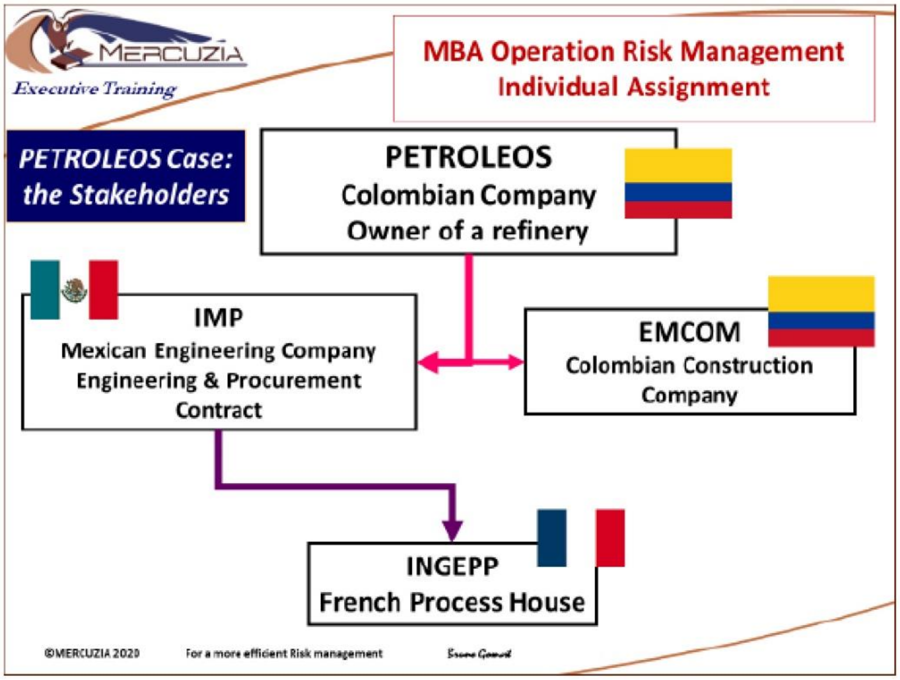
Back in the 90's, an international industrial project in the Latin America Oil & Gas industry involved four stakeholders: a Colombian Owner PETROLEOS, a Mexican General Contractor IMP, its Colombian partner EMCOM and a French Process House INGEPP working as a sub-contractor to IMP.



INGEPP, which was awarded in February 1998 a sub-order, has been quite satisfied until early July 1999 with the way the project has been going on:

- This was the first industrial construction of its latest up-to-date technology for producing hydrogen and such would serve as an excellent marketing reference.
- The forecast initial project margin was excellent.

Six weeks later, mid -August 1999, such a project turned into nightmare for INGEPP, pushing INGEPP shareholders to consider filing bankruptcy.

Case main topic is to analyze and find out why INGEPP fell into such dramatic situation, to suggest sources of improvement and to recommend actions to be carried out to salvage the Company.

I. Case History (Tendering & Execution):

- **Santa Fe de Bogota, Colombia, January 19th, 1997:**

On January 19th, 1997, the board of directors of the Colombian State Company **PETROLEOS** took the decision to extend the production capacity of one of its onshore refineries by adding an alkylation plant. The extension project was to be executed on a turnkey basis, with an EPCC type of contract (Engineering Procurement Construction Commissioning).
An international call for bidding was launched and three main contractors tendered: a Mexican Engineering Company, an American General Contractor and a Japanese Engineering Contractor.

- **Santa Fe de Bogota, Colombia, December 12th, 1997:**

The Mexican Engineering Company **IMP** (**I**ngenieros **M**exicanos del **P**etróleo) secured the main order, on a turnkey basis, for US$ 50 Mio.
Prior to closing the main contract, IMP had entered into partnership with the Colombian Company **EMCOM** (**EM**presa **CO**lombiana del **M**ontaje), which main scope of was Civil Works and Plant Erection on site.
Because IMP did not own any hydrogen production process, IMP selected **INGEPP** (**INGE**nierie **P**rocédés **P**étrochimiques), a French Process House, specialized in the oil & gas processing for more than 20 years, to perform the design, detail engineering and delivery on CIF basis of an hydro-isomerisation unit, a key equipment considered to be the heart of the new alkylation plant. That hydro-isomerization unit had to be specifically designed and tailor-made for PETROLEOS refinery.

