Knowledge and Geographic Ties Strengthen Capital Lending for the Energy Industry

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The energy industry needs loans to run its business. The costs of those loans and the restrictions they may impose on how energy companies operate are a concern for management. Armed with the right information and legal counsel, however, companies in the energy industry can negotiate the best terms possible to reduce costs and garner greater freedom to run their businesses.

The energy industry's prominent presence in Texas parallels New York City's preeminence as a financial stronghold – which means that having a relationship in both regions is critical. Lindsay Sparks, a partner in the corporate department of Paul Hastings, LLP, works with companies and their financial teams to understand their capital and financing needs. Sparks says that having access to financial resources based in Manhattan enables her Texas clients to secure the best deals possible. It is especially necessary to provide not only information on fees and costs, she says, but insight that can give clients more flexibility to operate. This is particularly important due to the restrictive covenants that lenders seek to impose on their borrowers in the credit facility documentation.

"Credit can restrict you from operating, that's the problem," says Sparks. "If you aren't well advised, you don't have a notion of what you can negotiate and what your competitors are getting. As a result, you may agree to terms that don't allow you to adequately compete."

When Sparks advises clients about the interest rates they should expect, the fees they should be paying and trends in the market, the market knowledge of her colleagues in New York can make a significant difference and ensures her clients the most complete and up-to-date information. "Making this type of connection improves the quality of representation and the range of deals we're working on," she says.

Ensuring Solid Debt Counsel

When oil and gas prices plummeted in 2014, a number of oil and gas companies were forced to file bankruptcy as they could not lower costs. Sparks says the shock of that price drop still reverberates throughout the energy industry. "A lot of companies were completely over-leveraged and they relied on debt too much to fund their production costs. Most of my clients have learned a really hard lesson. If they didn't ultimately need to file themselves, they've learned from their competitors you needed to file in order to right size their balance sheets."

That lesson is being applied today to how the energy industry finances hydraulic fracking, which has become a major factor in the industry's growth. Hydraulic fracking involves a combination of water, sand and chemicals pumped at high pressure down wells to liberate oil and gas from below the surface. This mix needs to later be transported away and disposed of properly. While this has increased the supply of energy, it comes at a higher cost than traditional drilling.

Sparks says her clients are managing the costs through use of debt, cash flow and partnerships with private equity firms. "One important thing the recession has done is train people and focused them on managing and lowering production costs, such that it allows them to maintain and increase their returns," she explains.

She says that prior to the 2014 price drop and resulting oil and gas bankruptcies, some clients didn't fully realize the value of having good debt counsel because they viewed their lenders as partners and didn't focus enough on negotiating terms that were to their advantage, leading to lenders' having too much ability to restrict companies' operations.

After this string of bankruptcies, Sparks says her clients still view their lenders as partners, but there's been a change in the relationship. "They realize they have to focus on their rights under credit agreements and the flexibility they need to grow their business while managing that debt on a daily basis. It's critical to have good counsel to get the terms you need to efficiently achieve your business goals."

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