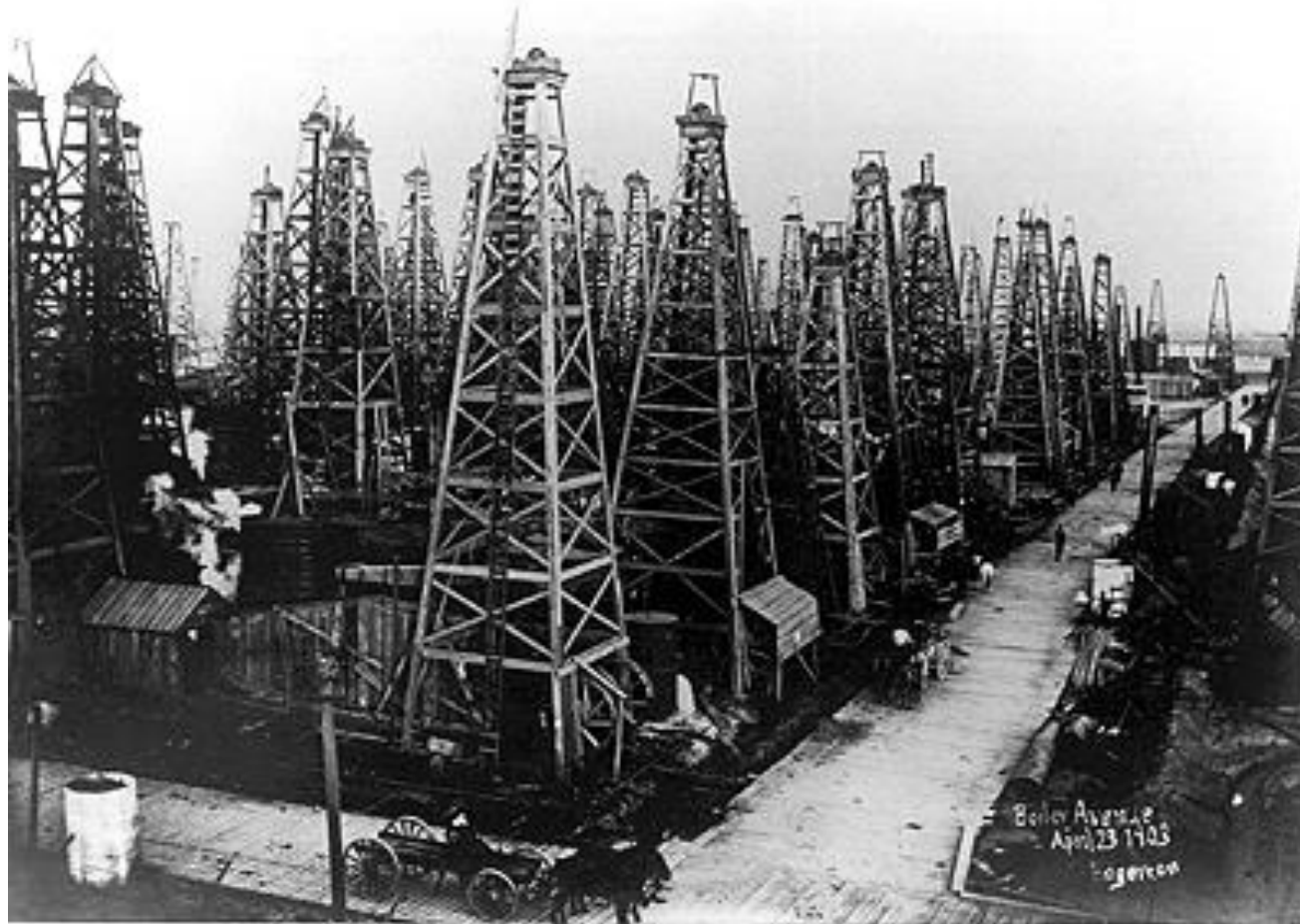
# PRIVATE MINERAL OWNERSHIP

- Historical Mineral Ownership from Ancient Greeks to 20<sup>th</sup> Century.
- Many countries did not assert national ownership of minerals until WWI proved its strategic value.
- Today, only 3 countries, including the U.S., permit some level of private ownership of hydrocarbon reserves.

