



Construction Claims In South America

W. Tom Thweatt

Copyright © 2012 Long International, Inc.



LONG INTERNATIONAL



Construction Claims In South America

W. Tom Thweatt

Table of Contents

1. SOUTH AMERICA CONTRACTING OVERVIEW	1
1.1 ACTIVE CONTRACTING INDUSTRIES AND COUNTRIES	2
1.2 MAJOR OWNER COMPANIES.....	5
1.3 MAJOR INTERNATIONAL CONTRACTORS	7
2. COMMON CONTRACT TYPES IN SOUTH AMERICA	8
2.1 LUMP SUM CONTRACTS	8
2.2 TYPICAL CONTRACT FEATURES	8
2.2.1 <i>Time is of the Essence Clauses</i>	9
2.2.2 <i>Escalation Clauses</i>	9
2.2.3 <i>Local Content Clauses</i>	10
2.2.4 <i>Delay and Disruption Claims</i>	10
2.2.5 <i>Schedule Liquidated Damages</i>	11
2.2.6 <i>Anti-Corruption Clauses</i>	11
2.2.7 <i>Waivers of Consequential Damages</i>	12
2.2.8 <i>Project Execution by Joint Ventures or Consortia</i>	12
3. TYPICAL DISPUTE RESOLUTION APPROACHES	14
3.1 MEDIATION AND ARBITRATION VS. LITIGATION	14
3.2 TYPICAL SOUTH AMERICAN PROJECTS' ARBITRATION VENUES	15
4. SOUTH AMERICAN BUSINESS CULTURES	16
4.1 HOW THIS MAY AFFECT THE CLAIM RESOLUTION PROCESS	17
4.2 POTENTIAL PERSONAL IMPACT ON CLAIM PARTICIPANTS	17



Construction Claims In South America

1. SOUTH AMERICA CONTRACTING OVERVIEW

South America is the world's fourth largest continent, stretching 5,000 miles north to south. It includes the southern-most inhabited region of the world. The Andes Mountains contain 38 peaks higher in elevation than Alaska's Mount Denali, the highest peak in North America. It boasts the world's largest river, largest rain forest, highest major city (La Paz, Bolivia) and driest place (the western coast of Chile, where measurable rain falls only once every fifteen years, on average). South America's population is 25% larger than that of the United States, and 75% of its people live in overcrowded urban conditions. Many of the remaining 25% live in isolated rural areas lacking even basic infrastructure and services such as clean water and sewage treatment and disposal facilities. Immense areas of South America are completely inaccessible by road or rail, primarily in the Amazon rain forest and in the remote regions of the Andes Mountains. Two countries are land-locked, Bolivia and Paraguay; Bolivia is rich in natural gas, but has difficulty commercializing the resource due to lack of ocean access. Bolivia's government is currently negotiating with Peru and Chile to obtain a right of way for a gas pipeline to the Pacific through one or the other of the countries, but a peasant uprising against the gas export plan resulted in 80 deaths and caused the downfall of President Gonzalo Sanchez, who was replaced by Vice President Carlos Mesa.

South America is a region rich in natural resources, but its twelve countries and one protectorate are generally somewhat lacking in their capabilities to manage those resources. South America melds a large number of active capital projects, scant availability of adequately trained and experienced project management resources, and certain government officials seeking opportunities for personal gain. These problems often lead to corruption and mismanaged projects.

It would be inaccurate to characterize all South American government officials as corrupt, or to characterize all South American project management personnel as inadequately trained or inadequately experienced. There are gratifying exceptions to these generalizations, but unfortunately, their less-capable counterparts frequently outweigh these exceptions in both numbers and influence.

One must keep this backdrop in mind when considering working in the South American business and industrial arenas. The business climate and the prevailing cultures dictate the contracting strategies followed by owners and contractors, and they also influence the likely paths to be taken in the event a contract goes off track and results in claims and/or counterclaims.



Construction Claims In South America

1.1 Active Contracting Industries and Countries

While there is a great diversity of industries in South America, the three predominant industries are oil and gas (exploration and production, treatment and upgrading/refining), mining and agriculture. Agriculture, as used here, includes the raising of food crops for human and animal consumption, raising of poultry and livestock, fishing, and related industries. South American governments invest in major infrastructure projects as and when financial and political considerations allow, but this segment of the industry is more sporadic in nature than are the three predominant ones listed above. As a result, the region lacks the continuity needed to develop and maintain a skilled workforce and cadre of local EPC contractors capable of self-performing major infrastructure projects. Thus, international contractors from outside South America execute most major infrastructure projects, frequently utilizing South American companies and labor as subcontractors to enhance local content.

