Anticipated acquisition by Seawell Holding (UK) Limited of Noble Drilling (UK) Limited

ME/3503/08

The OFT's decision on reference under section 33(1) given on 13 March 2008. Full text of decision published on 28 March 2008.

Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Seawell Holding (UK) Limited** (Seawell) is a provider of contract platform drilling services to the offshore oil and gas industry. Its core business is platform drilling, engineering and well intervention (including upgrade and modification) services. Seawell's turnover during 2006 amounted to some £43 million.

2. **Noble Drilling UK Limited** (Noble UK) is also a provider of contract platform drilling, engineering and well intervention services. Its turnover in 2006 was £33 million.

TRANSACTION

3. Seawell is proposing to acquire the entire issued share capital of Noble UK from its parent company, Noble Corporation (Noble). For its part, Noble intends to withdraw from contract platform drilling in order to focus on its core activity: mobile offshore exploration services for oil and gas reservoirs.

4. Seawell submitted a Merger Notice to the OFT on 30 January 2008. The extended statutory deadline for the OFT to reach a decision is 13 March 2008.

JURISDICTION

5. As a result of this transaction, Seawell and Noble UK would cease to be distinct. The parties overlap in the supply of contract platform drilling

services and their combined share of such services provided on operational oil and gas platforms in the North Sea section of the UK Continental Shelf (UKCS) is above 25 per cent, and as a consequence the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

Product scope

6. Platform drilling services comprise the skilled manpower used for drilling and support services provided under contract by companies such as the merging parties for the extraction of oil and gas from wells underneath offshore drilling platforms. This market is competed for by tendering and bidding for drilling services contracts.

7. The platforms themselves and all drilling machinery (including derrick towers and other related equipment) are owned by the oil and gas companies who are the customers in this market. Demand for contract drilling service comprises:

    a. onshore management and support
    b. offshore drilling and maintenance
    c. maintenance and inventory management
    d. Health, safety and environment ('HSE') and risk management
    e. provision of third party services (equipment and personnel)
    f. procurement services
    g. logistics coordination
    h. consultancy, and
    i. engineering and modification of the drilling facility.

8. Seawell submits and third parties concur that all these types of contract platform drilling services are or can be bundled into one contract for the customer and therefore constitute one single product market.

9. There are currently 54 platform drilling facilities owned by 15 oil and gas companies on the UKCS. According to Seawell's estimates, only 14 of these platforms are currently in operational mode.

10. Operational mode is one in which the platform is resourced with a complete crew ('active string') of around 30 personnel who carry out drilling and other related services and thus form part of the wider complement of personnel working on that platform.

11. According to Seawell, aside from these operational platforms, the remaining 40 platforms are currently in either idle[1] or preserved[2] modes.

12. On the supply side, Seawell submits that providers of drilling services on mobile exploration rigs have the necessary skill set to be able to supply fixed platform drilling services. The main difference between mobile and fixed platform drilling services is that mobile drilling requires additional marine, piloting and technical expertise. From a demand side perspective, however, fixed platform drilling services and mobile rig drilling services are separate and different products.

13. On the basis of the evidence before it, the OFT has taken a cautious approach and considered that the appropriate product frame of reference for the purpose of this merger analysis is that for the supply of contract fixed platform drilling services. Mobile drilling services are discussed further in the section below on barriers to entry.

Geographic scope

14. Seawell proposes that the relevant geographic market comprises at least the UK. It submits that contractors active in neighbouring regions are also in a position to bid for platform drilling contracts in the UK and points to examples of successful entry into the UK by Norwegian contractors including Odfjell in 2003 and Seawell itself in 2004.

15. Customers, however, have told the OFT that it is essential for suppliers to have a national, or even regional, presence. In this regard, the OFT notes that both Seawell and Noble UK deliver contract services exclusively in the North Sea area.

16. Accordingly, based on the evidence before it, and without prejudice to the scope of the geographic market being wider, the OFT has taken a cautious approach and focussed its analysis of the impact of the merger on a narrow geographic frame comprising the North Sea section of the UKCS.

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[1] Idle mode is a term for relatively short periods of platform activity where no new wells need be drilled or where maintenance is being carried out. Drilling manpower is operationally downsized – typically to around seven personnel – but maintained in readiness for forthcoming work that specifically involves drilling.

[2] In preserved mode, exploitation of the oil/gas reservoir is either suspended or is no longer viable. No major drilling operations are carried out and the costs of platform maintenance are minimised by resourcing the facility with a crew of two personnel making intermittent visits.

HORIZONTAL ISSUES

Unilateral effects

17. A majority of customers and competitors contacted by the OFT during the course of its investigation concur with Seawell's proposition that the parties' combined market shares should be assessed using a proxy consisting of the number of active strings (see paragraph 10) on platforms that are in operational (as opposed to idle or preserved) mode. This is on the basis that the number of platforms being so serviced is an apposite working indication of potential revenue.

