Session 9: Risk Management Opportunities and Parochialism and Other Barriers to Overseas Involvement

1.463 Globalization of the E&C Industry
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Useful Definitions

- Off-take Risks
- Structural Lending
- Shadow Tolls
- Sweat Equity
- Force Majeure
- Backlog
- Memorandum of Understanding (MOU)
- Exit or Take-out Strategies
- Multi-lateral Lenders
- Mixed Credits

- Parastatals
- Balance Sheet and Off-Balance-Sheet Financing
- Structural Lending
- Lloyd’s Names
- MGIC/OPIC COFACE
- Rational Exuberance
- Credit Default Swaps

**Class – Any Others?**
Risk Management

- Assume the Risk
- Share the Risk
  - Tax Shelters
  - Joint Ventures
  - Partnerships
- Shed the Risk
- Sell the Risk
  - Insurance
  - Hedging
  - Local Borrowing Derivatives
Differing Views of Risk

- Sponsor Risks
- Completion Risks
- Off-take Risks
- Country Risks
- Structural Lending Risks
- Contractor Risks
Risk in the International Arena
A “Witches Brew”

- Decisions influenced by competitive motivations
- Pitfalls of sweat equity and following the leader
- Go/No Go vs. full scale risk assessment
- Off-take risks provide an excellent opportunity to review risk in general, and in the international AEC field, in particular.
Off-Take Risks include:

- Whether the off-take agreement terms are clear, reasonable and enforceable
- Whether the terms are subject to government monitoring and regulation
- Whether there are any escrow provisions
- Whether the off-take terms can be adequately covered by other guarantees (e.g., MGIC, OPIC, etc.)
- The integrity of the purchase contact (northwest U.S. power agreements)
The enforceability of user charges (Washington State, Bangkok Expressways)
The credit worthiness of “Off-Taker” or provider of “Shadow Tolls”
The pricing mechanisms including flexibility, regulatory framework and ease of adjustment
Whether the off-take agreement could be subject to accusations of favoritism, cronyism and corruption (ENRON, India)
- Whether there are adequate dispute resolution procedures
- The effectiveness of the rule of law, and legally, how secure are the off-take agreement
VMS Asset Management Contract

The VMS asset management program offers insight into a number of risk management issues and opportunities including:

- Privatization
- Outsourcing
- Risk Management and Risk Transfer
The VMS initiative involved:

- Outsourcing the maintenance of 250 miles of interstate highways in Virginia
- It was an unsolicited proposal with significant risk. The bid, once submitted, was open to competition for 30 days.
- The cost of preparing the unsolicited proposal was almost $2 million
- Local Virginia contractors fought it
- The contract pioneered a new concept, asset management. What is it?
- The roads had to be returned to the state in their original condition
- No “Acts of God,” e.g., force majeure or wiggle room, hurricanes, excessive snow claims could be made and it was performance based
- It was a new business and became one of the 10 fastest growing companies in the U.S. according to “Inc.” Magazine
Critical Issues

- Prior state record keeping, lacked detailed costs, breakdown
- Introducing new approaches to maintenance
- Required software/database support, and
- Presented a number of risk management concerns
Certain factors are essential to success in privatization and concession initiatives. These include:

- Proper enabling framework
- Proper selection of concessionaire (balance price/quality, qualified owner/operator, etc.)
- Reliable revenue flows
- Proper risk allocation among the partners, government, concessionaire, lender/financier, contractor and operator.
- Firm price, fixed-term design/build or design/bid/build contracts
- Reasonable covenants and financing terms
- A clear, equitable and transparent franchise agreement
- Clear understanding of underlying political realities and public needs
- A proper regulatory framework to resolve disputes and misunderstandings, revise tariffs, etc.
They were the world’s richest and shrewdest investors, “The Electronic Herd,” to use Tom Friedman’s term, and they rode a wave of globalization, buying bonds and investing in attractive emerging markets and, when the emerging countries defaulted, they were livid.

“There should be lunatic asylums for nations as well as individuals,” one investor wrote in the London Morning Post, denouncing a defaulting country as “a nation with whom no contracts can be made.”
Strategic Planning

- Vision Statement – the Inspiration

- Strategic Plan

- Tactic Planning – the Perspiration
Transparency International

- All of the top 20 countries were wealthy and all but 5 were European!

- At the other end, the last 10 except Iraq, are relatively poor.

- Why are the United States and Japan only in 18th place and France in 23rd?