September 3, 2013

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856

Dear Technical Director:

Thank you for the opportunity to respond to the Financial Accounting Standards Board’s (“FASB”) Exposure Draft on Leases (Topic 842) referred to herein as (the “Exposure Draft”). Our comments are specifically focused on the lessor accounting guidance outlined in the Exposure Draft, as it could have the greatest impact to both our Company and the oil and gas drilling industry as a whole. While we conceptually agree that some traditionally off-balance sheet lease structures should be reflected more prominently in the financial statements, application of the Exposure Draft to our drilling contracts would replace our current process of consistent and economically accurate revenue recognition with a complex model that negatively impacts the financial reporting process. Specifically, the proposed accounting model introduces unnecessary judgments and complexity into revenue recognition, reduces the transparency of our financial information, reduces comparability of financial information across our peer group, and significantly increases the manpower required to administer the proposed model suggested by the Exposure Draft.

Background

Noble Corporation (“Noble”) is a leading offshore drilling contractor for the oil and gas industry. We perform contract drilling services with our fleet of 79 mobile offshore drilling units located worldwide. Our global fleet is currently located in the following areas: the United States, Mexico, Brazil, the North Sea, the Mediterranean, West Africa, the Middle East, India, Asia and Australia. We maintain an advanced fleet and a highly capable, experienced workforce. Significant amounts of resources are spent by Noble, and our industry, to ensure that our crews are trained and capable to handle our highly complex rigs.

Under current accounting guidance our drilling contracts are not been deemed to be leases.¹ The industry generally applies a revenue recognition model similar to construction contracts whereby revenues generated from drilling and labor contracts are recognized as services are performed and revenues from bonuses are recognized when earned.¹¹ Revenues from our contracts require us to perform under the contract and are not based solely on the passage of time.
General Comments

While we understand the objectives of the FASB in releasing this Exposure Draft, we believe, as it pertains to the majority of our drilling contracts, the Exposure Draft is either not applicable or incompatible with the underlying economics of our transactions. We further believe this Exposure Draft, as currently drafted, would impair the overall quality of financial reporting for the drilling industry.

Our primary concern with the Exposure Draft deals with the ambiguity of the term “lease.” We are concerned that those who interpret this Exposure Draft will apply this guidance to items that are not presently deemed a lease. We fear this application will add complexity and inconsistency to our financial statements and will cause confusion to investors and users of financial statements because the Exposure Draft will be forced into situations where it will not portray the economic picture of an entity's business. We generally object to any accounting model, where equipment used in the delivery of construction services, would be considered a lease obligation of the client (or a lease receivable to the contractor).

Our basic business model is to construct wells for our customers. In very simple terms, our customers provide drilling location and well specifications, and we use our crews and equipment to provide well construction services. While we utilize highly technical equipment in the delivery of these well construction services, the services we provide are no different than other construction contractors building office buildings, roads, or other assets using highly complex machinery in providing services for their clients. Noble is not in the business of selling our rigs and our customers are not in the business of operating or buying an offshore drilling fleet.

In the offshore drilling industry, we currently utilize an accounting and disclosure model that provides investors and other users of our financial statements and transparency into our results of operations and financial condition. Industry analysts currently are able to accurately forecast expected results because of this model of transparency. We believe that application of the proposed Exposure Draft will severely hinder transparency because this model does not match the underlying economics of our typical transactions or business model and is heavily impacted by estimates and judgments which can vary widely from company to company within our industry. For these reasons, the standard, as currently proposed would make it harder for users of our financial statements to compare companies across our industry. Some industry analysts share our concerns and have already publicly expressed their concerns surrounding the impact that the Exposure Draft would have if applied to our industry.

It is within this general framework, we provide the following responses to the specific questions set forth in the Exposure Draft.
Response to Exposure Draft Questions


Response to Question 1:

The Definition of a lease in the Exposure Draft, including the determination of the ability to direct the use and receive the benefits from use of the asset as outlined in paragraphs 842-10-15-9 through 842-10-15-16, is overly broad and ambiguous.

