DRILLING CONTRACTOR

DRILLING AHEAD

Operators take 'magnifying glass' to contracts to beat down rates

Mike Killalea
Editor & Publisher

THE ECONOMIC PRESSURE cooker is on, and oil companies have reverted to their time-honored tradition of beating contractors down on rates and contract terms.

One offshore contractor, a battle-scarred veteran of earlier rig wars, told me the other day, "I feel like a prostitute. Operators are taking a magnifying glass to all contracts to look for a reason to weasel out. But then they say they will stay with it if contractors will just lower their rates. Don't ask how I'm doing, even with long-term contacts."

Rowan Companies Chairman/CEO **Bob Palmer** recently told a **US Senate** committee investigating the state of the industry that, "Long-term contracts are being challenged by the customers, often on the narrowest of technical or legal issues, in an effort to cancel or renegotiate the contracts at lower prices, forcing contractors to choose between uneconomic contracts or litigation." Mr Palmer was speaking from experience, as one whose company faces just such a dilemma.

THE WOLF WITHIN

Now, it is inaccurate to say that long-term contracts have no meaning for operators. They veritably ring with meaning when an erstwhile operator is seeking to hedge against the likelihood of increased future dayrates and the specter of a rig shortage.

However, recent events demonstrate that when the slightest sliver of light shines through a slit in rig supply and demand, oil companies quickly shed off the sheepskin of partnership, baring the wolf within.

Several of these suspiciously convenient contract cancellations have occurred of late. A couple of examples stand out.

In December, **Mobil North Sea** abruptly cancelled its contract for **R&B Falcon Corp** semisubmersible Jack Bates under a breach of performance clause, claiming equipment and personnel deficiencies. R&B Falcon, which believes it is in the right, is not taking this lying down and has said it intends to pursue "legal remedies to enforce its rights under the contract".

What's worrisome to many is the vague and largely subjective nature of these supposed "performance breaches". The case has wrought the odd picture of contractors rallying round a competitor.

For example, **Robert E Rose**, President/CEO of **Global Marine**, stated recently, "We hope R&B Falcon will fight this vigorously and that they will prevail."

Then, in January, **Rowan Companies** announced that **Amoco UK** had cancelled a 1-year contract for the newbuild jackup Gorilla V. Reportedly, the rig was dumped following a period of intense negotiation—i.e., pressure—to rethink the Gorilla V's $183,000 dayrate.

Drilling non-performance was the justification for the cancellation. However, the Gorilla V was reportedly waiting on weather to move to the location. It had not had the opportunity even to spud its first well.

SPIRIT OF PARTNERSHIP?

Is this the much-ballyhooed spirit of partnership that has inspired contractors to invest in high-ticket and high-tech equipment, upgrade fleets and attract new people?

DANTE'S RECRUITING MOTTO?

If so, it sounds a chilling note for aligned goals and customer-supplier relations. It also telegraphs a sour message to those young people the industry will need for the future. Perhaps the oilfield should adopt from **Dante** a new recruiting motto:

"Abandon all hope ye who enter here".

OILFIELD BLUES '99

The foregoing is not to ignore the very real woes of producing companies. After a year of routine announcements of record profits, the tide has turned 180 degrees. **Shell Oil's** net income for 1998, excluding special items, fell $1,160 million from 1997 to $730 million—a 61.4% plunge. **BP Amoco**, now reporting in the aggregate, also took a hammering. Replacement cost operating profit for the new goliath's E&P activities fell 50% to $3,162 million, after adjusting for special charges. **Texaco** reported a 50% decrease in income for '98 and a whopping 80% plunge for the 4th quarter. **Phillips** lost $210 million in the 4th quarter, compared with $210 in net income for the same period in 1997.

And a recent survey by IPAA found that more than 136,000 oil wells and 57,000 natural gas wells have been shut in since November 1997. These shut-ins, IPAA says, represent 41,000 lost jobs and a monetary loss of $25 billion over the past 14 months.

