

EPC Contracts For Project Finance Lawyers

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Today's session



- The subject is not “EPC Contracts,” it’s “EPC Contracts *for Project Finance Lawyers*”
- What’s the difference?

EPC contracts for EPC lawyers



- What is the best price, schedule and performance standard for this project? How can you induce the best bid and have it stick?
- Who is the best contractor for the job? How do you attract that company and keep it coming back for more jobs?
- Which is the right lien form, indemnity clause, and insurance program?
- Do the drug test and COVID-19 protocol comply with privacy laws?
- ...

EPC contracts for project finance lawyers



- Assume this contract has the best contractor, price, schedule and performance standards
- What assurances are there that the *drawdown, startup date, output and efficiency* terms baked into the **Model** will be honored?
- If they aren't honored, what remedies are immediately available to service the debt and recover other loss?
- And *regardless* of how good a deal this appears to be, can the owner get out of it—suspend, terminate, assign for security or assign outright?

Project delivery methods



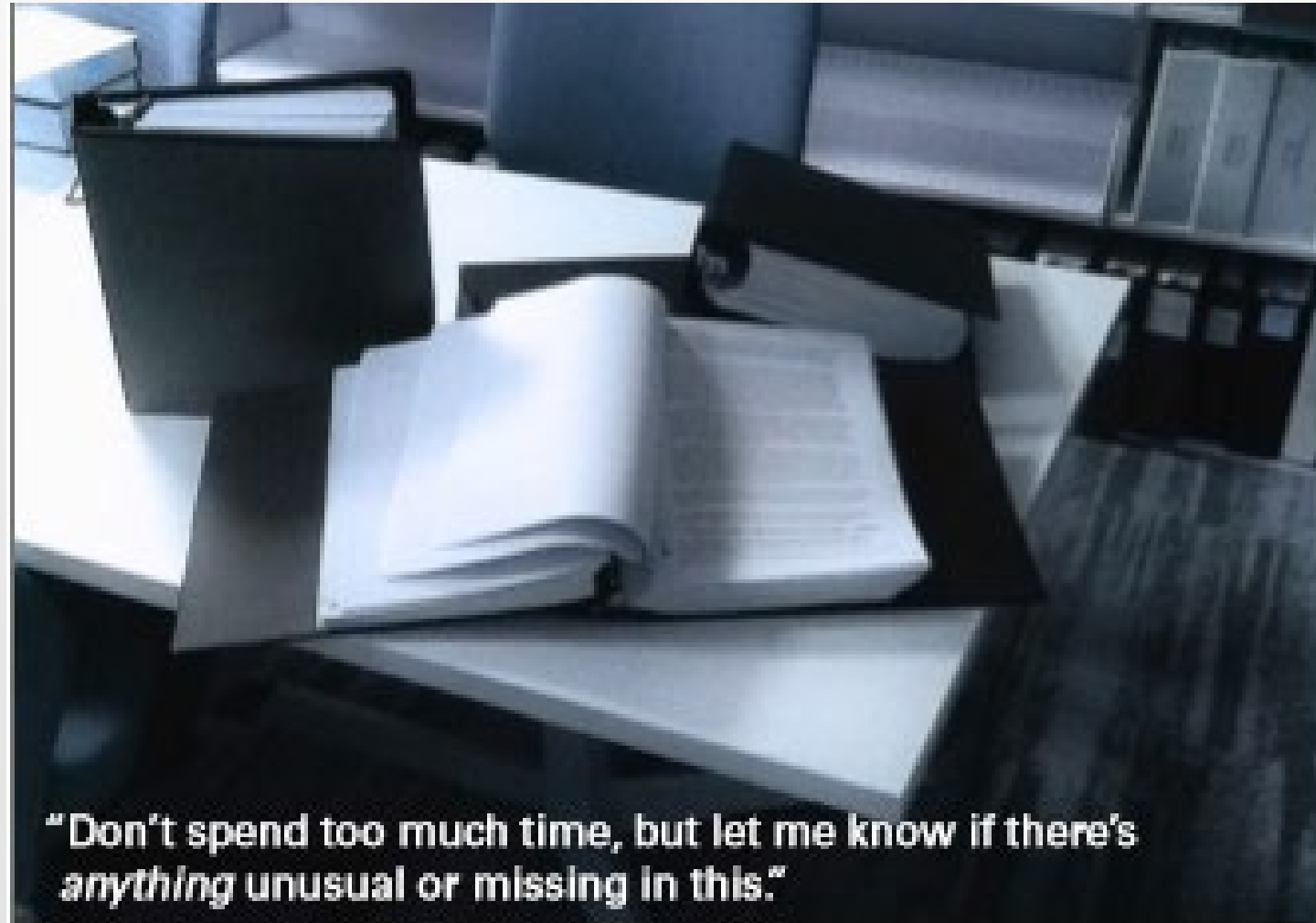
- Design-Bid-Build (DBB, low bid)
 - Owner (O) retains architect or engineer (A/E) who produces complete *design*
 - O *bids* construction work per design
 - O awards contract to General Contractor (GC) who *builds*
 - + *Competitive bidding, complete definition, O controls A/E, public works laws*
 - *Competitive bidding, contractor selection, evolving design, A/E vs GC, time*
- Construction Management (CM, CM@R, CMC, ...)
 - O retains A/E, construction manager (CM) and multiple trade contractors, vendors
 - + *CM expertise in preconstruction phase, O controls A/E, CM can assume risks or just advise*
 - *Points of responsibility (A/E vs CM vs TC₁ vs TC₂...), overlapping or conflicting roles*