Brazil takes up almost half of South America's land area. Its 178 million population is 49% of South America's population, and its US\$ 405 billion Gross National Product represents 62% of South America's GNP. Brazil's population is four times that of the second most populous South American nation, Colombia. Its GNP is 5.2 times that of Argentina, the second-ranked South American nation in terms of GNP. Stated succinctly, Brazil drives the South America economy. When Brazil stumps its toe economically, South America collectively goes to the podiatrist.

To put South America's economies in perspective by making an economic comparison, the United States' GNP is about 25 times that of Brazil and 15 times that of all South American countries combined.

Following is a brief summary of the major contracting industries by South American country, presented in decreasing GNP order.

Brazil

Population (millions):	178.4 (United Nations, 2003)
Major Industries:	Oil and gas, mining, manufacturing, agriculture
Average Annual Income:	US\$ 3,070 (World Bank, 2001)
GNP:	US\$ 405 billion (World Bank, 2001)



Construction Claims In South America

Argentina

Population (millions):	38.4 (United Nations, 2003)
Major Industries:	Agriculture, oil and gas, mining, manufacturing
Average Annual Income:	US\$ 6,940 (World Bank, 2001) – Before the December 2001 financial collapse
GNP:	US\$ 78.5 billion (World Bank, 2001) – Before the December 2001 financial collapse

Venezuela

Population (millions):	25.7 (United Nations, 2003)
Major Industries:	Heavy crude oil, upgrading heavy crude oil, mining, aluminum production, agriculture, steel, basic manufacturing
Average Annual Income:	US\$ 4,760 (World Bank, 2001)
GNP:	US\$ 50.9 billion (World Bank, 2001)

Colombia

Population (millions):	44.2 (United Nations, 2003)
Major (Legal) Industries:	Oil and gas, mining, agriculture
Average Annual Income:	US\$ 1,890 (World Bank, 2001)
GNP:	US\$ 40.5 billion (World Bank, 2001)

Chile

Population (millions):	15.8 (United Nations, 2003)
Major Industries:	Copper mining, agriculture, paper and pulp, chemicals
Average Annual Income:	US\$ 4,590 (World Bank, 2001)
GNP:	US\$ 25.6 billion (World Bank, 2001)

Peru

Population (millions):	27.1 (United Nations, 2003)
Major Industries:	Agriculture, mining (copper, zinc, gold, lead), oil and gas
Average Annual Income:	US\$ 1,980 (World Bank, 2001)
GNP:	US\$ 24.5 billion (World Bank, 2001)

Ecuador

Population (millions):	13 (United Nations, 2003)
Major Industries:	Crude oil, agriculture
Average Annual Income:	US\$ 1,080 (World Bank, 2001)
GNP:	US\$ 9.9 billion (World Bank, 2001)



Construction Claims In South America

Uruguay

Population (millions):	3.4 (United Nations, 2003)
Major Industries:	Agriculture, automobile manufacturing
Average Annual Income:	US\$ 5,710 (World Bank, 2001)
GNP:	US\$ 8.1 billion (World Bank, 2001)

Paraguay

Population (millions):	5.8 (United Nations, 2003)
Major Industries:	Agriculture
Average Annual Income:	US\$ 1,350 (World Bank, 2001)
GNP :	US\$ 4.7 billion (World Bank, 2001)

Bolivia

Population (millions):	8.8 (United Nations, 2003) - Two thirds are indigenous, the highest proportion of any country in the world
Major Industries:	Agriculture, natural gas, mining (zinc, gold, silver, lead, tin, antimony)
Average Annual Income:	US\$ 950 (World Bank, 2001)
GNP:	US\$ 4.5 billion (World Bank, 2001)

Surinam (*Formerly known as Dutch Guiana*)

Population (millions):	0.4 (United Nations, 2003)
Major Industries:	Mining, oil, agriculture
Average Annual Income:	US\$ 1,810 (World Bank, 2001)
GNP:	US\$ 1.5 billion (World Bank, 2001)

Guyana

Population (millions):	0.8 (United Nations, 2003)
Major Industries:	Mining (bauxite), agriculture
Average Annual Income:	US\$ 840 (World Bank, 2001)
GNP:	US\$ 0.3 (World Bank, 2001)

French Guiana (*A French Protectorate, not an independent country*)

Population (millions):	0.2 (United Nations, 2003)
Major Industries:	Agriculture
Average Annual Income:	Unavailable
GNP:	Unavailable



Construction Claims In South America

1.2 MAJOR OWNER COMPANIES

Mr. Thweatt's background is in the oil and gas exploration and production and oil refining areas. Thus, he has slanted the listings of major owner and major contractor companies in this document to these areas. While there are major mining projects in several of the South American companies, Mr. Thweatt has no direct experience in those projects and can bring no expertise to a mining discussion.