# **RULE OF LAW**

- Certainty of title
- Certainty of contract
- Certainty of right to produce

# RULE OF CAPTURE AND THE WILD, WILD WEST



# PRORATION CREATED THE PRODUCERS' NEED AND SOLUTION

- Proration Tamed the Rule of Capture
- Well production and monthly field production was tied to market demand
- Limited production also brought control over market prices and more predictable cash flow
- Reduced production reduced the producer's cash flow, creating the need for leverage
- ***Proration was the catalyst that created modern energy lending in the US***

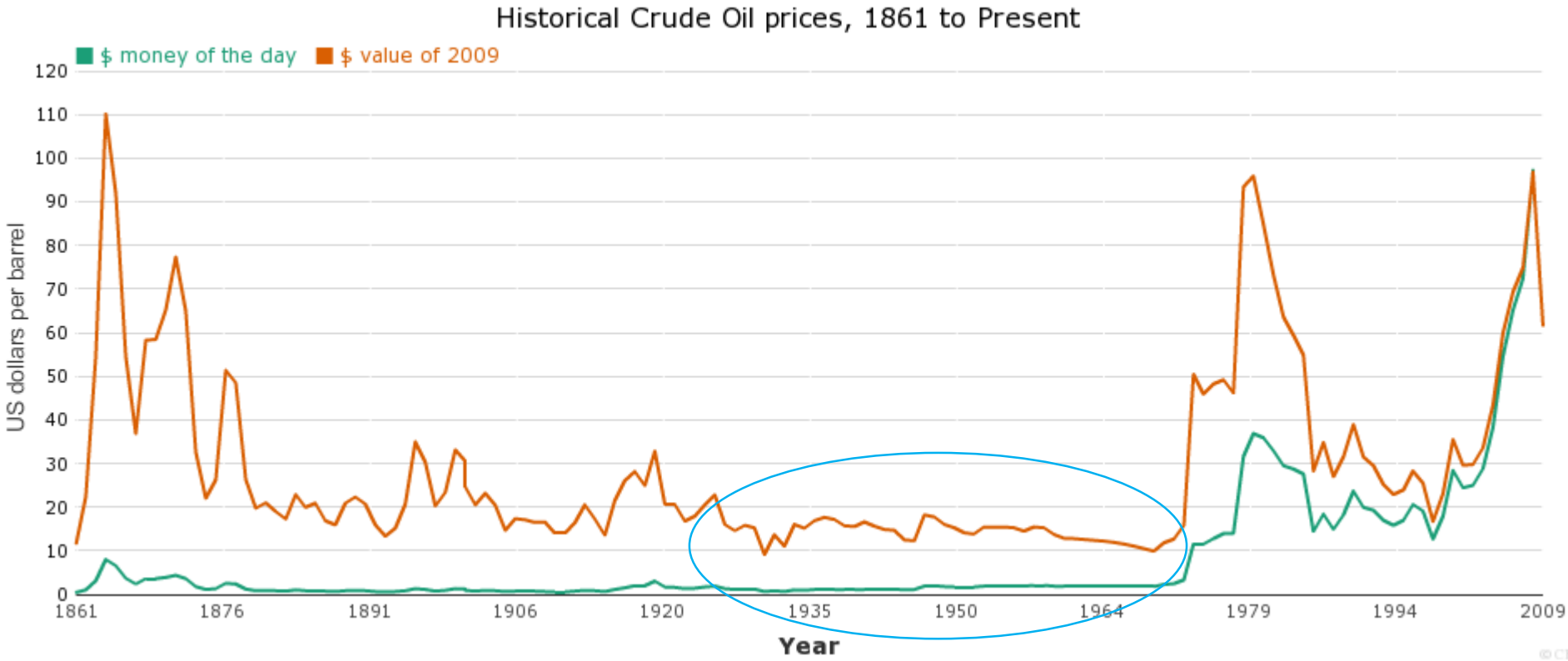
## ACCESS TO CAPITAL

Originally, banking was prohibited in Texas -  
Anti-Banks, Anti-Railroads, Anti-Major Oil  
State Banking Permitted in 1904 – no branches, no  
interstate banking

This Local Bias was a blessing and a curse –  
Early on, it helped independent producer (source of  
Railroad Commission)  
But by the 1980's it would prevent the rescue of Texas'  
homegrown banks.