Project delivery methods



- Engineering, Procurement & Construction (EPC)
 - Variants or alternative names: Design-Build (DB), EPCM, DBOM, DBFOM, BOOT...
 - O may initially retain a schematic or conceptual A/E and a CM (alternative: FEED)
 - O retains EPC contractor (maybe the CM or FEED, maybe not)
 - EPC retains the executive A/E that produces the remaining designs, and retains the subcontractors and suppliers
 - + *Near essential for project finance (ballgame!), single point of responsibility, induce and select the best contractor, time savings compared with DBB*
 - *O does not control executive A/E, issues with evolving design, loss of O leverage, possible lack of competition given CM's role or inside track*
- No project delivery method is perfect for every project

What is an EPC contract?



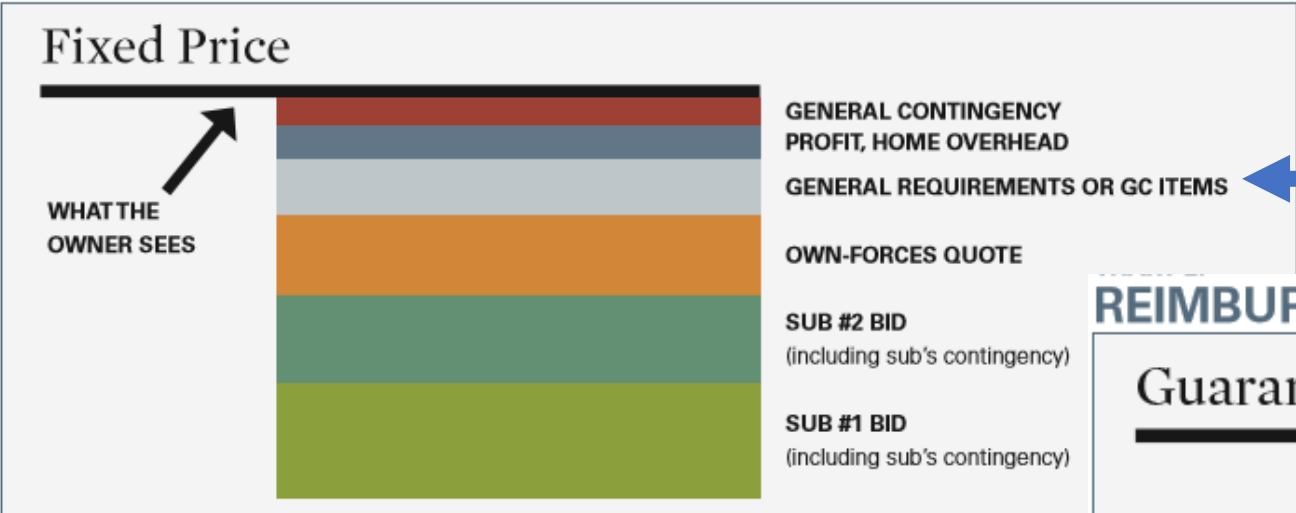
What is an EPC contract?