Each South American country, even Paraguay with no with oil and gas resources, originally established a monopolistic National Oil Company (NOC), wholly owned by the respective national governments. These NOCs controlled all matters relative to oil and gas importation, distribution, pricing, resources and projects. Beginning in the early 1990s, many NOCs found it difficult to make the large investments required to explore for and develop new oil and gas fields. Argentina was forced to privatize its national oil company, Yacimientos Petroliferos Fiscales (YPF), as the country's fiscal collapse loomed, selling YPF to Spanish oil company Repsol. Bolivia privatized Yacimientos Petroliferos Fiscales Bolivianos (YPFB) in 1994, but a July 2004 national referendum may result in re-nationalization of the oil and gas sector. Brazil ended Petrobras' monopoly on upstream exploration and production in the mid-1990s, allowing foreign companies to bid on offshore blocks up for lease. Venezuela's government oil company, Petróleos de Venezuela S. A. (PdVSA), nationalized the oil and gas industries in 1974, paying each owner the equivalent of one US dollar for each refinery or production field taken over in the nationalization. It then began partnering with major international oil companies in the mid-1990s to obtain the foreign investments required to develop its huge deposits of extremely heavy crude in the Orinoco River basin and to upgrade the heavy crude to synthetic crude for export to its US-based refineries. Ecuador ended PetroEcuador's monopoly in 1999, allowing international companies to produce oil in the Amazon basin in the east and to build a large-diameter crude oil export pipeline across the Andes to the Pacific coast.

Only Chile's Empresa Nacional de Petróleo (ENAP) and Paraguay's Petropar currently operate monopolistically; the remaining NOCs now partner with or lease exploration and production rights to international oil companies, to gain the investment funds necessary to develop their respective energy reserves. It is now common in South America for the NOC to hold a minority stake in major projects, with the international oil companies holding the controlling interests. This is largely due to the desire of the South American governments to develop their oil and gas resources to generate export revenue streams faster than would be possible if they had to finance 100% of the cost of the facilities themselves. With financial control comes contracting and technical control, as well, so most South American contracts now have a distinct offshore/international bent.

Construction Claims In South America

In the listings below of the major oil companies that are active in each country, the country's NOC, if there still is one, is listed first, followed by other major international companies that are active in the respective countries.

<u>Country</u>	<u>Major Active Oil Companies</u>
Argentina	RepsolYPF, Pan American Energy, Petrobras Energía (formerly Pérez Companc), ChevronTexaco; Argentina now has no NOC
Brazil	Petrobras (NOC), AGIP, Amerada-Hess, ChevronTexaco, El Paso, ExxonMobil, PanCanadian, RepsolYPF, Shell, TotalFinaElf, Unocal
Bolivia	YPFB (NOC), Pérez Companc, Pluspetrol, Shell, El Paso, Petrobras, British Gas
Chile	Empresa Nacional de Petróleo, ENAP (NOC)
Colombia	Ecopetrol (NOC), ChevronTexaco, Occidental Petroleum, BPAmoco
Ecuador	PetroEcuador (NOC), Hunt Oil, Petrobras, ChevronTexaco, Occidental, RepsolYPF, EnCana, AGIP
Guyana	GuyOil (NOC), CGX Energy, AGIP
Paraguay	Petroleos Paraguayos, Petropar (NOC)
Peru	PetroPeru (NOC), ExxonMobil, Occidental, Shell, Hunt Oil, Anadarko, RepsolYPF, Sonatrach, Pluspetrol
Surinam	Staatsolie (NOC), Burlington Resources, Shell, TotalFinaElf, Korea National Oil Company, Koch Petroleum
Uruguay	ANCAP (NOC), Gaz de France, Sempra Energy
Venezuela	PdVSA (NOC), ExxonMobil, TotalFinaElf, ConocoPhillips, Shell, Murphy Oil



Construction Claims In South America

1.3 MAJOR INTERNATIONAL CONTRACTORS

While there is a large number of South American engineering, procurement and construction (EPC) contractors, few of them are capable of competing in their home countries or in the international marketplace as independent contractors on major EPC projects. Rather, most are specialty contractors who normally work as subcontractors to the major international EPC contractors who do compete for the large contracts in South America.

