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HAND DELIVERY

The Honorable Anne K. Bingaman
Assistant Attorney General
Antitrust Division
United States Department of Justice
10th Street & Constitution Avenue, N.W.
Washington, D.C. 20530

**Re: Request for Business Review by Proposed Joint
Purchasing Association**

Dear Ms. Bingaman:

On behalf of our clients, Baker Hughes Inteq, Dresser Industries, Inc. and M-I Drilling Fluids L.L.C. ("association members" or "members"), we hereby request a statement by the Department of Justice, pursuant to the Business Review Procedure, 28 C.F.R. §50.6, of its current enforcement intentions regarding the formation and activities of an association they propose to create for the purpose of purchasing barite in China, quality testing the Chinese barite proposed to be purchased, and arranging for the transportation of the Chinese barite to the United States.

Through the association, its members hope to achieve a higher quality and more reliable supply of barite from China than they are able individually to effect.

Background

Barite, a soft, dense, chemically inert mineral, is used as a weighting agent in drilling fluids to counteract upward pressures in the well column and provide well

control.¹ While other minerals can be used in place of, or in combination with, barite, barite is the mineral of choice for its purpose.²

China is the largest barite producing country in the world, accounting for approximately one-third of the world's production. Other foreign and domestic sources of barite include India, Mexico and Nevada. Currently, about 60% of the barite used in drilling fluids produced in the U.S. is imported, and more than 70% of those imports are from China.

Recently, severe problems have been encountered by U.S. drilling fluid producers in their purchases of barite in China.³ Barite used in the U.S. must meet three sets of quality specifications:

- (1) API specifications on specific gravity, soluble salts and grind size;
- (2) EPA specifications on mercury and cadmium content for offshore use; and
- (3) Industry specifications on carbonates and sulfides content.

Many shipments purchased from Chinese suppliers have failed to meet one or more of these specifications.

An increasing number of Chinese suppliers are purchasing barite from Chinese miners, with little or no regard for quality control. The result has been the mining and inadequate ore sorting of vast quantities of substandard barite. Established provincial brokers also have been purchasing this substandard material, fearing the material will be bought by other suppliers in the now more open economy. Consequently, hundreds of thousands of tons must be screened at the Chinese ports to separate the barite from heavy clay contamination. Even then, the U.S. buyers often receive material that does not meet the above quality specifications, having relied on the often unreliable

¹ See U.S. Bureau of Mines, *Mineral Commodity Summaries*, January 1995, at 24. In addition, barite is also used in the production of paint, rubber, glass and barium chemicals. *Id.*

² See *id.* at 25. To a very small extent, hematite is used as a weighting agent in drilling fluids. Hematite, however, is heavier, more expensive and more abrasive than barite, and results in substantial wear on drilling equipment.

³ See Joyce Griffiths, *Barytes Supply Not At Oil Well*, *Industrial Minerals*, July 1995, at 25; see also Big Problems for Chinese Supply, *Mineral PriceWatch*, September 1995, at 3; J.B. Griffiths, *Barytes Prices Rising In Response To Tightening Supply*, *Mineral PriceWatch*, July 1995, at 10, 11; *Barytes Supply Problems*, *Industrial Minerals*, April 1995, at 19.

mandatory Chinese testing authorities. In order to compensate for the low quality product, purchasers have blended low grade barite with higher grade barite purchased from elsewhere or from the individual U.S. buyers' internal domestic production. This approach, however, results in higher costs for the raw material.

Additional problems have arisen when U.S. buyers purchase Chinese barite and arrange for shipment from China, only to have the product sent to another U.S. buyer at the last minute. The current situation leaves U.S. buyers unaware of any quality, supply or shipment problems until it is too late. As a result, the parties are forced to maintain greater inventories to counteract shipments that do not arrive, are delayed, or are of substandard quality.

Drilling fluids produced by association members both are sold to independent drilling fluids companies and are self-consumed in connection with their own vertically integrated drilling fluids service operations. Barite constitutes, on average, approximately 15% of the cost of the drilling fluids in which it is used. Depending on the formation properties encountered at a particular well site, this percentage will vary. As a component of the drilling services offered by association members, the barite contained in the drilling fluid constitutes an even smaller percentage of the total cost.

The Proposed Association

Association members propose to form a corporation in the Cayman Islands which will act to accomplish the following:

- (1) Negotiate for the purchase of Chinese barite from Chinese suppliers and resell the barite to association members;
- (2) Provide or arrange for quality testing of all purchases for association members prior to loading at the Chinese port;
- (3) Negotiate for improvements in Chinese supplier quality control; and/or
- (4) Arrange and negotiate on behalf of association members for the shipping of barite from China to association member facilities.

