RIG SHARING AGREEMENTS — A REVIEW OF SOME OF THE KEY ISSUES

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I. INTRODUCTION

For most oil and gas companies, drilling contracts are one of the most important contracts. Having use of a drilling rig is critical to any operator's exploration and development program. While drilling contracts always pose difficult issues, particularly in the area of risk allocation, the higher the day rate, or the longer the term, the more difficult the drilling contract can become. And when rigs are in short supply or a downturn in the economy makes a long term contract hard to justify, contracting a rig can be even more problematic. In such instances, energy companies sometimes consider using a rig sharing agreement. However, while rig sharing agreements can reduce the economic risk of committing to a long term drilling contract, such agreements can also significantly increase a company's risk if not carefully negotiated. Issues such as sharing of liability, when a transfer of the rig is effective, impact of a default by an operator, risk allocation, and practical operating issues are all magnified in importance when there is more than one operator involved. Consequently, while the drilling contract addresses these issues vis-a-vis the drilling contractor, the rig sharing agreement has to anticipate how the sharing parties will answer these questions.

In analyzing rig sharing issues, it is important to keep in mind that there are generally two different types of rig sharing agreements. The first type involves a situation in which two or more energy companies negotiate a drilling contract with a drilling contractor with the understanding by all parties that the term will be shared between them (or possibly others). With all parties involved in the negotiations, each party has the opportunity to try to negotiate contractual provisions that will fit that party's existing contractual approach (particularly with respect to structuring indemnity and insurance provisions to fit with their respective existing risk allocation programs). While this may not always be easy, addressing such issues prior to execution of the drilling contract and rig sharing agreement maximizes the parties' ability to develop a workable approach acceptable to all sharing parties.

The second type of rig sharing agreement involves the situation in which an energy company has entered into a drilling contract but thereafter, for one reason or another,[2] decides that it wants to assign a portion of the term to another operator.[3] In this situation, the assignee may be at substantial risk that the existing provisions of the drilling contract will not fit with its existing contracts or its existing approach to contractual risk allocation.

II. LIABILITY FOR PERFORMANCE AND OTHER COMMERCIAL ISSUES

A. No Joint and Several Liability

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[2] This can happen because an operator wants or needs to curtail its activities, or it can happen for a "good" reason, such as rigs being hard to get and the operator wanting to exchange its right to use the rig for an interest in another operator's project.

[3] If the entire balance of the contract is assigned, no sharing contract is necessary. The primary questions will be whether the consent of the drilling contractor is necessary and whether the assignor will be relieved of liability for future performance of the contract. It is only when the original party plans to once again use the rig (or wants the right to control its use at a future date) that a rig sharing agreement is necessary.

When two or more companies decide in advance to share a drilling rig, one of the most important goals is to make it clear that the companies do not intend to be jointly and severally liable to the drilling contractor[4] This is often an essential point for the sharing companies, and a contract may not be possible if the drilling contractor will not accept this premise.[5] Even if the principle of several liability is accepted, however, it is important to resolve questions during the negotiations concerning the obligations between each operator and the drilling contractor and the relative relationship of the operators between themselves.

B.Identifying the Responsible Operator and Clarifying Its Rights and Obligations?

Once the parties have addressed the issue of several liability, the next major issue involves making sure that the contract is clear as to which operator is liable to the drilling contractor at any particular time and what happens if there is a problem. The sharing agreement must address when each operator is responsible for the rig and how and when that responsibility is transferred between the two operators so that only one operator is responsible at any one time both as to payment and as to other contractual obligations. As to which company owes indemnity, or is itself entitled to indemnity, and for what risks, the answers may be different and are discussed in more detail later in this Article. Also at issue is what happens when there is a default on the part of one of the sharing parties — how does that impact the rights and obligations of the drilling contractor, the defaulting operator, and the other operator. And what if the drilling contractor is the defaulting party — what are the options available to the operator then using the rig (and what rights or input in such discussions will the other operator have).

1. Transfer of the Drilling Rig

One critical item in drafting the sharing agreement is to identify the moment at which one of the sharing parties becomes the "active" or obligated party under the drilling contract. Assume for a moment that the drilling contractor has finished work on a well for Operator A and is in process of mobilizing to Operator B's well site when a force majeure occurs. Who is responsible for payment of the day rate during downtime resulting from the force majeure event? What if the rig has been released by Operator A but mobilization to Operator B's location cannot begin because of a problem with the rig or because the vessels required for mobilization are delayed?[6] These issues are typically solved by identifying a clear point in time at which the other sharing party becomes responsible for complying with the obligations of the "Operator" under the drilling contract and accepting the associated risks. In many contracts, that transfer point is when the rig has completed the well, rigged down, and is a certain distance away from the well heading for the next location. Whatever the point in time, however, the parties must analyze and understand how they will make that transition, what notice is required, and how the transfer will be evidenced. Some of those questions may be answered in the drilling contract, but, as discussed further below, the notice requirements between the sharing parties

[4] This issue is significantly more difficult in an assignment type situation (in which the sharing party assumes responsibility for a well slot or a particular number of days in an existing drilling contract).
[5] When the parties are jointly entering into a long-term drilling contract, the primary reason for agreeing to share the rig is often the need to reduce each company's potential contractual exposure. Depending on the circumstances, one or both of the sharing parties may not have corporate authorization to assume potential liability for the entire term of the drilling contract.
[6] In this article, the terms "drilling rig" and "rig" are used as generic terms to describe numerous types of drilling rigs and the terms are intended to include drill ships. The type of "rig" that is being used will determine what is involved in demobilization, including whether towing vessels will be required

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