There are a few notable exceptions. Argentina's Techint is a major international EPC contractor that self-performs major projects worth hundreds of millions of dollars, and in some cases, projects in excess of US\$ 1 billion. Techint was the sole EPC contractor on the OCP oil and Camisea gas pipeline projects in Ecuador and Peru, respectively. Techint completed the OCP project in late 2003, and is now nearing completion of the Camisea project. Techint has also taken on major petrochemical and refining projects in Argentina, Brazil and Chile, and is particularly active on pipeline projects in the Middle East.

Other major South America-based EPC contractors include Brazil's Odebrecht, which specializes in large civil and infrastructure projects such as roadways, bridges, dams and buildings and Argentina's SkanskaSADE. SkanskaSADE is a wholly owned subsidiary of Swedish contractor Skanska. SkanskaSADE competes for small to mid-sized projects to about \$100 MM in Argentina, Chile and Peru.

American, European and Asian contractors execute by far the greatest number of major oil and gas and refining projects in South America. There are several reasons for this, including staff and labor resources, client relationships, financial strength, project experience, and project management experience. The primary players in South America include such well-known companies as KBR, Technip, Fluor, Bechtel, JGC, Saipem, Halliburton, Dragados and Skanska.



Construction Claims In South America

2. COMMON CONTRACT TYPES IN SOUTH AMERICA

2.1 LUMP SUM CONTRACTS

Most contracts for major projects in South America are Lump Sum Turn Key (LSTK) or some variant thereof. Under an LSTK contract, the contractor generally takes on the obligation to provide an operating plant designed and built in compliance with a set of contractual specifications and product quantity and quality requirements. The predominance of LSTK projects in South America probably stems from the NOCs' history. NOCs typically attempted to firm up the cost of a project before committing to its construction, and LSTK contracts give the owner the opportunity to know the contract value before signing the contract. As is typical outside South America, almost all South American LSTK contract bid packages give the owner the right to cancel the project after the bidding period and before signing the contract, without penalty, if the bids are not in line with the owner's budget estimate.

Variants of the LSTK contracting strategy include Petrobras' recent model of breaking major projects up into smaller pieces and executing each piece as a lump sum contract. For example, on major pipeline projects, Petrobras tends to use three to four major contracts, splitting the scopes of work into separate contracts for engineering plus procurement of all materials except the line pipe, procurement of line pipe, and construction. In this contracting model, the owner is generally the overall project management coordinator, and has responsibility for putting all the pieces together to form the whole. Petrobras began moving toward this reduced-scope contracting model due to significant delays and cost overruns on multiple offshore platform projects that were too large for a single contractor to manage adequately in times of heavy competition for resources. One such offshore Petrobras project experienced delays in excess of eighteen months and claims from the contractor in excess of US\$ 1 billion.

Another variant is developing Front End Engineering Design (FEED) projects on a cost reimbursable basis and then soliciting LSTK bids for the EPC phase of work. PdVSA tends to use this contracting model in Venezuela, as it did on the Hamaca/Ameriven heavy oil upgrader project, whose FEED work began in 2000. It is significant to note that PdVSA generally only uses the reimbursable type contracts for work performed outside Venezuela; the work performed on major projects inside the country still tends to be on a lump sum basis.

2.2 TYPICAL CONTRACT FEATURES

The owners of most major industrial projects in South America are partnerships, joint ventures, or consortia made up of the South American country's NOC and at least one major international oil company. The contracts covering the projects invariably include the international oil company's major requirements, plus the NOC's own sacred cows. In other words, the contracts



Construction Claims In South America

tend to be more complex, restrictive and strict, because they include “must-have” requirements of multiple owners.

2.2.1 Time is of the Essence Clauses

Major international EPC contractors working for US or European clients normally do not accept “time is of the essence clauses”, because a single missed contractual milestone, even an intermediate milestone, may allow the client to successfully declare that the contractor is in material breach of the contract. It is usually not in the owner’s best interest to make such a declaration for missed intermediate milestones. However, the “time is of the essence clause” may be used to put the contractor in breach and to terminate the contract for cause if the owner is generally dissatisfied with the contractor’s performance on the project and wants to terminate the contract for cause as a result of delay and/or other performance problems.