# 1935-1969: RELATIVE PRICE STABILITY



# 1930-1970 ERA -- PRODUCTION LOANS

- Secured Term Loans tied to Production
- Simple Documentation – Note, Mortgage and Assignment of Production
- ABC Loans and Production Payments

# 1970-1980'S: A TIME OF VOLATILITY

Middle East



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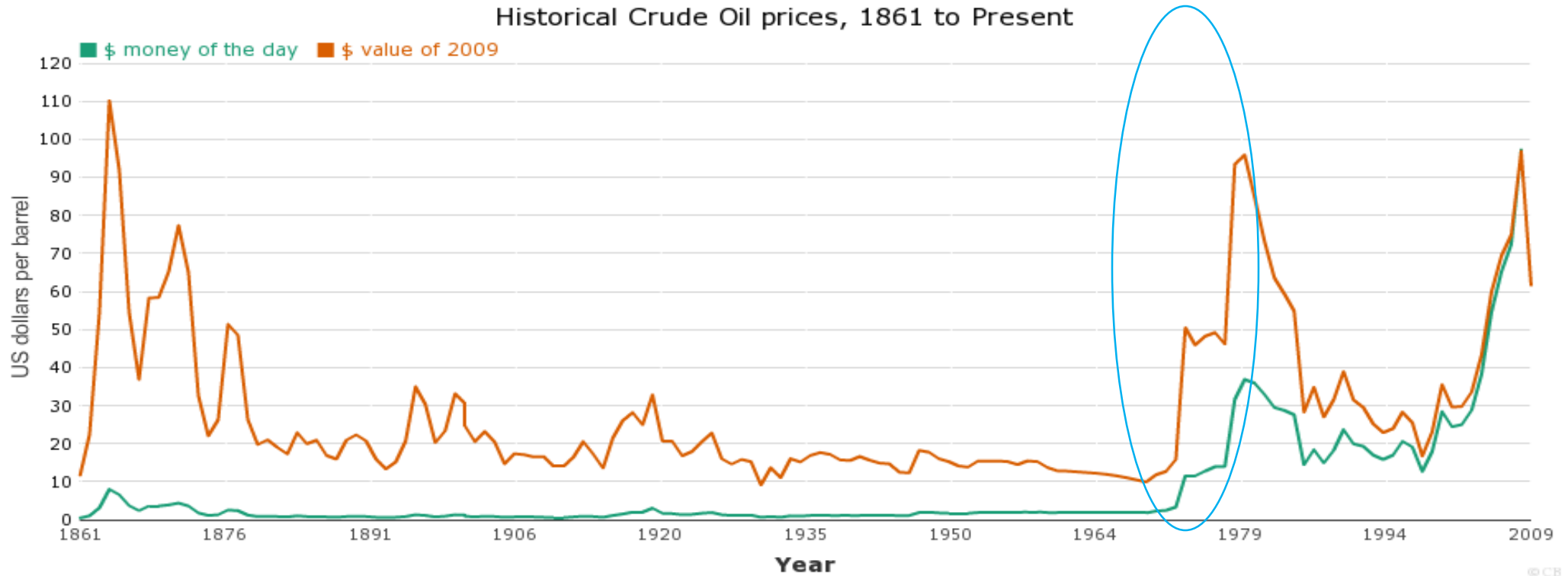
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# 1980'S: TRANSITION FROM RELATIVE PRICE STABILITY TO WILDLY UNPREDICTABLE PRICES



# PRICE VOLATILITY GENESIS OF THE BORROWING BASED REVOLVER

## Problem:

- Increasing oil prices caused Producers to demand more credit for mortgaged oil and gas property.
- Fluctuation in prices caused Bankers to need safety net when prices fell.