- **Owner-Contractor Agreement** (*Construction, EPC, D-B, LSTK, GMP, ...*)
- **General Conditions (meaning #1!)** (*OCA and GC often combined in manuscript forms*)
- **Special or Supplementary Conditions**
- **Plans (index sheet) (usually evolving)**
- **Specifications, usually per Construction Specifications Institute (CSI)**
Division I. *General Requirements* (meaning #2!)
D2. *Existing Conditions*, D3. *Concrete*, D4. *Masonry* ... (up to Division 48 now)
- **Exhibits** (*lien waivers, change orders, pay applications, certifications, direct contracts, ...*)
- **Schedules** (*Schedule of Values, safety plans, insurance, Subguard, guarantees and processes*)
- *[...and codes, regulations, statutes, caselaw, policies, and “Prudent Industry Practices”]*

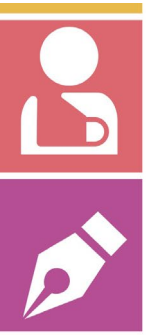
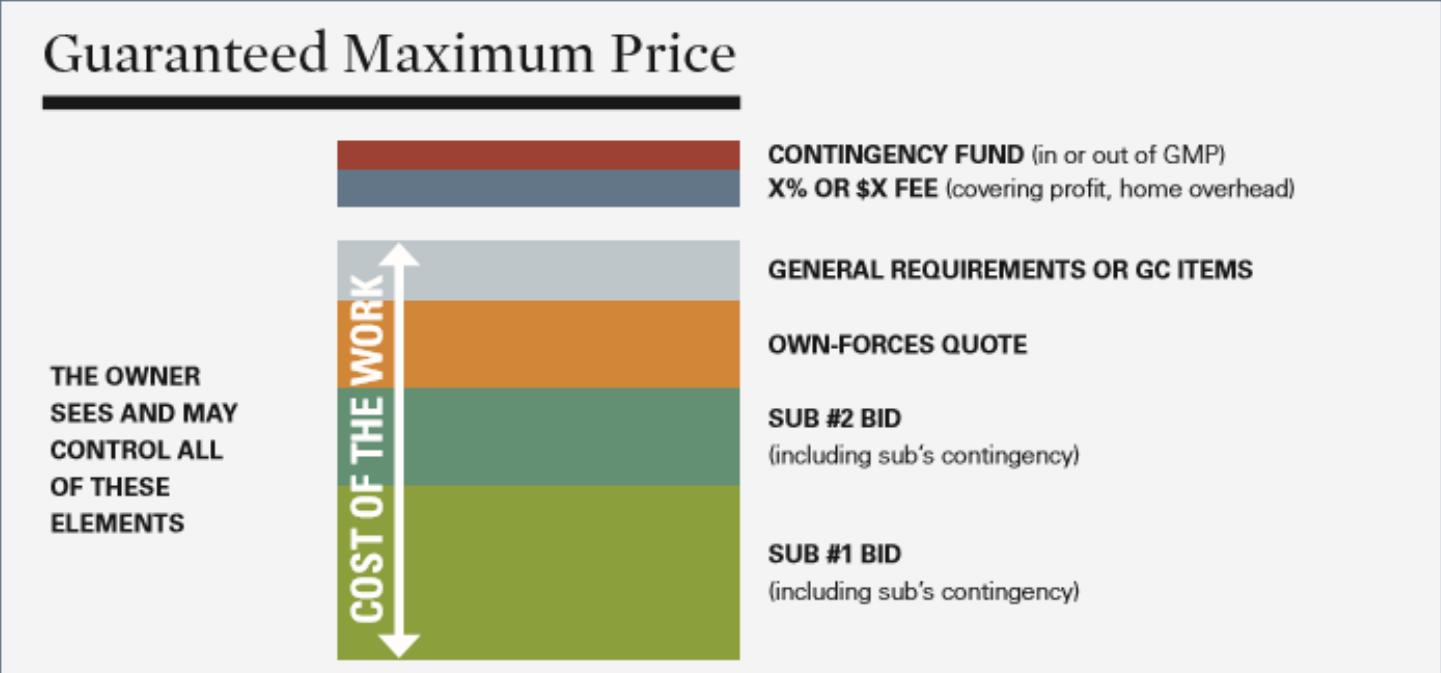
EPC Prices