Owners tend to press harder in contract negotiations for South American contracts to include a “time is of the essence clause” in some form, probably because South American projects have a history of being finished late more often than the same owners’ projects in other regions of the world. Some EPC contractors consider time is of the essence to be a walk-away issue, but others, particularly those who are based in Latin America, tend to resist the clause less strenuously. The net result is that “time is of the essence” clauses tend to appear in South American project contracts more often than they do in contracts for projects in other regions of the world.

2.2.2 Escalation Clauses

Due to the extreme volatility and inherent instability of many of the South American countries’ monetary systems, it is common for South American contracts to include a complex escalation clause, which is almost never included in a similar contract in the United States or Europe. Without these escalation clauses, few if any contractors would take on the financial risk inherent in a major contract that will sometimes take three to four years to complete. In some cases, the escalation clause applies only to local labor costs. In other cases, such as PdVSA contracts in Venezuela, separate escalation formulae are applicable in the same contracts to labor and in-country sourced equipment and materials. The complexity and ambiguity of the escalation clauses often give rise to claims that result from disagreements on how they are used to calculate the financial relief for the contractor.



Construction Claims In South America

2.2.3 Local Content Clauses

Another feature of South American contracts that is not normally included in American or European contracts is the requirement for the contractor to utilize “local content” to some specified degree. Local content refers to the use of the host country’s labor pool, equipment and materials on the project. Some contracts require that local content be “maximized” or “optimized” without specifying the required levels of local content. Others require a minimum local content set at a specific percentage of the work to be performed. This often requires that the EPC contractor set up on-project local recruiting and training programs to develop the requisite numbers of semi-skilled and skilled labor. Some South American countries reinforce the local content requirement by making it difficult to impossible for the contractor to obtain work visas for imported labor or customs clearances for imported equipment and materials unless and until he has demonstrated that he has met the local content requirements. This practice frequently results in delays to the completion of the project and exposure to schedule liquidated damages.

An insidious result of local content requirements is that inordinate competition for trained local labor resources often develops in regions where multiple construction projects are under way simultaneously and where the local trained labor pool is insufficient to satisfy all projects’ local labor requirements. Contractor A sets up and manages a recruiting and training program well, but finds that Contractors B and C, working on nearby projects without setting up adequate local labor recruiting and training programs, tend to raid his cadre of trained personnel to help meet their own local content requirements. Contractor A is forced to pay a premium wage rate to re-hire his former trainees a few months later from Contractors B and C. Contractor B or C then ratchets up its wages and overtime pay package to attract the same trained employees back from one or both of the other two contractors. The results are high project turnover rates and an upward spiral of prevailing labor costs. The practice is difficult to stop, as each of the three contractors may believe that the escalation clause in its contract that puts the burden for higher wage costs on the owner. Contractors B and C think they are saving money by reducing up-front labor recruiting and training costs. However, delays and productivity losses occur due to the high turnover rates, and the escalation clauses give no relief for these two factors. All three contractors frequently find out late in the construction phase that they are exposed to schedule liquidated damages and huge labor cost overruns not covered by the escalation clause, due the labor turmoil and resultant productivity losses. Claims almost always ensue.

2.2.4 Delay and Disruption Claims

Delay and disruption claims are more common under South American contracts than they are in most other regions, due to the general shortage of local skilled labor, the strong influence of labor unions and the tendency for the unions to utilize wildcat strikes, work slowdowns and



Construction Claims In South America

sabotage of equipment, materials and tools to achieve their goals. It becomes difficult to adjudicate a delay claim when the delay arises from a series of unofficial work stoppages and slowdowns, even when the contract may give the contractor force majeure protection for such things as “strikes” and “insurrection”. A common practice in Venezuela’s Jose Industrial Zone is for militant union organizers to use burning tires and automobiles to block both ends of the only roadway that provides access to the work sites within the zone, effectively keeping all workers off the jobsites without officially declaring a strike.

2.2.5 Schedule Liquidated Damages

Liquidated damages (LDs) clauses for schedule delays are as common in South American contracts as they are in other regions of the world. The major difference in these ubiquitous schedule LDs clauses is that the potential amount of LDs on South American contracts tend to be higher than on contracts in the US or Europe. The daily LD accrual rates tend to be higher as a percentage of the contract value, the LD caps tend to be higher and it is less likely to see a grace period before LDs kick in on a South American contract.