- **Mexico, February 19th, 1998**

IMP faxed to INGEPP a Letter of Intent, confirming the purchase order for the design, detail engineering, intermediate delivery on a FAS basis (Free Alongside Ship, European harbor) completed by a final delivery on CIF basis (Cost, Insurance & Freight, Colombian harbor) of an hydro-isomerisation unit, pre-assembled on a modular basis.

- **March 1998 – February 1999: Project execution**

Two reported major difficulties, one originating from each side:

- <u>INGEPP</u> could not stick to the original project schedule. Due to lack of internal resources, the Basic Engineering had slowly started, causing one month delay. Furthermore, the Procurement Department faced serious difficulties in finding a workshop big enough to pre-build the module components. All those resulted in the module delivery to be already 4 months behind schedule in February 1999!
- <u>IMP</u> was unable to pay more than 34% of the 3rd payment term. IMP which ran out of cash had informed INGEPP that there would be probably several months before it could pay the balance of the 3rd payment. Actually, a month after INGEPP mailed its 3rd invoice, INGEPP Bank account was credited with only US$ 250,000 instead of US$ 750,000.

- **March 16th, 99:**

Both parties had something to be forgiven by the other party:

- INGEPP for being already very late in its project schedule,
- IMP for not being in a position to pay 100% of the 3rd payment term.

Negotiations started among parties to settle two requests:

- INGEPP to be granted an Extension of Time so as to avoid being subjected to Delay LD's,
- IMP to be granted a postponement of the 3rd term unpaid balance until the 4th term milestone.

- **June 10th, 99:**

An amendment to the main order was written by IMP:

- The delivery date (Free Alongside Ship, FAS) was postponed until June 25th, 99.
- The 4th payment term due upon FAS delivery was increased by the unpaid balance of the 3rd term, plus some US$ 15,000 of interests.

- IMP committed to speed-up any future payment: *"at the earliest possible time after receiving INGEPP invoice original"*.

- **Le Havre, France, June 25th, 99 :**

All equipment (weighing 350 tons in total) was ready to be delivered FAS (Free Alongside Ship) at Le Havre harbor (French Harbor, Atlantic Ocean), waiting for the harbor authorities green light.

- **Paris, France, June 28th, 99 :**

Green light was given by harbor authorities to enter harbor premises and the 4th invoice (amounting US$ 3Mio) for FAS milestone was immediately express-mailed to IMP at Mexico city.

- **Le Havre, France, June 30th, 99 evening :**

The 16 boxes of equipment were loaded on board, ready to be shipped on CIF (Cost, Insurance & freight) to Colombian Barranquilla harbor, Caribbean sea.

- **Paris, France, July 5th, 99**

The INGEPP VP Finance contacted the INGEPP Bank as soon as he arrived in his office, expecting to get a confirmation that the US$ 3Mio wire transfer, due to be made soon, took place!

- **Paris, France, July 6th - July 9th, 99**

The INGEPP VP Finance had become more and more stressed, calling up to ten times a day his bank: no single transfer was announced. On his side, the INGEPP Project Manager called several times a day the IMP Project Manager and each time got the same answer: *"according to the IMP Accounting Department, the transfer should be made any time!"*

- **Paris, France, July 10th, 99**

Upon his arrival to the office, the INGEPP VP Finance found on the fax machine a document sent by the INGEPP Parent Company representative agent office in Mexico. It was a copy of a Mexican finance newspaper release: *"It was disclosed by Mr Morales, IMP Finance VP on July 9th evening that the IMP Group has been facing a very significant cash flow problem and would probably not be in a position to refund a US$ 100Mio loan due to an European Bank Consortium by mid-July 99"*.

