Drill fast, safe and friendly with incentive contracts

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INCENTIVE CONTRACTS ARE achieving success around the world. Higher quality wells are being delivered for 10% to 30% lower cost. Successful incentives come in many forms. They range from a simple “thank you” for a job well done to a promise of future work or monetary payments. People involved with successful incentive programs all agree on the reason for success. Incentives create an environment where it is in the best interest of individuals, departments, service companies and contractors to co-operate. Incentives focus everyone’s attention on clear targets relating to cost, productivity, quality, reliability, safety and environmental concern. The most effective incentive contracts are short, easily understood and based on trust. Lengthy legal contracts attempting to be “completely fair” and covering all possible contingencies must be avoided. Incentives that consistently work the best are easily understood by rig crews and service company personnel. Rewarding achievement of mutually agreed targets unlocks the potential of people at every level in an organisation.

The most effective incentive programs make awards based on delivering a high quality product at lower cost. For example, a quality measure is minimum formation damage so each well produces without the need for costly stimulation. Another quality measure is good cement bonding effecting isolation between reservoirs. The money to pay the incentive comes from drilling the well ahead of schedule and under budget. If the well is over budget, no money is available to pay an incentive bonus even if quality targets are met. When the well is under budget, bonus money is paid as a percentage of the quality targets achieved.

KEY SUCCESS FACTORS

There are at least ten key success factors required to implement effective incentive contracts. Incentive programs missing one or more of these key elements may fail to provide meaningful performance improvements. Erratic results have given incentive contracts mixed acceptance in the oil industry. What follows is a discussion of each of the ten key factors and why each one is so important to the success of any incentive program.

Clear Business Objectives. ADCO drills wells to produce oil and gain information about the reservoir. Drilling wells quicker without meeting these two objectives is unacceptable. Drilling wells quicker without being safe is also unacceptable. The payout of any incentive award is conditional on gathering good quality reservoir information and delivering a wellbore capable of high productivity with a defect free completion. Failure to safely deliver a quality well results in the drilling team losing all or part of the incentive award even if the well is finished ahead of schedule. The finished well must meet or exceed customer expectations before money accumulated in the incentive fund is paid out. ADCO’s expectations are simply stated:

• Protect the environment.
• Deliver quality well completions;
• Drill wells quicker;
• Operate safely;
• Take time to plan your work;
• Use correct tools for the job;
• Look after your own safety;
• Watch out for the safety of others.

Drill quicker means:

• Get all planned cores, logs and tests;
• No leaks in casing, tubing or wellhead equipment.
• Eliminate liquid discharge to waste pits;
• Prevent crude oil and diesel spills.

The importance of clearly defining business goals and expectations cannot be overstated. Without this understanding of business priorities, there is no founda-
Drilling Contractors • Contracts tend to be simpler instead of long term working relationships. Operator and contractor have common, continuous improvement.

Involv All Affected Parties Early. Traditional contracting relationships are characterised by “tell, you do” from the operator’s side and a “you call, we haul” attitude by the service companies. Incentive contracts encourage operators and service companies to move beyond these traditional work practices into a more co-operative relationship. It is worthwhile to look at operator, rig contractor and service company relationships to better understand why it is crucial to involve all affected parties early in the incentive plan process.

Traditional Adversarial Relationships. Traditional adversarial relationships share characteristics:
- Job awards based on lowest price competitive tender;
- Complex contracts used to allocate blame for failures;
- Contractors try to maximise profit per job income with add- ons;
- Operators try to minimise contractor’s invoice charges;
- Narrow communication channels exist between operator and contractor staff;
- Information treated as confidential or on a “need to know basis”;
- Even the simplest agreements are put in writing because operator and contractor staff don’t trust each other;
- Mistakes are buried or hidden from outsiders;
- Individualism is rewarded.

Cooperative relationships. Cooperative relationships share characteristics almost the opposite of adversarial relationships. Their main advantage over adversarial relationships is to better stimulate the working environment to create opportunities for innovation and continuous improvement.
- Operator and contractor have common, shared objectives;
- Long term working relationships are common;
- Contracts tend to be simpler instead of trying to cover all possible contingencies;
- Operator pays for results, not the amount of contractor effort;
- Operator and contractor share risks and rewards;
- Organisation admits to and learns from mistakes;
- Information flows freely between individuals, across organisations and between companies;
- High levels of trust between team members who believe that each person will competently do their job;
- Teamwork is rewarded.

Cooperative relationships take a long time to build trust between individuals. This is especially true for individuals who have previously operated in adversarial environments. Getting all parties involved early is the surest way to build the trust and understanding needed to realise the full benefits from any incentive program.

