

USEA TALK

Ni Men Hao. Wo hen gaoxing zai zheli gen da jia jian mian. Wo jin tian xiang jiang yi jiang zai zhongguo xianmu de fengxian guanli. Dui bu qi, wo shang mian yong yinyu jiang.

Good afternoon. My name is Meg Utterback and I will be speaking on the topic of controlling risk on international projects and specifically projects in China.

As everyone in this room knows the oil and gas sectors are slated for tremendous growth in the coming years.

For the next 3 decades total direct investment in the oil sector is estimated at around \$119 billion.

Upstream exploration and development will account for about \$69 billion, although annual spending will decline as domestic production falls.

The downstream refining sector will need about \$50 billion.

In the gas sector annual capital investment will average \$3.3 billion.

Such growth means construction opportunities, with associated risks. In my brief time, I will only be able to hit a very few of the risks encountered on such projects.

I limit my discussion today to the construction side and do not address such things as offshore oil exploitation and petroleum contracts.

Risk allocation is at the heart of a good negotiation and a good contract.

This room holds both owners and contractors with very different objectives on who should bear the risks of certain events on the project.

Whether it is construction of a pipeline, a power plant, a refinery, the problems encountered are the same or similar. Many of these projects will be

undertaken by a Chinese US joint venture or other collaborative effort given that the regulations in this sector often require a Chinese partner.

Risk avoidance requires due diligence

Familiarize yourself with the

Country Risks

Financial Risks

Qualify your potential partners

JV

Owner

Vendors and subcontractors

Today I will address a few of the problems most often encountered by foreign firms on projects in China.

First and probably foremost

Changing regulatory environment

Lack of consistent application of the regulatory scheme

Varying interpretation of laws and regulations between local provincial and national governments

What do you do?

Identify the pertinent regulations upfront.

Establish strong in country relationships.

Seek consensus among the governing bodies as to the interpretation.

Rely on your in country relationships- owners, subcontractors etc to assist in clarifying grey areas.

Use consensus building here too to overcome later issues about applicable regulations and their interpretation.

Areas where this may arise—environmental- increasingly a sensitive area, tax- ever a problem, labor, permitting and local approvals, customs, foreign exchange laws, etc.

Second

lack of local engineering capacity; limited numbers of project engineers and project managers.

What do you do?

Assess the local market early.

Confirm availability of talent;

recruit and import talent as necessary;

consider interning Chinese in your company before embarking on the project to assist in establishing a common view of project management.

Investigate your subcontractors to confirm their labor resources and prior project performance.

Third

Intellectual property protection

Or lack thereof. Every US company entering China worries about IP protection. How to protect your design, your equipment, your project know-how

What do you do?

Identify what you are at risk of losing.

Decide whether this technology or design is essential to the project—eg would a cost solution work just as well.

Assuming you have performed appropriate due diligence of your partners, consider entering into licensing agreements and insure that your contract contains provisions addressing ownership and use of the technology at issue.

In many instances in the oil and gas sector the regulations may require the foreign partner to forfeit its technology to the Chinese partner.

Be aware of the regulations that may impact technology transfer.

Fourth

Subcontractor and vendor materials and workmanship

At times these may not fully meet Western standards.

What do you do?

Again, upfront due diligence can avoid many of these issues.

Know their performance and skill set.

Set clear contract specifications.

Early meetings and conversations about the contractual requirements may go far to avoiding unwanted and unwarranted claimed variations under the contract.

Finally, a comment about dispute resolution—when you have the option, go to Hong Kong.

Many will tell you about the improvements in CIETAC and the faster and increased likelihood of enforceability of CIETAC awards.

While CIETAC rules were recently amended, the improvements may be slow to manifest.

More and more Chinese companies are agreeing to international arbitration, most in Hong Kong over ICC.

You still have the issue of enforceability which can be particularly troublesome in China where there is no law against fraudulent conveyance, meaning that your defendant can waste or sell off assets and become judgment proof while the suit is pending.

Most of you will partner with state owned enterprises where this risk is minimized.

Whenever possible opt for arbitration over local courts and HK over Cietac.

Thank you for your time and please do not assume that there are no other risks that need managing. The risks are many and varied and good project delivery requires that you account for all or at least most of them.