18. On such a measure, the merged entity would have seven (an increment of two) out of a total of 14 service contracts on platforms currently in full operational mode on the UKCS (a combined share of 50 per cent with an increment of 14 per cent). Of the other two drilling contractors in this region, KCA Deutag currently operates six active strings (43 per cent), the remaining string being operated by Odfjell (7 per cent).[3]

19. Seawell argues that competition between platform drilling contractors plays out through bidding processes. When contracts are put up for tender (the number for the whole of the UKCS typically being no more than one annually) all drilling contractors competent to provide services on the UKCS under the North Sea are invited to bid. Third parties have confirmed that all contracts are competitively bid in accordance with the EU Procurement Directive. [4]

20. The majority of third party comment also indicates that the key business factors that customers prioritise in awarding contracts are health and safety, organisational and engineering modification capability, personnel competence and operational excellence. One customer submitted that price competition is a consideration only if all of these criteria can be met in the first place.

21. On the majority of occasions where agreements provide for this, customers exercise the option to extend existing drilling contracts. The effect of this, given that contract extension is becoming increasingly prevalent, has been an overall reduction in the number of new platform drilling tenders; Seawell submitted details of a total of only nine such tenders for drilling services on the UKCS that have come up over the last eight years.

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[3] The parties provided market share data for the UKCS as a whole. In the absence of any suggestion to the contrary, the OFT has used this data (here and elsewhere in the decision) as a reasonable proxy for the market shares in the North Sea section of the UKCS.

[4] Directive 2004/17/EC - Coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors.

22. These bidding data indicate that the merging parties are relatively close competitors, and that the merger will result in a reduction of service providers from four to three. The parties were two out of four bidders on eight of the nine tenders. Some customers also commented that the parties are close competitors on the basis that they both have operational bases in the UK. However, one customer submitted that Noble has over the last 18 months been sending clear signals to the industry of its intent to exit the market for contract platform drilling services and focus instead on mobile exploration.

23. Customers have commented to the OFT that switching between the remaining suppliers of contract drilling services is possible although typically achieved at the time of a new competitive tender. In addition, competitors have remarked that switching is easy and that previously customers have sponsored new market entry by foreign suppliers. Seawell cites evidence of sponsored entry in the invitations to Smedvig (Seawell) and Odfjell to tender for platform drilling in the North Sea section of the UKCS. Odfjell was successful in securing a contract from Talisman in 2003 and Smedvig succeeded in securing a contract from Shell in 2004 (see section below on buyer power for more information on the potential to sponsor new entry).

24. One competitor was concerned that the merger could lead to an overall reduction in prices bid by competing suppliers in future tenders. Since such a reduction in price would be to the customers' advantage and since such an effect would be pro- rather than anti-competitive, the OFT does not consider this proposition to raise concerns.

25. None of the customers contacted by the OFT during the course of its investigation had any concerns regarding any potential adverse effects on competition as a result of the merger. The OFT places a relatively significant degree of weight on this particular absence of concerns given that customers in this market are typically large and sophisticated oil and gas companies, who are typically well placed to assess the potential impact on competition of a merger between two industry suppliers.

26. Nonetheless, in light of the potentially close competition that exists between the parties, and the fact that the merger results in a reduction in the number of current providers of platform drilling services from four to three, the OFT has taken a cautious approach and considered further below whether the prospect of entry or the existence of countervailing buyer power would be sufficient to offset any potential loss of competition arising from the merger.

Coordinated effects

27. Third parties concur with Seawell's proposition that the characteristics of the contract platform drilling business preclude the possibility of the proposed transaction facilitating coordination between the remaining competitors in this market. Third parties also confirm that there is a lack of transparency in the procurement process.

28. All customers agreed with the proposition that there will remain a strong post-merger incentive for drilling contractors to bid aggressively.

29. In addition to suppliers having no knowledge of the prices submitted in competing bids, service contracts are differentiated to the extent that they call for variations in the components listed in paragraph 7 and the available evidence indicates that there has been (with only nine contracts tendered over the past eight years) and will continue to be a lack of repeated interaction.

30. Given also that tender specifications are multi-dimensional – with customers prioritising a range of factors either ahead of or alongside price – scope for monitoring the bidding behaviour of rivals is limited. Finally, the available evidence does not suggest that Noble has acted as a 'maverick' in this market.

31. Overall, based on the available information, the OFT does not consider that the merger will increase the ability or the incentives of the remaining competitors to coordinate their commercial behaviour.