Traditionally our drilling contracts have not been considered to be leases. With the release of the Exposure Draft there has been debate within the oil and gas industry as to whether our contracts qualify as leases. We do not believe our typical drilling contracts should qualify for lease accounting under the Exposure Draft and recommend that the FASB clarify guidance to address this concern.

The Exposure Draft includes the following two part assessment to determine whether a contract contains a lease: a) fulfillment of the contract depends on the use of an identified asset and b) the contract conveys the right to control the use of the identified asset as determined by the customer's ability to both direct the use and receive the benefits from use of the identified asset.

The following outlines the main points supporting our opinion that the majority of our drilling contracts do not convey the right to control the use of our rig assets to our customers and we therefore should not be considered a lease.

Under the majority of our drilling contracts, we provide drilling services and maintain the responsibility to direct the use of the asset during the term of the contract. In essence, we construct a well to the general specifications defined by our customers. We maintain primary control over planning and methodology used in performing the contracted work, including the execution of the drilling program. Our customers are responsible for specification of output, including determination of drilling locations and timing, and have representatives on-board who observe and inspect the performance of our activities. However, under the majority of our contractual arrangements, our customers do not have responsibility for the day-to-day operations of our rigs. The Exposure Draft states that, "rights that give a customer the ability to specify the output of an asset... would not, in isolation, mean that a customer has the ability to direct the use of that asset." In our opinion, our customers' involvement in the determination of drilling location and timing are equivalent to specification of output.

The Exposure Draft implies that a customer's involvement in the design of the asset may be indicative of the customer's ability to direct the use of the asset during the term of the contract. In our opinion, this is not the case as it relates to our rigs. While our customers may be involved in the design of certain newbuild rigs or upgrade/suitability projects, this involvement does not transfer our ability to direct the use of the rig throughout the term of
the contract. As outlined previously, we maintain primary control over rig operations and maintenance throughout the term of the majority of our drilling contracts.

Although our customers derive the potential economic benefits from our drilling services (the potential production of oil and gas once the well is complete), we do not believe our typical drilling contracts convey the right to economically benefit from the use of the asset itself. While our asset is important to the process, it is the combination of the asset and our highly trained crew’s ability to utilize the asset which determines the success of our contracts.

Because under the majority of our contracts, customers do not have the ability to control the operation of the asset, nor the benefit of the use of the asset in isolation, we do not believe our drilling contracts meet the criteria of a lease outlined in the Exposure Draft.

To clarify the ambiguity within the Exposure Draft related to the determination of the customer’s ability to control the use of the asset and the confusion regarding services which utilize capital intensive assets, we propose the following modifications to the Exposure Draft paragraphs 842-10-15-10, 842-10-15-11 and 842-10-15-16. These proposed changes would more clearly segregate the evaluation of the customer’s ability to direct the use of the asset (e.g. operational control or power) from the ability to derive the economic benefits from the asset’s use which has caused ambiguity in the analysis of classifying a contract as a lease in a situation such as ours.

842-10-15-10 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 and operation of the asset that most significantly affect the operating performance and economic benefits to be derived from use of the asset throughout the term of the contract.

842-10-15-11 Examples of decisions that could most significantly affect the economic benefits to be derived from use of an asset include, but are 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.

842-10-15-16 A customer does not have the ability to derive the benefits from use of an asset if both of the following occur:
   a. The customer can obtain the benefits from use of the asset only in conjunction with additional goods or services that are provided by supplier and not sold separately by the supplier or other suppliers.
   b. The asset is incidental to the delivery of services because the asset has been designed to function only with the additional goods or services provided by the supplier. In such cases, the customer receives a bundle of goods or services that combine to deliver an overall service for which the customer has contracted.
One might argue that the bifurcation of a contract into its leasing and service component would address the concerns noted above, but bifurcation of our drilling contracts into separate asset lease and service components does not reflect the underlying economic reality of the transaction and would not improve the quality of financial reporting. In our industry, we compete based on our demonstrated ability to drill wells in a safe and efficient manner. Providing a highly competent crew capable of operating and maintaining our advanced fleet, is the primary performance obligation underlying our drilling contracts. Separate evaluation of the asset and service components under our drilling contracts is not beneficial to either external financial users or internal management reporting and does not reflect the economic reality of the transaction. In essence, our contracts are analogous to a construction contractor who utilizes a large piece of machinery to complete a large construction project. Currently, the offshore drilling industry produces comparable financial information that is meaningful to the investing public, analysts, and other users of our financial statements. Bifurcation would severely reduce comparability across the industry, introducing significant judgments and estimates regarding the asset and service components of our contracts and will lead to ambiguity and complexity to the users of our financial statements.

