**Arthur "Buzz" Gralla, Jr Testimony**

**Statement of Arthur R. Gralla, Jr. Executive Vice President Bank One on behalf of the Independent Petroleum Association of America**

**United States Department of Commerce**
**The Emergency Oil Gas Guaranteed Loan Program Act of 1999**

*September 22, 1999*

I am Arthur Gralla, Jr., executive vice-president of Bank One, which is located in Houston, Texas. Bank One is a national bank with an expertise in energy lending. I am here today to testify on behalf of the Independent Petroleum Association of America (IPAA) which represents the interests of our nation's 7,000 independent producers which produce approximately 40 percent of America's crude oil and 66 percent of America's natural gas.

We appreciate the opportunity to testify and wish to thank Secretary Daley and the United States Department of Commerce for its efforts to implement the Emergency Oil and Gas Guaranteed Loan Program Act of 1999. We especially wish to thank Senator Domenici and his staff for their authorship of this important piece of legislation. We also wish to thank Senator Byrd for his assistance and support during the legislative process, and those that worked so hard to navigate this legislation through the House of Representatives.

**Key Issues for Success of Program**

The focus of the program should be to help companies get back on solid financial ground through a two-part lending program. The oil and gas industry is a very capital-intensive industry that has always relied heavily on internal or industry partner financing. Due to the price crisis, this industry financing has been nearly impossible to obtain. It is critical that this program helps maintain the industry infrastructure, especially personnel and the resource base. First, the loan guarantee program should provide restructuring of debt and/or a stretch loan to help companies meet employment obligations and survive their current debt obligations caused by the industry downturn. Second, it should create development capital that will allow companies to regain the production and reserves that were lost during the price downturn.

The industry has endured an 18-month downturn, and although the price has rebounded in the past month and half, it is not been enough to help most independent producers regain solid financial footing. As cash flow declined, many companies were forced to take on additional debt to survive through the price crisis and meet financial obligations and payroll. Payment of their debt obligations in order to stave off bankruptcy forced companies to neglect their resource base. In the oil and natural gas industry, if you are not reinvesting your money back in the ground to maintain your current production or finding new production, the company is liquidating itself.

Today, we have seen crude oil and natural gas prices recover. However the companies' cash flow is still down due to the decline in their production. Companies' production has declined by up to 50 percent in some cases, so they have not been receiving the cash-flow needed to meet increasing financial obligations. For companies to recover--as prices have--we must improve their cash-flow and the employment base.

The industry believes there are two types of companies that could benefit from the oil and natural gas loan guarantee program. The first group of companies are the ones that have had to take on more debt to stay afloat. This has pushed them close to bankruptcy. They need to restructure their debt to stretch their loan payments and pay a lower cost of capital to maintain their current production. Lower principal and interest payments will allow them to move some low risk undeveloped reserves to the producing category. This action will increase the cash flow that could be directed more at the resources of the companies than servicing their current debt load. Given a longer time frame, these companies can work with their resource back to financial health.

The second type of company is one whose lending capabilities have been stretched to the limit. This type of company has a good group of properties, however it has a large portfolio of PUDs (proved undeveloped reserves), that with some additional drilling or workover capital, could work its way out of the current price situation.

The industry is not looking for this program to address companies that have no chance for recovery, and who were not injured as defined in the legislation. Nor does it want the oil loan guarantee program to become a scheme by lending institutions to remove the "at risk" loans from their loan portfolios.

I would like to highlight a few key points that the loan program should include to ensure it is successful. First, the loan process must be a streamlined, so that it moves quickly from loan origination to review, and to issuance of funds. If this process is bogged down with unnecessary paperwork or a burdensome review process it will not benefit the intended recipients of loan guarantees.

Second, the "loan originator" should not be limited to just bank debt vehicles. As I will discuss later there are many capital providers and financial instruments available to the energy industry. It would be a disservice to the industry to disqualify any current energy lender that is actively servicing this market. There are many vehicles that would be appropriate for this loan guarantee program with sound, established fiscal lending practices. It will be imperative that the energy lender work with the applicant to secure the loan guarantee, and receive a reasonable return for that effort. Hopefully, this group of lenders will be able to "pre-qualify" for this program by participation, or through prior approval by another government sanctioned program or entity (i.e. SBA.)

The third item of importance is the repayment criteria for the guaranteed loan. There are many questions that arise here that will needed to be answered. However, one important item is the amortization schedule. As mentioned earlier, the advantage of this program would be to free up some of the producers’ capital by reducing their current principal and interest obligation over a longer time frame as suggested in the legislation. There are many other issues such as: title; insurance; reporting requirements; form of assignment agreement; indemnification; release of liens and certain bar restrictions-to name a few that would also have to be determined.

The fourth item is the interest rate. The industry does not view this program as "free money." It is low cost money that is being made available to maintain the resource base of oil and natural gas reserves and the human infrastructure that is so critical to this nation. In maintaining these two elements, we will preserve many companies that have been unduly harmed in this downturn. The industry realizes that the capital providers should receive a reasonable rate of return on their money for efforts and risk. The energy-lending sector also realizes that this is a program structured to benefit independents and service companies. The Department of Commerce may want to look at a blended interest rate that would address the two types of lending this program should address, restructuring and development funds. Each of these may require different interest rates.

**Energy Lending Overview**

There will need to be clear and defined obligations set forth for both the lender and borrower. Listed here are just a few broad categories: how to apply for the loan; eligibility requirements of both capital providers and industry recipients; agreed performance clauses in the loan; the amounts of guarantees available in specific time frames; the loan approval process and other loan requirements. This program shows much promise. However, many questions need to be answered about its structure by those knowledgeable of the about lending to the energy sector.

In order to help this group charged with this task, I would like to give a short overview of typical lending practices of capital providers to the oil and natural gas industry. Natural resource lending is different than nearly all other industries because there is a depleting asset. I have included with my written testimony a copy of a much broader overview of energy lending.

1. Energy lending vehicles (bank loans, subordinated debt, VPPs, mezzanine, private equity and public markets.)
2. Looking at risk
3. Financial statements, reserve reports, performance statistics, management bios etc.
4. Bank review process

**Summary**

If the Department of Commerce follows sound fiscal lending practices for the oil and gas industry, the oil loan guarantee should benefit greatly from this program. It will help provide the capital where it is needed most to help maintain the domestic resource base and the employees that are needed to develop the resource.

As the industry looked at this proposal, it was felt that there was tremendous potential for this program to aid the U.S. independents and service companies, if it was structured properly. As we move forward, I would like to propose that an industry panel of experts help the Department of Commerce in the formulation of this program. The last thing that the IPAA wants to see is a program that becomes overly bureaucratic for any participant, and does not benefit the industry as intended.

This concludes my comments. Thank you for holding this hearing and for granting me the opportunity to testify.