The above comparisons are based on refinery and chemical or petrochemical projects, and specifically do not include comparisons with the huge schedule LDs on power plant projects in the US that bankrupted several companies during the merchant power plant construction boom of the late 1990s and the early years of the new century. On some of those power plant projects, LDs were capped as high as 100% of the LSTK contract value. The EPC contractors seem to have learned a lesson from the power plant boom, and are no longer willing to accept LDs that high for power plants; since the merchant plants are frequently financed privately by financiers who require the high schedule LDs as a prerequisite for making the project loans, the merchant power plant construction market has all but died in the US in the last three years or so.

Negotiations between owners and contractors on many large South American claims on refineries and chemical/petrochemical plants almost always involve contractor demands for schedule relief (to reduce the contractor’s exposure to schedule LDs). This phenomenon is more common and the negotiations on schedule relief tend to be more adversarial in South America than is the case on projects executed elsewhere in the world.

2.2.6 Anti-Corruption Clauses

Interestingly, it is more common to see anti-corruption clauses in South American contracts than in those for projects in other regions of the world. Project owners from outside South America may demand that the clauses be included based on their perceptions that corruption may be more prevalent in South America than in some other regions. EPC contractors usually cannot successfully resist the inclusion of such clauses, since a vigorous pre-contract-award negotiating



Construction Claims In South America

posture against an anti-corruption clause may be interpreted by the owners as de facto evidence that the contractor has already participated in corrupt activities or plans to do so in the future. The EPC contractors also probably realize that enforcement of the few anti-corruption laws that exist in South America is almost non-existent, so the clause is not likely to change actual post-contract-award behavior.

2.2.7 Waivers of Consequential Damages

As is common in almost all world-wide LSTK EPC contracts, most South American contracts include reciprocal waiver of consequential damages clauses, which preclude either the owner or the contractor from recovering consequential damages (e.g., loss of profits, loss of future income) arising from execution of the contract. It is noteworthy that applicable law in the jurisdiction where the project is located and/or the law that is applicable under the contract's own terms may negate the waivers of consequential damages in cases of willful misconduct on either party's part. While the definition of willful misconduct varies somewhat by jurisdiction, it generally boils down to the performance of an act, or the failure to perform an act when the duty existed to perform it, when the party knew that its action or failure to act was substantially probable or almost certain to damage the other party.

It is not unprecedented for an owner or a contractor to claim willful misconduct and go after consequential damages on projects in Latin America. Once the defense against consequential damages is breached, the consequential damages can quickly mount up to staggering sums far in excess of direct damages.

2.2.8 Project Execution by Joint Ventures or Consortia

For various reasons, including sharing of risks, local content requirements, availability of resources and differing corporate experience by the participants, most major LSTK EPC projects are executed by Joint Ventures (JVs) or Consortia. There is no "typical" JV and no "typical" consortium.

Joint Ventures generally take a share-and-share-alike approach, under which the JV partners share in the risks and rewards based on a percentage split of JV ownership. The work is usually not split into separate scopes for execution by each partner as discrete mini-projects within the overall project; rather, the partners all furnish resources based on their respective capabilities and capacities to do so, and they split up the profit at the end of the project after all project costs have been paid.

Consortia, on the other hand, tend more toward having defined splits of work between the consortium partners, with each partner having full responsibility to execute its scope for a fixed



Construction Claims In South America

price, and all the risk of that particular scope of work is absorbed by that partner. For example, Consortium Partner A might be responsible for all engineering and procurement services on a lump sum basis, while Consortium Partner B is responsible for all construction on a lump sum basis. Although consortium agreements differ from case to case, most specify that the partners accept the risk of executing their respective lump sum scopes of work, with no recourse against the other partner in case of an overrun.

Consortia as described in the preceding paragraph are extremely risky in South America and elsewhere. Partner A has every incentive to cut costs on engineering services, for example, because Partner B is responsible for construction with no recourse against Partner A if engineering errors and deficiencies force a lot of construction rework and increased construction costs.

Mr. Thweatt's recommendations on partnering on major projects in South America and elsewhere include the following:

- Use Joint Ventures instead of Consortia whenever possible, so that all partners have financial incentives to ensure total project success, rather than just the success of each partner's respective portion of the project;
- Structure the JV Agreements so that neither JV partner has a financial incentive to cut corners or to transfer risks from its portion of the work to another partner's portion;
- Structure the JV Agreements so that all partners share in risks and rewards based on their respective ownership percentages of the JV;
- Always have a single partner empowered to make decisions for the JV or Consortium, because failure to make a timely decision is often a de facto decision to take no action, when timely action may be urgently needed to control an escalating problem;
- Never accept risk for an area of work that is outside your company's control; *e.g.*, a Consortium partner should not accept all of the construction cost risk for construction rework that arises from errors, omissions or changes made by another partner to its engineering work. Because the construction partner has no control of engineering, it should not accept full responsibility for construction cost overruns that arise from defective engineering.