Response to Questions 3 and 4:

The accounting model for Type A leases may result in accounting treatment that is not representative of the underlying contract economics. Further, the use of the concept of “insignificant” used to distinguish between a Type A and Type B lease is ambiguous.

For the majority of our drilling contracts, application of the accounting model for Type A leases is not reflective of the underlying economics of the transaction. We are not in the business of selling our rigs, and our customers are not in the business of owning and operating an offshore drilling fleet. An accounting model that effectively results in the transfer, for accounting purposes, of the rig assets from our books to the books of our customers is not reflective of the underlying business and economic transaction between the parties. As noted in our 2012 Annual Report, our business strategy is to be the preferred offshore drilling contractor by operating in a manner that provides a safe working environment for our employees while protecting the environment and our assets and by delivering exceptional customer service through a large, diverse, and technically advanced fleet operated by competent personnel. Stated simply, our strategic objective is to own and operate an advanced rig fleet.

Application of an accounting model that would effectively remove a portion of our fleet from the balance sheet, in-lieu of customer receivables, would be misleading and would not be representative of our financial position.
For that reason we recommend the following revision to paragraph 842-10-25-6:

If the underlying asset is not property, an entity shall classify a lease as a Type A lease unless one of the following two criteria is met:

a. The lease term is not a significant for an insignificant part of the total economic life of the underlying asset
b. The present value of the lease payments is not a significant portion of insignificant relative to the fair value of the underlying asset at the commencement date.

Like many offshore drillers we spend a significant amount of time and resources to build and maintain a fleet that is capable of drilling in difficult environments in a manner that protects the environment and the safety of those on board the rig. It is not unusual to have a newbuild rig be built for greater than $600 million with an estimated useful life of 30 years, with certain rigs lasting longer in practice (with modifications, upgrades, or other improvements). Contracts for the most technically advanced newbuilds often have a 5-10 year initial contract term. Offshore drillers have been known to commit to shipyard projects without an underlying contract. The building of a rig requires underlying financing in a manner that is efficient and effective in order to maintain a competitive advantage within the industry. By defaulting a majority of drilling contracts into the Type A lease accounting model (assuming we are classified as a lease), the Exposure Draft would dismiss the substance of the underlying transaction, resulting in non-meaningful changes to the financial statements that could negatively impact our ability to continue to raise capital and execute our strategic plan.

Response to Question 6:

While we do not believe our drilling contracts qualify for lease accounting under the Exposure Draft, the following discussion summarizes our interpretation of whether contractual day rates would be considered in measuring lease receivables, if applicable.

Paragraph 842-30-30-2 states that the lease payments included in the lease receivable shall consist of the following:

a. Fixed payments, less any lease incentives payable to the lessee
b. Variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate at the commencement date
c. Variable lease payments that are in-substance fixed payments
d. Lease payments structured as residual value guarantees (as described in paragraphs 842-30-55-1 through 55-2)
e. The exercise price of a purchase option if the lessee has a significant economic incentive to exercise that option (assessed considering the factors described in paragraph 842-10-55-4)
f. Payments for penalties for terminating the lease, if the lease term (as determined in accordance with paragraph 842-10-25-1) reflects the lessee exercising an option to terminate the lease.
Dayrates and other consideration outlined in Noble’s drilling contracts are variable based on performance and are dependent on the actual rig utilization during the contract term. For example, separate rates are typical for activities including mobilization, demobilization, rig moves, operating, standby, re-drill, repair, etc. The rates are negotiated for each contract with our customers and can vary from 100% of full operating rates to zero. Because payments are variable based on performance, payments under our drilling contracts should be excluded from initial measurement. The Exposure Draft notes that variable lease payments are recognized in profit or loss in the period in which that income is earned.xvii

Response to Question 10

By not providing for a different approach for related party leases ("RPLs") the Draft creates an additional burden on Companies who will be forced to account for RPLs under legally enforceable rights when the economic substance of the transaction may be to satisfy a specific business requirement.

