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Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk CT 06856-5116

Hans Hoogervorst, Chairman International Accounting Standards Board 30 Cannon Street London EC4M 6XH

Re: Exposure Draft Leases (File Reference No. 2013-270)

We appreciate the opportunity to comment on the Financial Accounting Standards Board (the "FASB") and International Accounting Standards Board (the "IASB") Exposure Draft, *Leases* (the "ED"). We are an international offshore drilling contractor that provides ultra-deepwater drilling services to the oil and natural gas industry. Shares of our common stock trade on the New York Stock Exchange.

In general, we support the Boards' efforts to improve financial reporting related to lease transactions. In particular, we believe financial reporting would be improved from current standards by removing any abuses of lessees structuring operating lease transactions to achieve off balance sheet treatment. Further, we believe the Boards have made positive changes from the previously issued Exposure Draft on Leases in 2010 (the "2010 ED"). However, as proposed, we have strong concerns that the ED's stated objectives for leasing standards will not be met. We believe there would be significant costs to preparers to implement the lease accounting proposed in the ED. Additionally, we question whether the financial user community, such as investors, credit rating agencies, etc., will benefit sufficiently from changes in the ED to outweigh those costs. We urge the Boards to conduct further research and field studies with impact analysis on the costs and benefits of the proposed changes prior to finalizing any new leasing standard.

Based on the 2010 ED and subsequent redeliberations of the Boards (including discussions on the IASB and FASB Staff Paper from the week commencing April 11, 2011 entitled "Definition of a lease – application examples" that provided example 4 related to application of the lease definition to a drilling rig), our primary concern in reviewing the ED is to understand the definition of a lease as applied to our drilling contracts. In our view, a proper understanding of the underlying economics of how our business is transacted and how our readers of our financials evaluate our Company makes it impossible to conclude that drilling contractors should be considered lessors. Notwithstanding, as discussed below, we are asking the Boards to consider introducing some additional clarity in the definition as it relates to the contract drilling industry.

We interpret the ED's proposed provisions to affirm that our drilling contracts, and drilling contracts in general, are not and do not contain a lease. Nevertheless, we are concerned there is sufficient judgment required in the ED that an alternative conclusion could be reached by those less familiar with the facts and circumstances of our industry and our Company that we will discuss below. If a conclusion was reached that our drilling contracts contain leases, we believe the resulting accounting under the ED would not portray a faithful representation of our results and financial position. This conclusion would add additional complexity and potentially confusion to our financial users in interpreting our financial reporting. Specifically, we're concerned that such a conclusion would make it necessary for us to provide

non-GAAP measures to remove any impacts in accounting from the leasing standard (as proposed) and reconcile to what is our existing revenue recognition model using GAAP as of today (prior to adopting the proposed standard).

Background on our Industry and Company

Within the offshore contract drilling industry in general, operators (e.g. national oil companies, major oil and gas companies and independent oil and gas companies) concentrate on finding and producing oil and gas. As such, operators generally hire a drilling contractor to provide the rigs, personnel and expertise to do the job of drilling offshore wells. Whereas the operator ultimately holds the rights to any oil and gas reserves discovered or developed for production as the result of the drilled wells, the drilling contractor provides a comprehensive suite of services, including providing the principal equipment necessary to drill wells, at a predetermined contractual rate as described in more detail below. In this way, operators and drilling contractors work together to ensure the well is drilled to specifications.

We provide services through our trained work crews' use of our ultra-deepwater drilling rigs and related equipment to drill wells for our clients. Our clients compensate us on a "dayrate" basis. In addition, we usually receive a lump sum amount at the start of a drilling contract for mobilizing the rig to the well location. Certain drilling contracts also provide a demobilization fee at the end of the contract. Under the provisions of our contracts for earning dayrates, we are essentially paid by the hour based on the performance of our drillship in accordance with a fixed operating dayrate. As specified in our drilling contracts, the operating dayrate is reduced for various performance scenarios, including, but not limited to, periods when moving the drillship, standing by while ready to drill and waiting on weather. Most significantly, we typically do not earn any dayrate during periods when our drillships are unable to perform drilling operations ("downtime"), such as when mechanical failure prevents drilling operations.

The wells we drill in offshore waters for our clients tend to be highly complex. The drillship we use to provide our services are also highly complex vessels consisting of many individual systems and sub systems each containing thousands of pieces of machinery, components and equipment. To drill wells to our client's specifications, comply with applicable laws and regulations, ensure consistency in our activities and, ultimately, achieve our goals as an organization, we have developed a structured management system that provides a framework applying to all of our business functions and operations. This system encompasses policies and procedures, organization and resources, supplier management, risk management, process management, continual monitoring, analysis and improvement, and system audits and reviews. Some areas to which we apply this framework include:

- Marine (safety of the crew, the vessel and the preservation of the environment)
- Maintenance (ensure rig equipment remains safe, reliable and fit-for-purpose at all times, including responsibility to maintain adequate tools and spare parts to ensure our rigs are capable of drilling)
- Drilling (casing, cementing, mud pump, mud tank and shakers, deck and crane operations, dynamic positioning)
- Well control (blowout preventers, well testing)

Our management system oversees all activities conducted on our drillships. A review of the activities we conduct on our drillships and our corresponding management systems clearly establish that we are responsible for day-to-day operations and maintain control over our fleet of drillships.

