

*"If a thing can be said  
it can be said simply."*  
Ludwig Wittgenstein



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## **Bargaining Power**

*Extracted from:*

*Fundamentals of Upstream Petroleum Agreements by C.P.Thorpe 2008*

*"Every battle is won and lost before it is fought." Sun Tzu, the Art of War*

The most important single factor in any contract negotiation is the balance of bargaining power. The question is: which party wants or needs the contract more, and what other alternatives do each of them have? The party with the better bargaining position will have the advantage in the negotiation and should be able to convert this into contract terms that are favourable to it. Historically in the upstream the party with the bargaining power has used it to impose its preferred terms on the other.

Bargaining position is primarily a function of the state of the market for the goods or services in question, and a significant imbalance between supply and demand can have the most striking effects on the balance of bargaining power. In 1980 high oil prices led to a record level of drilling activity in the North Sea and a huge demand for drilling rigs. An oil company wishing to charter a rig could not use the usual tendering procedure. If it could find any idle rig it had to accept virtually whatever contract terms the rig owner demanded, and charter rates for semi-submersibles rose to nearly \$100,000 per day. The oil price collapse of 1986 completely reversed the position.

So many rigs were idle that charter rates fell to around \$10,000 per day, and any oil company wishing to drill could effectively impose whatever terms they chose. With oil prices recently above \$100 per barrel, rig rates for semi-submersibles in the North Sea stand above \$300,000 per day.

Important as they are, market conditions are not the only elements in the equation. Other more personal factors also enter into it, a party's reasons for wishing to enter into the contract, its circumstances, expectations and attitude. Commercial necessity and financial distress can both force a party into a deal on terms which would not normally be acceptable. Similarly a party taking a particularly bullish view of the future will be keener to contract than market conditions alone might suggest.

Several times in my career as a negotiator I have been instructed not to do anything that would jeopardise the deal. Usually this was on the basis that announcements already made had led the markets to believe that the deal was as good as signed. An instruction to do a deal at any price can always be met, so this may sound like a good position for a negotiator to be in. But in fact a negotiator with these instructions is in a very weak position. Whenever the other party makes a “non-negotiable” demand, you have to accede to it. And if the other party realises this, the non-negotiable demands begin to proliferate.

There are many examples in the upstream industry of acquisitions where the buyer inquired too little, paid too much, and obtained insufficient contractual protection from the seller. This is usually because the buyer, having set its heart on the acquisition, fatally weakened its own bargaining position by depriving itself of the option to say no. Any number of personal factors like this may be operating to tip the balance of bargaining power one way or the other.

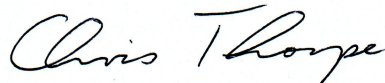
The aim in any negotiation is to maximise the advantage or minimise the disadvantage of your bargaining position.

Bargaining power is a relative matter rather than an absolute one. The question is not how much you want the contract, but whether you want it more or less than the other party, and while you will be aware of market conditions and of the strengths and weaknesses of your own position, you will not necessarily be aware of the personal factors affecting the other party.

Although you can be sure that you will hear about the strengths of his position, he will of course try to obscure its weaknesses.

So a negotiator should always try to look behind the other party's propaganda to the reality of his position, in order to establish where the balance of bargaining power really lies.

Bargaining power is intangible and not capable of being precisely measured. But it is very real, and experienced negotiators develop a very refined sense for it. The issue of bargaining power underpins the whole story of upstream agreements. It is the context that largely determines the outcome of every negotiation.



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