As has been noted above, we operate in a number of jurisdictions worldwide. Our fleet consists of a number of mobile assets that often work in different jurisdictions based upon customer demand. Because of this we often operate internally under bare boat charters ("BBCs") to allow us the flexibility to change jurisdictions to meet customer demand. By classifying these items as RPLs under the Exposure Draft we will have an additional burden of creating a full lease accounting guidance for something that was created for mere convenience of transport.

We believe an economic substance model would be a more appropriate standard. It would allow us to classify BBCs in a more simplistic manner that would match the underlying reality of the transaction itself.

For that reason, we would request a standard that would allow companies more flexibility and allow the company to at the underlying economics of the transaction in classification of its RPL.

Conclusion

We very much appreciate the opportunity to comment on the Exposure Draft and we further appreciate the difficulties and effort that the FASB undertook in creating this draft. We agree with the core objectives of the Exposure Draft to create additional transparency around traditional operating leases. However, if applied to our traditional drilling contracts, the proposed accounting model introduces significant judgments and complexity into revenue recognition, reduces the transparency and comparability of our financial information across our industry, and will significantly increases the administrative costs required to comply with the proposed accounting model. For these reasons we request that the Board create further clarity regarding the application of lease accounting to traditional oil and gas drilling contracts and consider removing such from the scope of this Exposure Draft. Additionally, we request the Board consider the benefit to the investing community upon application to this standard in
comparison to the substantial costs that companies will have to expend to in order to comply with the final leasing standard.

Respectfully submitted,

James MacLennan
Chief Financial Officer

Dennis Lubojacky
Chief Accounting Officer

1 Noble Corporation’s Annual Report on Form 10-K on page 67 states “Revenues generated from our dayrate-basis drilling contracts and labor contracts are recognized as services are performed.”

2 Ibid.

3 Exposure Draft “Proposed Accounting Standards Update Revised Leases Topic 842”: (842-10-15-3)

4 We note that the model in our contracts is strikingly similar to the IFRS/IASB Staff paper “Definition of a lease-application examples” Week commencing April 11, 2011 example 4(a). We specifically point to the analysis found in paragraph 30.

5 IFRS/IASB Staff paper “Definition of a lease-application examples” Week commencing April 11, 2011 paragraph 31.


7 Page 67 of Noble Corporation Annual Report on Form 10-K states “Revenues generated from our dayrate-basis drilling contracts and labor contracts are recognized as services are performed.”

8 Exposure Draft “Proposed Accounting Standards Update Revised Leases Topic 842”: (842-10-15-3).

9 Exposure Draft “Proposed Accounting Standards Update Revised Leases Topic 842”: (842-10-15-14)

10 Exposure Draft “Proposed Accounting Standards Update Revised Leases Topic 842”: (842-10-15-12).

11 IFRS/IASB Staff paper “Definition of a lease-application examples” Week commencing April 11, 2011 paragraph 31.


13 As reported in our Quarterly Report on Form 10-Q for the Three and Six months ended June 30, 2013 on page 51 our forecasted capital spending for 2013 is $2.9 billion.

14 Estimated cost for new dynamically position drillship see Noble Current Report on Form 8-K Exhibit 99.1 filed on September 1, 2011.

15 A copy of our latest Fleet Status Report can be found at http://phx.corporate-ir.net/phoenix.zhtml?c=98046&p=irol-reportsOther .

16 Known in the industry as “building on spec”. According to our Fleet Status Report released on August 8, 2013, we currently have two newbuild jackup rigs under construction which remain un-contracted.

17 Exposure Draft “Proposed Accounting Standards Update Revised Leases Topic 842”: (842-30-25-4).