Easily Understood Incentive Targets. There never seems to be a shortage of volunteers willing to help set incentive targets. Everybody wants to get involved. Suggestions generally range from complex systems of measuring success to the best way to punish contractors for failures. Two points to understand about incentive targets are critical. First, it is always in the operator’s best interest to have contractors get an incentive bonus. When the contractor “wins”, so does the operator. Designing incentive targets where the contractor’s risk of losing is greater than the reward is no incentive. Second, the targets must be easily understood by everyone involved in the incentive program without a detailed explanation. Too often targets have so many contingencies attached, no common understanding or interpretation is possible. This leaves the awarding of an incentive bonus open to the discretion of operator’s staff. Set clear targets and measures against these targets. Ideally, the operator will not have to decide if a bonus should be awarded because the award mechanism is unambiguous. Furthermore, the operator should not exercise discretion in the award by invoking an overriding contract clause. The people at rig site should know immediately if they met the targets or not.

ADCO’s incentive is funded by time saved against plan. Alternatively, money saved against budget can be used to fund the incentive award. The argument in favor of budget driven incentives is to avoid contractors getting an incentive award if the well is drilled over budget. Off-setting this possible disadvantage are two major advantages of using time-based targets. First, time-based targets are simple for the operator and rig teams to set and measure. Second, time-based targets give instant feed-back to the rig crews and service companies if they are ahead or behind schedule. Using money saved against budget is generally not known accurately for months after a well is finished. By then, it’s too late to do something to correct poor performance. Time based incentive targets give immediate feedback on actual vs planned performance.

Single Incentive Plan for All Participants. This is probably the most controversial key success factor. The argument against a single incentive plan for all participants has to do with fairness in allocating blame when things go wrong. The more traditional the organisation, the stronger the proponents in favor of incentive plans that encourage individual performance at the expense of teamwork.

Here is an example of how allocating blame discourages teamwork. Suppose that during the well completion, the liner cementing job fails and the liner lap has to be squeezed. Because the well is still completed ahead of schedule, an incentive bonus is earned. The cementing company is blamed for the liner lap failure and they receive no bonus. The rest of the service companies and the rig contractor receive a bonus. Some people say this is fair to all parties. Now consider these additional facts. The mud company saved on mud materials by weighting up with drill solids. The mud was in poor shape with high solids contributing to a thick fluffy filter cake. The drilling supervisor decided against running all the centralisers on the liner due to the poor hole conditions. The liner was run successfully to bottom. The service engineer restricted the circulation rate to five barrels per minute to prevent packing-off and premature setting of the liner hanger. The cementing company batch mixed and pumped the slurry per program, but the displace rate was limited by slow mud delivery from the rig tanks. The cement channeled, resulting in poor bonding and a liner lap leak.

Obviously the operator is the biggest loser in this example. Nearly as big a loser is the cementing company who got blamed for the failure when they were not at fault. The trouble with allocating blame is that team members are discouraged from helping each other for fear of being in-
Each quality measure is crucial to the long term success of a well. Each is simple to measure at the rig site although determining zone isolation is subjective, based on bond logs. Business priorities can vary from field to field and company to company. Choose simple quality measures that best represent the most important business priorities.

Monitor and Communicate Progress Frequently. An important part of any incentive contract is to frequently measure and communicate progress towards achieving targets. In this way, each team member sees how their daily decisions affect overall performance. Time vs depth curves on the rig floor are a great reminder to the rig crews. So is a scorecard showing the achievement of quality measures. Advertise success to other rigs to stimulate higher performance. Often, just knowing someone else was successful is enough to initiate success on another rig. Praise success and get more successes.

Reward Success Immediately. Reward people for success while the extra effort is still fresh in their mind. Awarding on a well by well or hole section by hole section basis works well. Quarterly or yearly awards have less impact. People tend to quickly forget the details of what they did. Any delay in the award loses impact. If crews are to receive a bonus, they should know as soon as the well is finished. The bonus doesn’t need to be paid that day but they need to know they earned it before the rig moves.

Adjust Targets as Experience is Gained. Incentives create an environment that defines business priorities, clarifies expectations, enhances planning and promotes teamwork. Performance improvements triggered by incentives are often substantial and well beyond even the most optimistic expectations. Both continuous learning and step changes usually occur. As performance improves, targets need to be tightened. Using a rolling average time for the last several wells is considered fair by both the operator and contractors. Be careful not to set targets so tight there is no longer an incentive for the rig crews and service companies to put forth extraordinary effort. As always, the operator stands to lose the most when incentive targets are not met.

Agree to Negotiate Differences. Keep incentive contracts simple and agree to negotiate differences. The simpler the contract, the better. Participants should give and take equally. Relationships built on trust and fairness will succeed.

Incentive Award Funding. Incentive award funding comes from drilling the well or completing the workover ahead of schedule. In the ADCO plan (Attachments 1 and 2), the operator contributes US $8,000 for every day ahead of plan. The amount chosen insures the rig crews and service companies see the award as significant. ADCO also realise substantial savings when the job is finished ahead of planned time. This creates a “win-win” situation for both the contractors and the operator. Incentive award amounts need only be perceived as significant by the participants. The actual amount will vary depending on local conditions. Larger awards than necessary are unlikely to further increase performance. Small awards may not be seen as worthwhile the effort required to achieve extraordinary performance. Getting the balance correct may require trial and error to see what works. Remember, it is much easier to increase the award than to reduce it. Start off with the minimum amount considered significant and increase upwards if necessary.

