DRILLING CONTRACTOR

DRILLING AHEAD

Mike Killalea
Editor & Publisher

A lot has been happening lately, and little of it good. The precipitous plunge in oil prices has returned the industry to a state of crisis unseen at least since 1992, when the US rig count set an all-time record low.

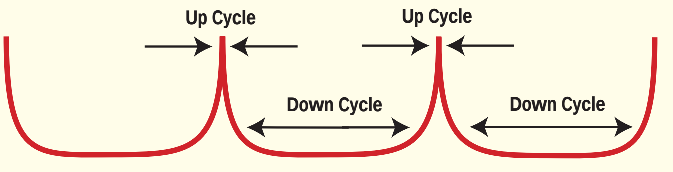
Black humor is rearing its head. One of the stories has it that the petroleum industry is on a 12/12 cycle: 12 months of prosperity, 12 years in the toilet.

Attitudes are grim, though. At best, audiences favor that joke with tight-lipped smiles. This is less a reflection on the quality of the witticism itself, but instead a gnawing fear that it just might be true.

THE U-SHAPED CYCLE

I have concluded that E&P fortunes predictably follow a U-shaped cycle. The U-curve is characterized by fast and furious spikes of frenetic activity followed by long and miserable craters in oil prices and rig count. (This curve was devised in jest, but actually tracks the course of stock prices for the oil-service sector. Stocks sharply peaked twice in 20 years, once in 1981 and then again in 1997.)

Figure 1: Killalea's E&P U cycle curve



Source: The story of my life.

OPERATORS RETRENCH

Operators are wasting no time retrenching in the face of price adversity. The recently released 1998 Arthur Andersen Outlook Survey found that 80% of majors and 56% of large independents plan to decrease US exploration spending. On the other hand, 46% of respondents plan to increase their domestic development spending, including a third of large independents and 54% of other independents. Internationally, an identical 80% of the majors and 31% of large independents responding plan to decrease exploration spending outside the US. Even worse, 40% of the majors and 38% of the large independents also plan to cut non-US development spending in 1999, the survey found.

As for employment, 79% of Arthur Andersen respondents believe E&P employment will fall in 1999. This is 180º out of sync with the 1997 results, in which 90% of respondents expected employment to increase. Further, only 33% said they are currently suffering from a shortage of skilled personnel, compared to 59% in the 1997 study.

NO RIG SHORTAGE SEEN

In stark contrast to the fears of rig shortage that characterized the last couple of years, operators are now confident that the supply of drilling equipment will be more than adequate. An overwhelming 84% of respondents said they did not expect a shortage of offshore rigs in the US this year. And a whopping 93% said there would be no shortage of US land rigs.

This, of course, operators would view as a bright spot. Contractors have a different view.

Respondents' estimates of the average low rig count for 1999 stood at 698. In comparison, the average low for 1998, as estimated in the 1997 study, was 892 rigs.

CONTINUED LOW OIL

The operators surveyed also had little optimism that oil prices would pick up

CAPITAL WIRELINES

Brian T Petty
Senior Vice President-Government Affairs

EU WORKING TIME DIRECTIVE (Brussels)—In a remarkable victory for IADC and its oil operator and contractor allies, the **European Commission** accepted virtually all the offshore industry's recommendations to be included in the new Framework Working Time Directive. In its announcement of the proposed new Directive, the Commission indicated how it will apply to offshore work, formerly "Other Work at Sea". Of utmost importance is the Commission's recognition that the Member States should have broad powers of derogation "with appropriate use of flexibility clauses built into the Directive to take account of operational and safety requirements."

With that said, insofar as offshore workers are concerned, they would be subject to an annual limit of 2,304 working hours, entitled to 4 weeks annual paid holiday, entitled to appropriate rest breaks, and night workers entitled to health assessments. The Commission conceded that annual leave could be rostered in, and that special circumstances may warrant working hours' extension "in the case of activities involving the need for continuity of service or production". Offshore work is defined as "work performed mainly on or from offshore installations (including drilling rigs), directly or indirectly in connection with the extraction or exploitation of mineral resources and diving in connection with such activities, whether performed from an offshore installation or a vessel." This definition was taken directly from the recommendation of the offshore industry's Work Time Work Group, in which IADC has been active since its inception nearly 6 years ago.