Construction Claims In South America

3. TYPICAL DISPUTE RESOLUTION APPROACHES

As noted above, contracts for major projects in South America typically meld the NOC's must-have terms and conditions with those of its international partners in ownership of the project. In the area of dispute resolution, Mr. Thweatt's experience is that the international oil companies generally prevail in getting their dispute resolution preferences into the contracts.

3.1 *MEDIATION AND ARBITRATION VS. LITIGATION*

Dispute resolution approaches in South America are not very different from those in other international locations. Mediation and arbitration are generally preferred to litigation, and the owners usually agree to structure the contracts' dispute resolution clauses accordingly. Both owners and contractors tend to view litigation as being more costly and time consuming than is binding arbitration.

Thus, construction disputes are resolved in South American contracts much as they are resolved in the US and Europe. The first step is normally to have executive management personnel from the owners' and contractors' organizations formally review disputed issues and to attempt to reach agreement. Failing to reach agreement at this stage, the next step is generally non-binding mediation, where both parties present their respective cases before a third-party mediator, who attempts to bring the opposing parties to a compromise that will resolve the dispute. As is the case elsewhere in the world, mediation is not successful unless both parties enter mediation willing to be disappointed in the outcome. Neither party will achieve everything it believes it is entitled to achieve at this step. There is also a discernible trend to approach the mediation step more cautiously than was done previously, with each party presenting only bare outlines of its case before the mediator. This is to avoid tipping one's hand and exposing the strengths or weaknesses of his case at the non-binding mediation stage before binding arbitration begins.

Arbitration on South American projects generally follows the pattern of projects in other regions of the world. It is common to use International Chamber of Commerce (ICC), American Arbitration Association (AAA), or United Nations Commission on International Trade Law (UNCITRAL) arbitration rules for South American projects. The choice of which arbitration rules to use is almost always set out in the contract when it is signed, which avoids conflict that could develop later if it were necessary to decide which rules to follow when an arbitration issue arises during or after the project.

The outcome of binding arbitration in South America is final and is enforceable in any court of law having jurisdiction, just as is the case elsewhere. There is generally no appeal of a final arbitration ruling, which is one of the reasons that contracting parties tend to believe that arbitration is less expensive and less time consuming than litigation.



Construction Claims In South America

A final observation on arbitration versus litigation is that many owners and contractors believe that an arbitration tribunal is more likely to make its decisions and rulings on a fairness basis rather than a strictly legalistic basis. While the arbitrators do not have the right to set the contract aside, they seem to be prone to judge issues more on the intent of the contract and the intent of the parties as they executed the project than on the letter of the law as written in the words of the contract.

3.2 TYPICAL SOUTH AMERICAN PROJECTS' ARBITRATION VENUES

Mr. Thweatt's experience in South America is that most contracts specify that the arbitration venue is to be in a neutral country, usually in Europe or the United States. Miami and New York are common American arbitration venues, as are London and Geneva in Europe. This is not a hard and fast rule. In the case of contracts involving strong NOCs such as Brazil's Petrobras, the arbitration venue may be held within the country.

The contract also generally specifies the language to be used in the arbitration proceedings. There is no set language in South American arbitration cases. The arbitration may be in Spanish if both parties speak that language. It may be in Portuguese if the parties are both Brazilian companies. In cases where not all parties speak the same native language, it is common to use English as the language of arbitration. However, that is not always the case, as the owner may require that the arbitration proceedings be conducted in his native language, even if that is not the contractor's native tongue.



Construction Claims In South America

4. SOUTH AMERICAN BUSINESS CULTURES

Succinctly stated, the business climate and the cultures in South America are different than they are in the United States or in Western Europe. The laws of the United States ban business practices that are rather common in South America. For example, Mr. Thweatt is aware of no laws in South American countries equivalent to the United States' Foreign Corrupt Practices Act (FCPA) Antibribery Provisions. This US law makes bribery of foreign officials for the purpose of obtaining or keeping business a felony punishable by fines and/or imprisonment.

The US Department of Justice is responsible for enforcing the FCPA, which applies to all United States companies and all companies doing business in the United States. Violation of the FCPA can give rise to both criminal and civil prosecution against companies and their individual employees. Violating employees found guilty at trial have been fined huge amounts and imprisoned. The law specifically bars the guilty employee's company from paying the fine for the employee. This is not a law to be taken lightly.