Barriers to entry and expansion

32. Evidence obtained by the OFT during the course of its investigation on barriers to entry is mixed.

33. The parties argue that barriers to entry are low for potential new entrants seeking to offer platform drilling services to oil and gas companies in the UK. In particular, the capital investment for the provision of such services is negligible. For example, Seawell submits that it required only £[-] of investment when it entered the market by securing a contract from Shell in 2004. One competitor, however, argued that set up costs are substantial and would take up to three years to recover dependent on the size of the operation.

34. The parties also argue that, in order to bid credibly for platform drilling services contracts, the main prerequisites are skilled personnel and a good reputation on the basis of experience and a proven track record.

35. Finally, the parties argue that mobile rig drilling operators and platform drilling contractors outside the UKCS are in a position to enter the market, and in doing so are able to achieve various synergies such as onshore and offshore personnel, management systems and overlapping clients.

36. Indeed, Seawell and Odfjell are both examples of recent entry in platform drilling services from neighbouring geographic markets. Odfjell entered in 2003 and Seawell entered in 2004 from Norway.

37. Notwithstanding these examples of entry, third parties argue that in current market conditions (where activity is declining and margins are low, particularly in comparison with mobile drilling services), there is relatively little likelihood of any further new market entry into the supply of contract platform drilling services.

38. On the evidence available to it, the OFT considers that while some barriers to entry may exist, such as reputation and experience, such barriers are clearly not insurmountable as evidenced by the relatively recent entry of Odfjell and Seawell.

Buyer power

39. The OFT considers that third party comment supports Seawell's submissions as to the existence of buyer power. Customers in this market are sophisticated and are able to manage the procurement process by devising contract terms on which they can lever their strong bargaining position – for example, by 'multi-sourcing' awards which gives them flexibility as to the number of active strings being used. As noted above (paragraph 23), Seawell also submitted that buyers are able to sponsor new entry, as illustrated by its own entry in 2004 in winning a contract from Shell, and that of Odfjell in 2003 in winning a contract from Talisman.

40. Seawell further proposes that when sophisticated buyers control the procurement process, the mere threat that a customer has the ability to widen the list of solicited bids can be sufficient to ensure competitive pricing (even if only a subset of potential contractors actually bid for a particular tender).

41. Comments from some customers concur with the submissions from the parties and competitors that customers can easily switch providers, and further that they can even sponsor new entry.

42. In light of the above, the OFT considers that the merged entity would be constrained post-merger by the countervailing buyer power of its customers, and in particular the ability of those customers to exploit their

strong bargaining position in tenders (for example, through 'multi-sourcing' awards), and also should the need arise to sponsor new entry.

THIRD PARTY VIEWS

43. None of the customers and competitors who engaged with the OFT expressed any concerns over the competitiveness of the market post-merger. All agreed with the proposition that there would be a continuing incentive for drilling contractors to bid aggressively in future. One customer pointed to benefits in the merger to the extent that it increased Seawell's portfolio of activity and gave it better scope to manage deployment of crews between platforms according to need (that than having to pay crews to be on standby for the lack of ability to deploy them elsewhere). Another customer saw an advantage in the merger removing the uncertainty of Noble's intention to exit the market. As already mentioned, one competitor commented that the merger could result in an overall reduction in prices bid by competing suppliers in future tenders.

ASSESSMENT

44. The parties overlap in the supply to the oil and gas industry of skilled manpower deployed in the provision of contract drilling services on offshore platforms.

45. Taking a cautious approach, the available evidence indicates that the appropriate product frame of reference to consider for the purpose of this merger analysis is that for the supply of contract platform drilling services and that the geographic focus of the OFT's analysis should be the North Sea section of the UK Continental Shelf.

46. A majority of customers and competitors agreed with a proposition that the parties' combined market shares should be assessed using a proxy consisting of the number of 'active strings' (see paragraph 10) on platforms that are in operational (as opposed to idle or preserved) mode. On such a measure, the merged entity would have seven (an increment of two) out of a total of 14 service contracts on platforms currently in full operational mode in the UKCS. Of the two remaining drilling contractors in this region, KCA Deutag currently operates 6 active strings, the remaining string being operated by Odfjell.

47. Despite the acquisition reducing the number of contract bidders from four to three, the OFT considers, on the basis of third party comments and in particular in the absence of third party concerns, that the merged entity will be constrained by the on-going buyer power of customers, in particular the ability of those customers to exploit their strong bargaining position in tenders (for example, through 'multi-sourcing' awards), and

also the ability to sponsor new entry in the event of the post-merger market failing to deliver on service and/or price.

48. All third parties agreed with the proposition that the market for the supply of platform drilling services will remain competitive and that a strong incentive will remain for the remaining bidders to bid aggressively. No customers or competitors expressed any concerns over the competitiveness of the market post-merger.

49. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

50. This merger will therefore not be referred to the Competition Commission under section 33(1).