The industry has many to thank for prevailing in the view that offshore work is unique and requires the broadest latitude in its design, but special thanks are due DGXVII, the Energy Directorate in the Commission, which was an active advocate for industry in the tough negotiations with DGV (Social Affairs). With the release of the Commission's proposal, the hard work of ministerial politics begins. Potential problems could arise in the European Parliament, where the trade unions wield considerable influence and which have criticized the Commission as being too deferential to the offshore industry. Nevertheless, under the existing EU constitutional authority, the Commission and EU ministers can, essentially, ignore Parliament. However, when the new EU constitution under the Amsterdam Treaty comes into force (expected in late 1999), Parliament will be given much stronger powers including the ability to change or reject Commission proposals. Thus, IADC has sounded the alarm to its members located in the EU to press their host governments to settle the offshore work proposal early in the year, rather than leaving it to a new Parliament to reconsider.

IADC was invited to a meeting of the **UK Department of Trade and Industry** (DTI) in early December 1998 to inform the UK Government of industry's reaction to the Commission's proposal. The meeting was also attended by representatives of UKOOA, BROA, IMCA, IAGC and OCA. The group urged DTI to press for a few slight technical corrections in the Commission proposal, and to urge Brussels to accept the proposal as early as possible.

Brian T Petty can be reached at:
1/202-29300670 • fax, 1/202-873-0047 • brian.petty@iadc.org.

soon. Respondents said they expected the West Texas Intermediate benchmark to average $16 in 1999, $17 in 2000 and $19 in 2003.

SCORE SLIPS

Global Marine's SCORE benchmark (Summary of current Offshore Rig Economics) also slipped. In November, the most recent data available, SCORE to 56.0%, a 2.1% decline from October. SCORE is a measure of dayrate relative to new-rig construction costs. Dayrate declines were noted in Southeast Asia, West Africa and the US Gulf of Mexico. North Sea dayrates remained relatively flat, according to Global Marine.

THE GOOD NEWS

There is good news in the Arthur Andersen survey, though, mostly centering on natural gas. Arthur Andersen describes industry expectations on natural gas as "bullish", noting that 55% of respondents expect the price of the commodity to increase 2%-4% annually. The survey participants predicted that Henry Hub natural-gas spot prices would average $2.25/Mcf in 1999, $2.30 in 2000 and $2.49 in 2003.

We can perhaps make lemonade from the lemons of another survey observation—that mergers and acquisitions would continue in 1999. It's hard to imagine anything that might top the **Exxon-Mobil** merger of the millenium. Who's to say, though. Maybe **Saudi Aramco** could buy Iraq, or **Azerbaijani International Oil Co** merge with **Petrobrás**. Farfetched, yes, but look what's already transpired.

Much has been written about the downside implications of oil-company mergers for the oil-service sector. Aside from the power of a larger customer to depress supplier pricing and to dictate operator-friendly contract terms, some aspects of the continuing merger fever could offer opportunity. First, assuming that streamlining and redundancy reduction is a goal of the merger, the merged company should then have relatively more funds, not less, available for exploration and development, which, after all, are its core businesses on the upstream side.

Layoffs are a regrettable and inevitable monument on the merger landscape. Reducing redundancy, as the euphemism goes, will widen the available pool of skilled personnel (and hopefully the service firms can avail themselves of these talents). It also widens the already ajar door for outsourcing—incentives, turnkey, partnering and so on. Service firms ingenious and energetic enough could carve out niches for themselves as oil-company handmaidens for well design, drilling and so on.

HIGH-PRICE BLUES

It wasn't too long ago that some were telegraphing warnings that the greater threat to the industry was not low oil prices, but high.

Those folks should be relieved these days. With oil hovering at or below the $11 mark, no one can complain that the commodity is over valued.