## Answer: Reserve Base Revolver

- Continental Illinois National Bank & Trust (circa 1979) introduced a revolving credit facility with availability tied to fluctuation in borrower's collateral value.
- Flexible credit available under flexible loan documentation.

# 1980'S – DECADE OF DESTRUCTION

**Penn Square –  
Canary in the coal mine July 4, 1982**



## **Texas Banks Failed or Acquired:**

- Texas Commerce Bank (acquired)
- Allied Bank of Texas (acquired)
- Mbank (Mercantile National Bank and Southwest Bank of Texas)
- First National Bank
- First Republic (Republic National Bank and InterFirst Bank)
- Texas American Bancshares
- National Bancshares
- BancTexas Group
- First City Bank

# DECADES FOLLOWING THE CRASH OF THE 1980S

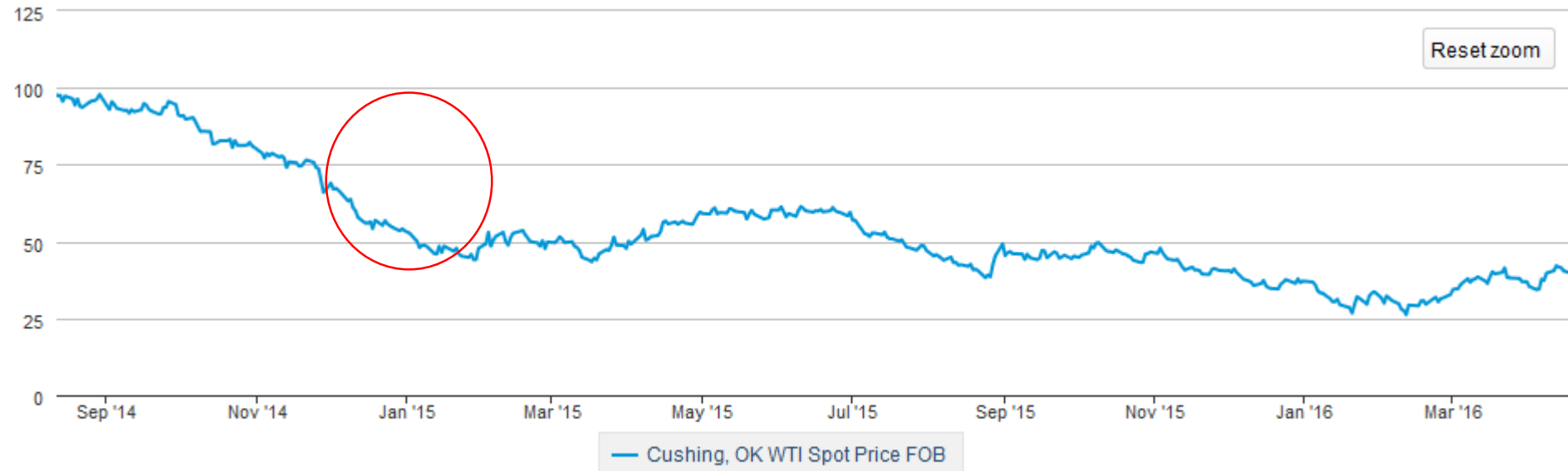
- **1990s** – Alternative Financing Sources, Futures Markets and Tax Credits
- **2000s** – Shale Revolution and Increase Demand for Capital, Private Equity Investment and The Great Recession
- **2010s** – Shale Revolution Continues, Complex Debt Structures, OCC Guidelines and OPEC's Thanksgiving Turkey Surprise.