- **Mexico city, Mexico, July 14th, 99**

A French delegation made of INGEPP Project manager and its Deputy flew straight from Paris to Mexico to attend an emergency project meeting required by INGEPP.
During that meeting, the IMP Project Manager and the IMP Procurement Manager stated the following:

- The news released by the Mexican newspapers were far too excessive. In fact, the cash problem that IMP was allegedly facing has been a very temporary one and should be solved within days!
- The payment of US$ 3Mio would definitively be made at the latest by end of July 1999.

Minutes of Meetings were signed accordingly.

- **Barranquilla, Colombia, July 29th, 99**

The 16 module boxes were unloaded at Barranquilla harbor and put under Colombian Custom bonded warehouse.

- **Paris, France, July 30th, 99**

INGEPP Bank confirmed that no money transfer was ever done from Mexico. In the meantime, IMP debt to INGEPP has increased up to 3.765 Mio US$, equal to US$: 2.75 Mio (4th installment) + 0.5 (balance 3rd installment) + 0.015 (interests) + 0.5 Mio (5th installment).

- **Mexico city, Mexico, August 1st, 99:**

Official announcement was made that IMP, despite its reputation of *"The best Engineering Company in Latin America"* and a backlog of orders amounting US$ 250 Mio, was obliged to file «*suspensión de pagos*».

IMP was put under "Chapter 11"[1] to benefit from the Mexican law protection.

- **Santa Fe de Bogota, Colombia, August 3rd, 99:**

Upon INGEPP specific request, PETROLEOS Project Management had a crisis meeting with an INGEPP delegation, during which the INGEPP Project team was made aware of the following:

1. PETROLEOS accepted to meet INGEPP because INGEPP was the licensor of the hydrogen production process. It was exceptional as PETROLEOS usually does not meet with subcontractors and suppliers.
2. IMP financial difficulties were not something new for PETROLEOS. This latter has known for a long time that IMP had serious cash difficulties. PETROLEOS had even decided to make some significant payments in advance to its main Mexican contractor so as to ease IMP financial situation.
3. For many reasons, in particular due to IMP, the whole Alkylation project has been far behind schedule and the overall delay was close to 7 months at the end of May 1999.
4. As a last fair gesture, PETROLEOS Project management had accepted early June 1999 to consider favorably the IMP request to be granted a seven months extension of time.
5. PETROLEOS, as State Company, could currently do nothing for INGEPP because PETROLEOS had only a contractual commitment with the company IMP and not with INGEPP.
6. The existing EPC Contract between PETROLEOS and IMP was including a specific provision dealing with Contract Termination, but only on two possible causes:
    - official bankruptcy of the Contractor IMP
    - total project delay exceeding 6 months

   Such a provision could not be executed because neither did IMP file bankruptcy, nor the Project Master Schedule had a delay exceeding 6 months after PETROLEOS decision to give an extension of time of 7 months, starting from July 1st, 1999.
7. Considering the IMP current situation which has been threatening the project achievement, three PETROLEOS executives have been publicly wondering whether it was still worth to continue with the project!

- **Paris, France, August 5th, 99:**

  INGEPP, a process house having 70 employees, has definitively entered into a **dramatic situation**:
  - The unpaid amount of US$ 3,5 Mio was more than three times the INGEPP working capital of € 1 Mio.
  - INGEPP had run totally out of cash and had heavy debts vis-à-vis its own suppliers.
  - The INGEPP Parent company (& main shareholder) was definitely reluctant to re-inject some money in the INGEPP company:

  ➔ Recalling that INGEPP activities were not in the Parent company core business (Power Engineering and Construction), two Parent company top executives and one INGEPP Board member had expressed their wish to have INGEPP **filing bankruptcy** by the end of year 1999 if INGEPP situation would have not significantly improved in the meantime.