OUT OF BALANCE

These sobering results are the product of a global oil bubble, an apparently harmonized supply-demand relationship thrown suddenly out of balance. So explains the 1999 edition of "World Oil Trends", a joint study by **Cambridge Energy Research Associates** and **Arthur Andersen**.

The study found that while oil demand increased in 1998 (for the 15th consecutive year), it was the smallest increase since 1985. The increase amounted to a mere 0.24 M bbl/day, only 0.3% above 1997 levels. To no one's surprise, the study showed that demand fell by 2.1% in Asia Pacific. In North America, demand growth was a sluggish 1.0%, largely due to inventory carry overs from the warm winter.

Meanwhile, supply of world crude oil and natural gas liquids reached an all-time high of 72.75 MM bbl/day, the study showed. The dubious credit for this new record goes to OPEC, and, in particular, to Iraq, that unfortunate, Saddam-ized nation. Iraq's 0.96 MM bbl/day production increase in 1998 boosted the OPEC average to a 19-year high of 27.84 MM bbl/day. (Production fell in 7 of the other 10 member nations.)

The worst may lie ahead, according to CERA President **Joe Stanislaw**. At the study's mid-February unveiling, he indicated he believed oil prices had not yet bottomed out.

Also, a new report by the **World Bank** published in February said that commodity prices injured by the Asian crisis, including oil, wheat, cotton and aluminum, may never fully recover.

THINKING UNTHINKABLE

In the E&P sector, the painful process of restructuring has begun—layoffs, mergers, retrenchment in capital expenditure. However, in today's industry, previously honed by years of hardship, most of the easy solutions may already have been achieved.

The challenge that lies ahead, claims Mr Stanislaw, is nothing less than a full overhaul summed up by 4 "Rs"—restructure, retrench, retool and rethink. "This is more than a cyclical event," he said. "This is a structural change in the industry."

A year ago, mergers on the scale of **Exxon/Mobil** or **BP/Amoco** would have inspired guffaws. The shape of future restructuring efforts could prove even more exotic. Combinations of state-owned and privately held producers might not be too farfetched, Mr Stanislaw said.

We must, he said, "think the unthinkable."

DRILLING CONTRACTOR

CAPITAL WIRELINES

Brian T Petty
Senior Vice President-Government Affairs

US OILPATCH CRISIS

(Washington)—**IADC** and other E&P trade associations have organized the Public Land Cooperating Associations Forum to address the current crisis in the onshore US oilpatch, and to respond to regulatory challenges presented by Federal and State authorities.

One of the forum's first tasks is to respond to the **US Department of the Interior's Bureau of Land Management's** comprehensive re-write of its oil and gas rules for drilling and production on US public lands. Drilling contractors will be represented in the effort by **Steve Adam** of **Nabors Drilling** and **Leroy Peterson** of **Peterson Drilling**.

IADC was invited by the **US Department of Energy** (DOE) to present its views on the impact of low oil prices on drilling contractors. IADC's **Brian Petty** met with **Bob Gallagher**, Special Executive Advisor on Oil & Gas to DOE Secretary **Bill Richardson**, and with Acting Assistant Secretary for Fossil Energy **Bob Kripowicz**. DOE was expected to release its recommendations for legislative and regulatory relief in February. These are drawn from suggestions by industry and as the result of visits to oilpatch centers such as Bakersfield, Calif, where DOE's Gallagher met with then-IADC Government Affairs chairman **Gary Green**.

In addition, hearings on the crisis in late January by the Senate Energy and Natural Resources Committee highlighted the urgency of the situation, and suggested possible federal actions to aid the industry. **Rowan Drilling** CEO **Bob Palmer** testified at the specific request of Committee Chairman **Murkowski** (R-Alaska).

IADC joined a mid-March "Crude Awakening Call Up" organized by IPAA to bring the oil price crisis message to Congress and the Administration. Producers and contractors from 33 producing states were expected to come to Washington to promote a relief plan adopted at an "Oil Price Crisis Summit" hosted recently by Oklahoma **Gov Frank Keating**.