The following quotation is from the Department of Justice/Department of Commerce Brochure on the FCPA, which is available on the DOJ website at www.usdoj.gov/criminal/fraud/fcpa/dojdocb.htm:

“Following passage of the FCPA, the Congress became concerned that American companies were operating at a disadvantage compared to foreign companies who routinely pay bribes and, in some countries, were permitted to deduct the cost of such bribes as business expenses on their taxes. Accordingly, in 1988, the Congress directed the Executive Branch to commence negotiations in the Organization of Economic Cooperation and Development (OECD) to obtain agreement of the United States' major trading partners to enact legislation similar to the FCPA. In 1997, almost ten years later, the United States and thirty-three other countries signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The United States ratified this Convention and enacted implementing legislation in 1998.”

A listing of the thirty-four signatory countries is available online at <http://www.oecd.org> under the theme “corruption”. In South America, signatory countries include Argentina, Brazil and Chile, but only Argentina has enacted implementing legislation. In other words, the vast majority of South America has not signed the accord and has not enacted implementing legislation.

Mr. Thweatt lived in a major South American country in the early years of this decade, beginning in 2001, and witnessed business practices that are against the laws of that country but that were largely ignored. One example is that all except the largest retail stores advertise a selling price for merchandise that includes applicable taxes, but offer discounts of 25 to 35



Construction Claims In South America

percent for payments in cash instead of by credit card or check. The shopkeepers bypass the tax payments required by the country's tax laws by selling for cash and keeping the transactions off the books. A final example of corruption in the country is the fact that Monsanto reported in a press release on January 19, 2004 that it was forced to halt its sales of genetically altered soybean seeds in the country because of widespread illicit cloning and "*the ballooning black market*".

4.1 HOW THIS MAY AFFECT THE CLAIM RESOLUTION PROCESS

Each major South American project contract of which Mr. Thweatt is aware, where a major international oil company is a part owner, specified an arbitration venue outside South America. These major international oil companies may not feel that an impartial arbitration panel can be empanelled in a country where bribery is either not against the law, or is not punished by rigorous enforcement of antibribery laws that may exist.

When the arbitration rules state that each party to the arbitration selects one arbitrator and that the two thus chosen select the third, the third (or "neutral") arbitrator is vitally important to the fairness and impartiality of the process. Neutral arbitrators must be selected via a transparent process, and they must be able to perform their arbitration duties in an atmosphere not clouded by bribery and other types of corruption. In many cases, this can best be accomplished by specifying the arbitration venue in the contract as a country where corruption is less likely to influence the outcome of the proceedings.

4.2 POTENTIAL PERSONAL IMPACT ON CLAIM PARTICIPANTS

Each person and each company contemplating doing business in South America should obtain all possible cultural and business climate information on the country before entering into a contract. If the person or company is American, it would be wise to obtain and carefully study the Foreign Corrupt Practices Act before beginning to do business. Mr. Thweatt can attest from personal experience that a person in an executive position in South America will probably have to make a moral decision on how to act, because he or she will probably receive one or more unsolicited offers to participate in a corrupt activity. It is much better to prepare oneself in advance than to be surprised and unprepared when the situation arises. Know the law and know your options. Some executives who are today personally bankrupt and in prison for violations of the FCPA may not have known the full implications of their actions when they broke the law, but ignorance of the law is not a defense against having broken it.

In summary, the business climate and cultures in South America are very different than they are in the United States and Western Europe. American companies or individuals doing or planning to do business in South America will be forced to operate on an uneven playing field, where some foreign competitors resort to business tactics that could very well land the American businessman in prison.



Construction Claims In South America



W. Tom Thweatt is a Senior Principal with Long International and has over 40 years of engineering, construction, and management consulting experience. He has extensive experience in major U.S. and international refining, chemical, petrochemical, pipeline, infrastructure and thermal/hydroelectric power generation projects ranging from US \$40 million to US \$2 billion. He has worked extensively in projects that were executed by multi-national joint ventures on both the owner's and the contractor's sides. Mr. Thweatt has served on Joint Venture and Consortium Executive Committees and has participated directly in claims negotiations and settlement agreements in excess of US \$100 million. Mr. Thweatt earned a B.S. Mechanical Engineering degree from the University of Texas at Austin, and completed the Duke University Executive Advanced Management Program. He is bilingual in English and Spanish.