  ➔ **The timeline to rescue INGEPP was definitively a short one: only 4 months left to think about possible solutions, to select and implement the most effective ones, to monitor how they develop and bring necessary corrections, if possible.**

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[1] Under some bankruptcy laws (USA, Mexico ...), filing Chapter 11 permits a company in distress to reorganize and remain in control of its business operations, subject to the oversight and jurisdiction of the court. Chapter 11 affords the debtor in possession a number of mechanisms to restructure its business. Debtors are also protected from other litigation against the business through the imposition of an automatic stay.

II. Main ORDER provisions (from IMP to INGEPP)

1) Price: Lump sum, US$ 5 Mio

2) Payment Schedule in favor of INGEPP:

- 10%, upon submission of a 10% « advance payment » bond
- 10%, upon Basic Design freeze
- 15%, 4 months after order, subject to significant progress of engineering and major components effective ordering
- 55% FAS (Free Along Ship) European harbor
- 10% CIF (Cost Insurance & Freight) Baranquilla, Colombian harbor

Payment by wire transfer, 30 days after receiving relevant invoice.

3) Bonds in favor of IMP:

- 10% « advance payment » bond, valid until FAS shipment
- 10% warranty bond (valid 12 months after the first production and no more than 24 months after the FAS date)

4) Master schedule & milestones:

- 50 weeks (i.e. February 5, 99) for FAS European Port
- 54 weeks (i.e. March 5, 99) for delivery CIF Barranquilla (Colombia) harbor

5) Delay Penalties (as Liquidated Damages):

1% per week of delay, limited to 5% of the contract value with one week grace period

6) Applicable law & Dispute settlement:

Mexican law, arbitration in Mexico City

7) Ownership transfer to IMP: automatic transfer

- Engineering documents: as soon as issued
- Equipment: as soon as manufactured

8) **Risk Transfer:** as per the available last revision of Incoterms (FAS & CIF)

Case Audit & Questionnaire

You are an Operation Risk Manager, employed by the INGEPP Parent company (and main shareholder). You have been requested to proceed with a first audit so as to **highlight the failures of such a project disaster** and **to suggest** not only possible **sources of improvement** to avoid facing again in the future such a nightmare, but also an **action plan for rescuing the INGEPP company** from its desperate situation.

Based on the above case history and on abstracts of IMP order main provisions, please carry out your audit in 4 steps.

I. TENDERING PERIOD

Risks analysis: Among the numerous major risks which could be identified by the INGEPP during the TENDERING PERIOD, **please list at least seven (7) of them.**
Risks mitigation actions: With regards to above identified risks, **which mitigation actions could INGEPP have taken** (upon INGEPP sales team suggestion) before signing the contract?

II. EXECUTION PERIOD

Risks occurrence: Among above major risks which could be identified by the INGEPP sales team during the TENDERING PERIOD, **list those ones which actually occurred.**
Risks management: With regards to those risks, **which actions could INGEPP Project team (and its Hierarchy) have quickly implemented to limit their impacts?**

III. LEARNING & RECOMMENDATION:

Give at least seven (7) key recommendations specific to that type of project you would suggest to your Top Management to avoid facing a similar situation if you sign in the future that kind of project.

IV. MARGIN RECOVERY & RESCUE PLAN:

What would be your suggestions to your rescue INGEPP?
Since early August 1999, INGEPP has been threatened to file bankruptcy. INGEPP situation has been highly critical and INGEPP has been in desperate need to be salvaged quickly.
Elaborate your rescue plan. To do that, identify the pros & cons of INGEPP situation…, revisit the other project stakeholders' situations and positions…, suggest realistic actions which could be implemented quickly with significant chances of success.
Please remember that time was of the utmost importance to salvage INGEPP.

Comments:

- **Read carefully the case as they are many clues to help you elaborating your answers.**
- **During the whole Operation Risk Management session, you have been disclosed few tips on how to sort out such a situation.**
- **Please be brief, sharp & concise in your answers. Get to the point!**
- **Respect the questionnaire breakdown, limit your audit to three (3) pages in total (font 11).**
- **Do not forget to put your name both on your assignment title (word or pdf) and on the document itself (first page).**