# OPEC'S 2014 THANKSGIVING TURKEY

Cushing, OK WTI Spot Price FOB

DOWNLOAD

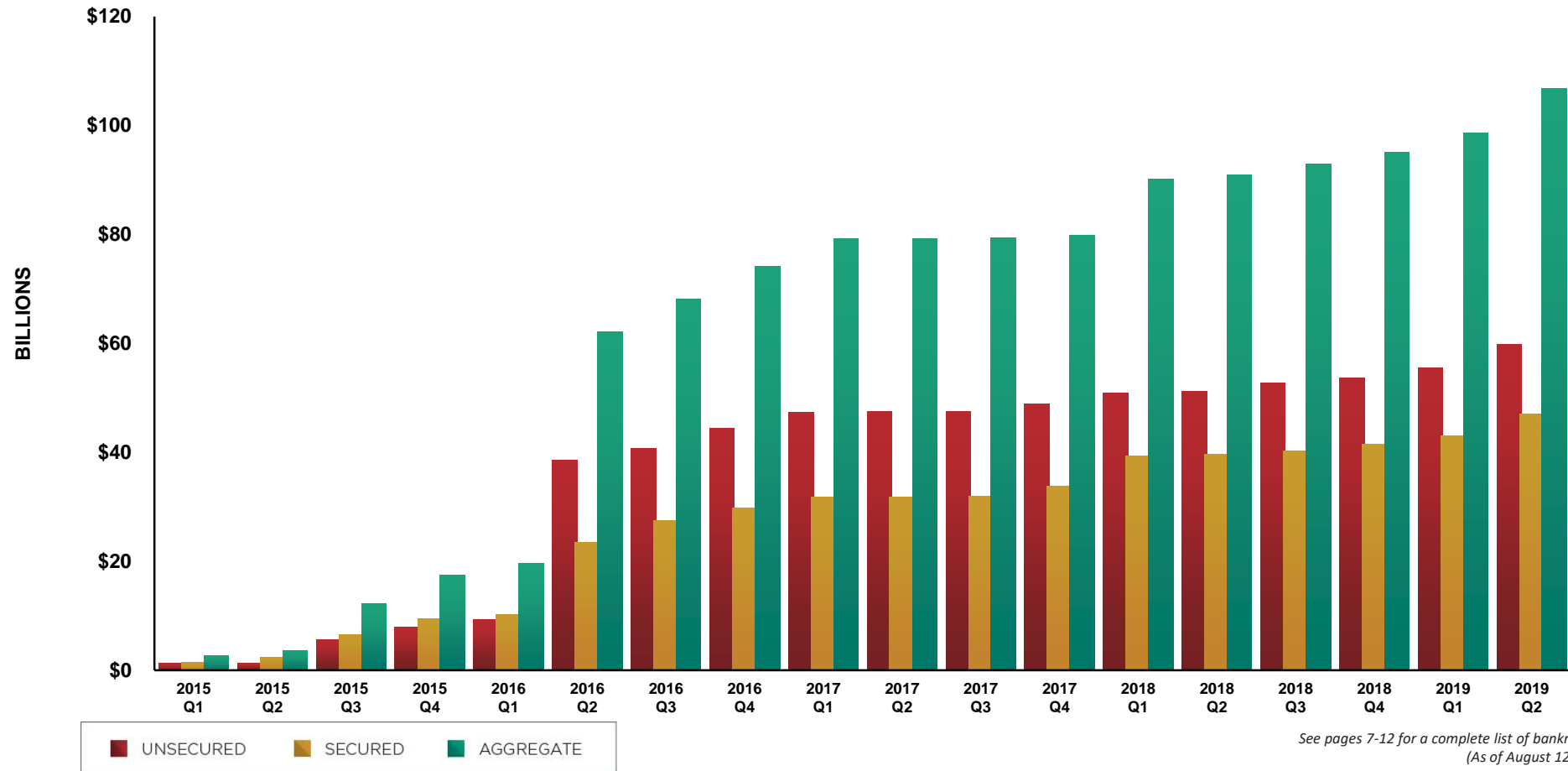
Dollars per Barrel



Source: U.S. Energy Information Administration



# 2015-2019 CUMULATIVE E&P UNSECURED DEBT, SECURED DEBT AND AGGREGATE DEBT

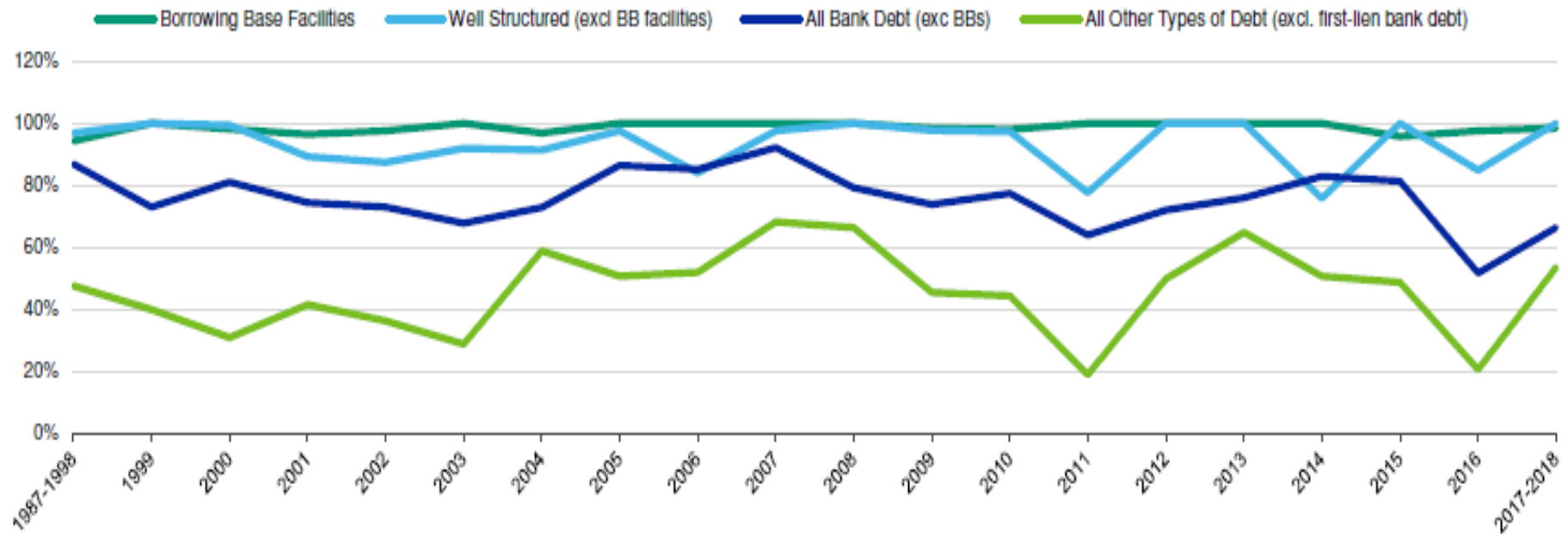


See pages 7-12 for a complete list of bankruptcies.  
(As of August 12, 2019)

# RBL STRUCTURE -- TAKES LICKIN' AND KEEPS ON TICKIN'

Exhibit 1

Borrowing base facilities consistently performed well, exhibiting low recovery volatility



Source: Moody's Ultimate Recovery Database

# CURRENT MARKET

- “Buy and Flip” Meets “Lower for Longer” becoming “You Broke It, You Buy It”
- Public Markets Sentiment has Turned against Oil and Gas Industry and Closed the “Easy Exit” Door
- New Mantra: “Go Slow, Live within Cash Flow”
- Demand for Debt Capital is no longer to maximize leveraged returns, but instead to keep the lights on.

# PE IMPACT ON CURRENT RBL TERMS

- Demands for 'consistent' terms across portfolio industries introduces foreign concepts
- Precedent Documents become 'Standard Market' overnight
- Decreased emphasis on the basics:
  - Oil and Gas Collateral
  - Financial Covenants
  - Lender Control

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