One word of caution when discussing incentive award funding. Some operator staff may take the position that drilling contractors and service companies are already paid to do their job. Why should the operator pay extra for what they are already supposed to be doing? The answer to this lies in understanding human nature. People get paid for meeting the basic job requirements. Extra effort on the job can result in promotion or special recognition, but there are no guarantees. There may also be peer pressure not to exceed the acceptable standard of performance. Although service companies have had incentive bonuses for years, the system generally works against the operator. For example, staff are rewarded for the number of sacks of mud materials used or the number of feet of hole logged. These types of incentives are “win-lose” in favor of the contractor. It is in the operator’s best interest to make incentives “win-win”. During incentive award funding discussions, it is best to accept that wages compensate for average effort and incentive bonuses compensate for extraordinary effort.

Incentive Award Payout. Setting the conditions of the incentive award payout is straightforward based on business priorities. Although incentive funds come from drilling wells quicker, incentive...
awards are contingent upon meeting a standard of quality acceptable to the business. Drilling wells quicker is necessary but not sufficient to merit a bonus. No incentive should be paid for wells that do not meet the needs of the business.

Under the ADCO incentive plan, money accumulated in the Incentive Award Fund is paid out only if the quality of the finished well meets or exceeds customer expectations. The incentive is paid on a well by well basis. A percentage of money is awarded for each quality target achieved.

- Awarded 30% for drilling planned trajectory in reservoir target;
- Awarded 30% for getting planned cores, logs and tests;
- Awarded 20% for achieving zone isolation between reservoirs;
- Awarded 10% for trying new tools and techniques;
- Awarded 10% for identifying and reporting lost time, nonproductive time and the inefficient use of men, materials and equipment.

If a lost time accident, unreported accident or a serious safety incident occurs, 100% of the incentive award is lost and no payout is made. If a serious spill of oily waste or trash is dumped at rig site, 25% of any incentive award payout is lost.

There is always some concern that the quality targets will not be met. The operator’s representative controls the job and always works to achieve them. The reality is that all the quality targets are generally achieved, but at the expense of taking more rig time.

Sharing Incentive Awards. Incentive awards are shared by the rig contractor and the service companies on a “no fault” basis. The split is mainly based on the contribution and the amount of impact each company has rather than the number of people employed or the value of their invoice. Determining the split can be controversial, so getting everyone’s opinion is useful. Each contractor and their staff must perceive the award as both fair and significant. If the potential reward is too small, there is little incentive to put forth extraordinary effort.

Incentive bonuses are divided among the staff depending on the company involved. Some companies include only those directly involved in the operation. Other companies include maintenance and warehouse staff to recognise the significant contributions they make behind the scene. The rig contractor includes the catering crew in the split. Some companies make the split equal for everyone. Some companies allocate according to salary or job grade. Whatever way it is done, make sure the staff agree that the split is fair.

Key individuals not currently included in the incentive award plan are ADCO staff. It is well recognised that drilling supervisors play a key role in drilling quality wells quicker. The engineers in the office also make major contributions during the planning of a well. Management makes a major contribution by creating a working environment that encourages innovation and change. If company policy allows, including these people in the incentive plan is well worthwhile.

SUMMARY

Effective incentive programs create an environment where it is in the best interest of individuals departments, service companies and the rig contractor to co-operate with each other.

Incentives create opportunities for innovation and continuous improvement.

Major performance improvements are achieved by challenging existing policies and procedures.

Incentives are an excellent way to promote teamwork between the operator, service companies and the rig contractor.

Clearly define individual roles and responsibilities so everyone knows what is expected of them and what to expect from team members.

The surest way to build the trust and understanding needed to realize the full benefits of any incentive program is to get all parties involved early.

Sharing incentive bonuses on a “no-fault” basis encourages teamwork and shared responsibility between all participants.

Understanding business priorities is the foundation upon which successful incentive programs are built.

Effective incentive plans define business priorities, clarify expectations, enhance planning and promote teamwork.

Measures of product quality must relate directly to business priorities.

Money is awarded for delivering quality wells that meet the needs of the business.

Effective incentive programs make awards based on delivery of a high quality product at lower cost.

Potential incentive awards must be large enough to compensate for people for extraordinary effort.

Time-based incentive targets give immediate feedback on actual vs planned performance.

Money for the incentive fund comes from drilling wells ahead of the planned target time.

Any incentive award is lost if there is a lost time accident or the well is not drilled safely.

Undistributed funds are retained by ADCO.

Putting incentive contracts to work is not a simple process. Incentive contracts fundamentally change the way people work together. Change that involves new ways of working is generally difficult. Incentive contracts require a great deal of time, understanding and management commitment to realise the full value for all involved parties. ADCO management understands this challenge and is committed to success; committed to drilling quality wells fast, safe and friendly.

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