Drilling for Black Gold Under the Model Form Drilling Contracts[1]

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Synopsis

§ 9.01. Introduction.

This article discusses drilling contract provisions and case law construing those provisions.[3]

Specifically, this article focuses on three model form drilling contracts that were drafted under the sponsorship of the International Association of Drilling Contractors (IADC), a contractor-oriented organization, and one model form promulgated by the American Petroleum Institute (API), an operator-oriented organization. Notwithstanding the respective orientations of these two organizations, these forms have much in common. While these model forms are often used without amendments, experienced parties modify these forms to address specific problems encountered in prior drilling activity, or to reflect relative bargaining power. Although major oil companies and large independent oil companies often use their own operator-oriented forms, and large drilling contractors often use their own contractor-oriented forms, such forms typically contain many provisions that are similar, if not identical, to the model forms.

§ 9.02. Negotiating the Drilling Contract.

After an oil and gas lease has been acquired and geophysical work has been conducted, the operator (the party who has the legal right to produce oil and gas from a given tract) may elect to drill a well. The operator may be the original lessee of the tract to be drilled, an assignee-lessee, a farmee, a designated operator under a joint operating agreement, or, occasionally, a fee mineral owner. While an operator may drill a well with its own crew and equipment, a well is most often drilled by a drilling contractor: a person or entity engaged in the business of drilling oil and gas wells.

Generally, the operator will invite several drilling contractors to bid for the job of drilling a well at a specified location and to a specified depth in accordance with detailed technical specifications that are outlined in the bid invitation. Using this scheme, the operator is seeking offers to drill. Some negotiation of contract terms may be necessary before the operator accepts one of the bids, thereby entering into a drilling contract. In addition, depending on the specific provisions of the drilling contract, either the operator or the drilling contractor, or both, will contract with various service companies and supply companies for special services, supplies, and equipment that are needed to complete the drilling project. These services may include surveying and staking the location, preparing access roads, providing water for the drilling operation, setting surface casing, providing drilling mud services, providing testing services, surveying for drilling deviation, acquiring directional (whipstock) or horizontal drilling equipment, and setting production casing.

Large operators will employ a drilling manager or drilling engineer, whose primary job is soliciting and negotiating the drilling contract. Large drilling contractors will also have a marketing or sales person whose primary job is responding to solicitations and negotiating final drilling contract terms. Whether these agents have authority to execute the contract on behalf of their respective companies depends on individual company policy. The principal officers of smaller operators and drilling contractors often negotiate terms, and they usually have authority to execute the drilling contract.

Negotiators should have expertise in the technical aspects of well drilling and should be able to estimate anticipated costs accurately. The financial success of drilling contractors, and to some extent of operators,[4] may depend on their respective negotiators' bargaining skills and ability to identify, negotiate, and clarify accurately and completely the many risks and technical details inherent in a drilling venture.[5]

Even though most drilling contracts are executed on model forms, these forms are generally modified by the parties and contain many blanks for specifically addressing detailed technical aspects of drilling that need to be fully and properly completed by knowledgeable personnel.

Often the operator will be a farmee, a party to a letter agreement, or a designated operator under a joint operating agreement. In other words, other working interest owners may have an interest in the proposed well and may be expected to pay a portion of the drilling and completion costs. Accordingly, in negotiating a drilling contract, the operator must consider any contractual or other legal obligations owed to other working interest owners. The operator must be especially mindful of any contractually expressed deadlines or specifications for the commencement or completion of wells and of any limits on the maximum