The conclusion above is also consistent with our current revenue recognition model that follows the economics of our operations. Under current accounting standards, we recognize revenue as earned based on contractual dayrates.

The following is a simple example of our revenue recognition pattern for illustrative purposes:

One of our rigs, Drillship A is contracted at a dayrate of \$600,000 for five years. During a quarter lasting 90 days, Drillship A experienced 10 days of downtime due to issues experienced on its subsea equipment. Drillship A conducts normal drilling operations for the remaining 80 days earning full dayrate.

We would record revenue of \$48 million (\$600,000 multiplied by 80 days) for Drillship A.

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." An entity would determine whether a contract contains a lease by assessing whether:

- 1. Fulfillment of the contract depends on the use of an identified asset.
- 2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response to Question 1

We believe the definition is overly broad and ambiguous. We recommend the definition be revised to exclude service contracts that can only be completed through the use of equipment from the scope of the ED.

The proposed definition of a lease is difficult to apply to the specific fact patterns we have provided above for our drilling contracts. Although we have determined the lease definition should not apply to our drilling contracts based on the ED, the ambiguity in the existing definition leaves open the possibility for an alternative conclusion that would not reflect the economics of our operations. Further, we find the five examples of applying these proposed requirements provided in paragraphs 842-10-55-7 through to 55-41 of limited use to the numerous varying situations to which they would be applied in practice by analogy.

The ED provides that "a customer has the ability to direct the use of an asset when the contract conveys rights that give the customer the ability to make decisions about the use of the asset that most significantly affect the economic benefits to be derived from use of the asset throughout the term of the contract" (842-10-15-10). Further, "a customer's ability to derive the benefits from use of an asset refers to its right to obtain substantially all of the potential economic benefits from use of the asset throughout the term of the contract. A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, consuming, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and by-products in the form of products and services" (842-10-15-15).

We do not believe the definition contains all necessary criteria to determine whether a contract contains a lease. We believe the "right to control the use" concept should also include criteria for determining who has the ability to control the activities that most impact the operating performance (e.g. productivity or utility) derived from the underlying asset.

This concept of control over operating performance also carries over in our view into issues with economic benefits. For our clients, the economic benefit of our services is potential production of oil resulting from a completed drilled exploratory or developmental well. For us, the economic benefit derived from the use of our assets is exclusively the payments of dayrates regardless of whether the completed well results in any potential oil production. The receipt of dayrate payments is always contingent on our operating performance due to the potential of downtime.

As a hypothetical example, if one of our drillships were to experience an issue with the marine, maintenance, drilling or subsea well control operating systems, resulting in downtime that lasted the duration of the drilling contract term, we would not receive any customer collections. Given this reality, we struggle to understand or support logic that suggests our drilling contracts could be construed as a lease, particularly since dayrate payments would not constitute lease payments as defined within the ED.

We are the party that most significantly controls the operating performance of the asset that directly and indirectly results in economic benefits to us and our clients, respectively. Given our control over operating performance and the

impact that downtime can have on our ability to earn revenue under the contract, we believe such concepts of operational performance should be incorporated into any final leasing standard.

The ED provides certain examples of decisions that could most significantly affect the economic benefits to be derived from the use of an asset including, but not limited to, determining or being able to change "any" of the following:

- a. How and for what purpose the asset is employed during the term of the contract
- b. How the asset is operated during the term of the contract
- c. The operator of the asset.

First, we do not believe if "any" of these criteria are met is sufficient to justify an automatic conclusion that the customer has the ability to direct the use of an asset. The assessment should take into account a consideration of all criteria. Secondly, we believe criteria "a" should be clarified or removed. For example, our clients generally direct us as to when and where to drill wells, although the location cannot deviate from the geographic area (e.g. list of countries, specific basins) specified within the drilling contract without our consent. This factor alone should not be a determining factor of whether our drilling contracts contain a lease. Although our customers designate the well location, we are contractually responsible for the operation of the rig and the safety of our crews, the rig and the rig equipment, including maintaining and directing the movement of our rig. Lastly, our view is that we, and drilling contractors in general, control and direct how their rigs are operated during the term of the contract. Our view notwithstanding, we suggest any final leasing standard would benefit from additional guidance for criteria "b" and "c". We believe the following concepts in existing GAAP from paragraph 840-10-15-6(a) are of relevance to "b" and "c" and should be incorporated into any final standard:

"The purchaser's ability to operate the property, plant, or equipment may be evidenced by (but is not limited to) the purchaser's ability to hire, fire, or replace the property's operator or the purchaser's ability to specify significant operating policies and procedures in the arrangement with the owner-seller having no ability to change such policies and procedures. A requirement to follow prudent operating practices (or other similar requirements) generally does not convey the right to control the underlying property, plant, or equipment. Similarly, a contractual requirement designed to enable the purchaser to monitor or ensure the seller's compliance with performance, safety, pollution control, or other general standards generally does not establish control over the underlying property, plant, or equipment".

Additional Comment

We believe the definition of a short-term lease should be modified to include only the non-cancellable period of the lease, which would be more consistent with the provisions for lease term. The costs and complexity of applying the provisions of the ED to leases that can be cancelled in the short term would far outweigh the benefits.

Conclusion

We believe offshore drilling contracts do not contain a lease. An illustrative example reaching this conclusion should be added to any final leasing standard.

Please contact us if you would like to further discuss our comments.

Respectfully submitted,

Richard Tatum, Director Financial Reporting

Paul Reese, VP Controller