Still, those who sang the high-price blues not so long ago have a point. High prices are the bane of demand growth. Conversely, low prices feed demand. As a result, the price fluctuations in the E&P industry that drive our inevitable cycles are self-correcting. When prices become too high, demand sloughs off, which drives down prices, which spurs demand, which increases prices. And so it goes.

Admittedly, this current downturn was prompted more by the economic downturn in Asia and by other freak circumstances, such as El Niño. El Niño is history, and there are signs that the Asian economies are recovering, albeit slowly. (In his editorial [p 11], IADC Chairman **Bernie W Stewart** eloquently outlines 3 causes for optimism, the slow Asian rebound among them.)

There is other evidence that this downturn will be shorter than many in the past, including the horror years of the mid-1980s. First, the world is far less awash in surplus petroleum than it was during the horror years of 1986. Surplus oil then equalled far more than a third of demand. Now, it hovers around 2%-4%. It is surprising just how far that thin margin can depress prices.

Also, producers in the early '80s, were much slower to cut back on CAPEX spending than today. As **Len Paton** of **Chase** pointed out at a recent Oilfield Breakfast Forum in Houston, OPEC in the early '80s was able to manipulate oil prices and maintain them at an artificially high level. Despite the fact that production was far outrunning demand, producers did not slow capital expenditures, exacerbating the glut. Today, as the Arthur Andersen survey shows, operators are wasting little time in cutting back on programs, especially exploration.

COMMODITY PRICE DECLINES

Ultimately, though, we must realize that our industry is tied to the fate of a fickle commodity, which makes for a tenuous umbilical at best.

Further, it has been a hallmark of economic history that commodity prices decline over time. This theory, despite empirical evidence, is less unequivocal than, say the law of gravity. Still, the evidence bears a certain weight.

At the recent Deep Offshore Technology conference in New Orleans, which I enjoyed attending, **Shell Offshore** CEO **Rich Pattarozzi** observed that the industry's history has long been one of sagging oil prices. "Why should we expect it to be any different now?" he asked. And, for the time being, there's little reason indeed. ■

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THE IADC CONNECTION

You can reach IADC headquarters at:
1/281-578-7171 • fax, 1/281-578-0589 • info@iadc.org • http://iadc.org

IADC HOLDS 22 JAN SESSION ON NEW EPA RULE

An IADC meeting scheduled for 0900 Friday, 22 January 1999 at IADC Headquarters aims at discussing and sharing information and ideas on proposed **US EPA** rules to establish an emission control program for new compression-ignition marine engines rated at or above 37 kilowatts (50 HP). Engines aboard US-flag marine vessels used for propulsion or auxiliary purposes would be affected. However, portable engines (those for which the fueling, cooling and exhaust systems are not integral parts of the vessel) are not included. However, portable engines must meet the non-road standards for onshore operations. As proposed, the rule would not apply to non-US flag vessels, irrespective of where they might be operated, but would apply to US flag vessels operating worldwide.

EPA made substantial changes to their original proposal in response to comments submitted by IADC. Most of the changes suggested by IADC were associated with "policy level" issues aimed at maximizing consistency between the EPA rules and MARPOL Annex 6 and the IMO's NOX Technical Code.

For more information, call **Alan Spackman**.

'99 CONFERENCE LINEUP AVAILABLE

Check out IADC's conference lineup on page 17. This year's calendar focuses on virtually every topic of interest to those involved in the global drilling industry—technology, well control, contracts and risk management, taxation, HSE, market trends, management and more.

- **HOTEL ALERT:** If you're interested in attending our 1999 IADC Directors and General Management Conference, please note that the hotel cut-off date is 20 Jan. Don't delay in making reservations!

MMS REGIONAL DIRECTOR LAUDS DEEPWATER GUIDELINES

Speaking at the 1998 Deep Offshore Technology conference in New Orleans, U**S Minerals Management Service** Regional Director **Chris Oynes** praised the IADC/OOC Deep Water Well Control Guidelines as an outstanding example of the industry working to improve safety.

"We were involved in that, but it was basically IADC's effort," he said.

Mr Oynes cautioned that one major incident in deep water could "kill the goose that lays the golden eggs". ■