EDITORIALS

From the Chairman

DARKEST BEFORE THE DAWN

JUST WHEN YOU THOUGHT it was safe to get excited about your business, the bottom falls out. Oil prices have plunged to 50-year lows. We talk about $12 oil, but according to the **American Petroleum Institute**, wellhead prices received by US producers at year-end averaged less than $8/bbl—down 47% from December 1997. Not surprisingly, producers have suffered sharp drops in earnings for 1998. The impact on drilling budgets has been predictable. So far, we have seen 20%-25% declines, with the possibility of even deeper cuts later in the year.

Bernie W Stewart, Chairman

The drilling industry's chief thermometer, the US rig count, plunged to a record 588 rigs in January, breaking the previous nadir of 592 active rigs, set in 1992—not so very long ago. According to API, US well completions fell a precipitous 26% in the 4th quarter of 1998, compared with the same period in 1997. Even more telling, oilwell completions dropped 45%.

1998's El Niño-spawned warm winter played a big role in depressing energy demand. The opposite effect, a sharp cooling spawned by El Niño's little sister, La Niña, was anticipated in many quarters to have a salutory effect on energy prices. So far in this warm winter, though, La Niña has been decidedly underwhelming.

There's no question that the short- and medium-term outlook is gloomy. But at the same time, there is reason to be optimistic beyond the next 12-18 months. First, the IEA forecasts that oil demand will grow 1.1 M bbl/day (1.5%) in 1999. This is more than triple the anemic 0.4 M bbl/day growth we suffered through in 1998.

The world is already on a collision course with depletion. The current drilling doldrums brought on by low energy prices will just hasten this event, because without new drilling, there just ain't new reserves, folks.

Oil supplies outside OPEC are already shrinking. The **International Energy Agency** recently revised its forecast for growth in non-OPEC oil supply downward. The IEA says non-OPEC oil will average 45 MM bbl/day, up a slight 0.4 M bbl/day from '98. The retardation in reserve growth, the IEA says, is a result of cutbacks in the US, North Sea and the former Soviet Union. Stripper-well production in the US is all but entirely shut in.

One of the main phenomena differentiating this downturn from that of the 1980s is the narrow margin between oil supply and oil demand. In the '80s, demand stood at about 48 MM bbl/day, but supply outran that figure by more than 15 MM bbl/day. In other words, world available production exceeded demand by more than 30%. Conversely, in today's market, the supply overhangs demand by less than 5 MM bbl/day. This is less than 7% of the world's 72 MM bbl/day demand. It won't take long for that thin surplus to be consumed.

In the Gulf of Mexico, new wells produce as much as 50% of a reservoir's recoverable reserve in the first year alone. This is due to today's highly efficient drilling and completion techniques and the types of structures being tapped. As a consequence, production capability, despite the drilling boomlet of 1997-98, is flat or declining. Therefore, we must drill more wells just to maintain production, let alone increasing reserves.

The genius of market economics, especially as it relates to commodities, is the market's ability to correct itself from extremes of both low and high prices. Abundant supply and low prices spur demand. Supply tightens in response and prices rise, ultimately discouraging demand, and bringing the cycle to closure.

The upshot is that the gap between energy supply and demand is inexorably shrinking. It remains for us to not only manage our resources cautiously, but to retain a solid foundation upon which to grow when the inevitable—and I believe significant—upturn arrives. ■

From the President

LAWYER VS LAWYER

FROM ITS INCEPTION, the drilling industry has been one built on gentlemen's agreements. One's word was one's bond. However, developments of late indicate that integrity is fleeing rodent-like from the foundering ship of oil economics.

Rather than business agreements founded upon a firm hand shake, it seems contractual obligations today are in shaky hands.

Lee Hunt, President
(a lawyer, by the way!)

Under the pressure of low commodity prices, long-term commitments are being winked at. The lawyers are out in battalions, eyeballing every catch phrase in a drilling contract, in hopes of a technicality to exit the agreement.

This is not a historic first, of course. The era of gentlemen's agreements and of contracts scrawled on the back of an envelope went out in the 1940s. In their own defense, drilling contractors of the day heeded their own counsel and developed the first IADC Model Form Contracts.

Law is based on precedent. And unfortunately, attorneys seeking to wriggle free from lawful long-term contracts are setting a bad precedent. Wise legal counsel is today shirking wisdom.

Lawyers can litigate all they want. But once business decisions have been reached, business people must follow through on their commitments with integrity. The result otherwise is to turn a firm handshake into a shaky hand. ■