Association members will be required to purchase Chinese barite exclusively through the association.⁴ Members will remain free to negotiate and

⁴ This requirement is intended to facilitate efficient negotiation with barite suppliers and spread the association's costs among each of its members.

purchase directly from non-Chinese suppliers and international carriers. The association may require members to make periodic purchase and shipping commitments in order to facilitate negotiations on behalf of the association.

The following limitations will be placed on the association and its activities:

- Negotiation on behalf of the association will be conducted by employees of the association or by an independent party hired by the association and not by an employee of an association member. Members will be prohibited from negotiating on behalf of the association. A board of directors made up of association members will approve aggregate contracts negotiated as aforesaid.
- The association will resell to its members at the association's cost.
- Communications between the employees of the association or the independent party engaged by the association and each of the individual association members will be kept confidential and not shared with other association members. Counsel will be present at any association board meetings between members and records of such meetings will be maintained. Members will discuss only publicly available information and purchasing and shipping issues related to Chinese barite at such meetings.

The formation of the association will enable its members to achieve significant efficiencies in the purchasing, quality inspection, and shipping of Chinese barite. These efficiencies and resulting certainty will benefit the ultimate consumers of drilling fluids and services.

The association members will be able to share the substantial costs⁵ of hiring an agent to test the quality of the material they purchase before it is shipped.⁶ The association will also attempt to negotiate with Chinese suppliers a means of correcting the current situation to help avoid future supply and quality problems, and save the costs of screening and blending the substandard material. To the extent that these

⁵ It is estimated that the costs to maintain sufficient personnel in China to monitor the quality of purchased barite would exceed \$100,000 per year for each party.

⁶ It is currently illegal in China to hire an independent foreign inspection company not endorsed by the Chinese government for barite quality inspection purposes. It is legal, however, for companies to inspect the purchased material themselves.

efforts require technical expertise, the association members can also share such expenses. Individually, the U.S. buyers have been unable to alleviate the quality and supply problems. However, the purchasing group may be able to do so, creating a relationship beneficial to both buyers and sellers, as well as redounding to the benefit of the ultimate consumers.

The formation of the association will also enable its members to achieve efficiencies in the purchase and shipping of Chinese barite. By negotiating for the aggregate needs of its members, the association hopes not only to obtain the benefits of more efficient negotiation of large volume contracts for both the raw material and its shipment to the United States, but also to attain greater predictability regarding the arrival of the Chinese barite and its quality.

An aggregate supply and shipping arrangement can eliminate the current unpredictability, reducing the need for, and cost of, maintaining excessive inventories. In addition, if the association negotiates a combined shipping contract, individual members will be less compelled to take full shipments of material, further reducing inventory costs.

Competitive Analysis of the Proposed Association

The proposed association is likely to produce substantial procompetitive benefits, without creating any potential for offsetting anticompetitive effects. The association would exercise no monopsony power in the purchase of transportation services, nor would it facilitate price fixing or otherwise reduce competition in any final product or service market.⁷

The association will account for far less than 35% of the total cargo shipments on any China/U.S. port pair. Accordingly, it will be well within the safe harbor repeatedly applied by the Department in connection with its analysis of joint shipping arrangements.

Likewise, it is extremely unlikely that the activities of the association would facilitate coordinated pricing. The theoretical antitrust concern is that, if the input jointly purchased and transported constitutes a high percentage of the delivered price of the product or service of which it is a part (at least 20%), uniformity of the cost among all competitors could increase the ease with which price and output decisions

⁷ The association will lack market power in the purchase of barite. However, even were that not the case, any exercise of monopsony power in the purchase of barite in China would have no direct, substantial, and foreseeable adverse effect on the U.S.

tacitly could be coordinated. In this instance, barite constitutes less than 20% of total drilling fluid costs, and an even smaller percentage of the total cost of all drilling services provided by the vertically integrated firms. In addition, the diversity of fluids and services provided by these companies, and the variance in the amount of barite in the fluids provided, further reduces the likelihood that the association would facilitate coordinated pricing.

Finally, although certainly unnecessary in this situation, all of the additional safeguards outlined above will be put in place.

Conclusion

The proposed formation and activities of the association will enable its members to attain a predictable supply of quality Chinese barite in the most cost-efficient manner possible. At the same time, it poses no risk to competition.

We would be pleased to provide you with any further information you deem necessary or that would facilitate a prompt review. Thank you for your consideration of this matter.

Sincerely,



Raymond A. Jacobsen, Jr.
Mark C. Schechter
Kieran M. Corcoran

cc: Baker Hughes Inteq
Dresser Industries, Inc.
M-I Drilling Fluids L.L.C.