FIXED-PRICE PRICING COMPONENTS



(Meaning #3!)

REIMBURSABLE-COST PRICING COMPONENTS



What are GCs or GRs?



- Not direct costs of items incorporated into final product
- Often, costs that do not have risks associated with them
- Direct Costs + GC/GR plus Fee (\$, or %, or % of Direct Costs)
- **GC/GR:** *mobilization, trailer, computers, phones, project executives, home office support, insurance for overall business, vehicles, utilities, cleanup, security, safety, protective devices (COVID-19), parking, temporary facilities*
- Fee \$ or % also varies with size and risks of job, carrots and sticks, % design complete, contingency, “float,” market conditions, presence of financier and its engineer
- So a 5% fee with lots of GCs is not necessarily a better deal than a 10% fee with limited GCs

EPC Contract Provisions



Parties & Definitions



Scope



Time & Money



Completion



Liability



Defaults & Disputes

Parties and Definitions



Parties &
Definitions

- Recitals describe structure and other agreements. Correct? Have you seen them?
- Key definitions are the *escape hatches*—clauses that may bust the price, schedule or performance standards. “Changes in Law,” “Force Majeure,” “Change Order,” “Owner-Caused Delay.” Time, or time and money?
- Priority of documents. Preference is for OCA and GC priority.
- Communications—can O contact A/E? can O contact subs?
- Party representatives, right to object to personnel
- O control over or input into subcontractor selection?

Scope



Scope

- EPC agrees to perform all work required by Contract Documents—or all work needed to produce a final facility consistent with overall program? Avoid incorporating bid proposal
- EPC accepts existing conditions and documents—and designs?
- Environmental, hazmat obligations and carveouts
- Employment and safety obligations
- Coordination among contractors, training of O personnel
- Exclusions from scope—O obligations are escape hatches.
This is where disputes are lurking
- O duties—make payments when “due,” get O permits, grant access, pay taxes, furnish special surveys (e.g., geotechnical, phase I enviro)

Time



Time &
Money

- Notice to Proceed (NTP) date, now or later?
- EPC commits to achieve Substantial Completion x days after NTP, Final Completion y days after that
- Initial schedule, critical-path method (CPM) schedule, “float” (what is it? who “owns” it?)
- Reporting of progress
- Recovery, acceleration for delays
- Warning, changes and delays can derail the schedule and cost commitments
- Limited notice to proceed (LNTP) for preliminary work—but watch project finance lender mortgage priority

Money



Time &
Money

- Contract Price
 - Fixed fee (stipulated sum (AIA), lump sum turnkey (LSTK))
 - Variable (reimbursable cost, guaranteed maximum price (GMP/GMC), time and materials (T&M), cost-plus, target price hybrid...)
- Include or exclude taxes, permits, other items—escape hatches
- Contingency—what for, who may use, how used
- Allowances—what for, effect of overrun or underrun
- Progress payments (monthly, or by milestones) against Schedule of Values, lien waivers; lenders like A/E or their E to certify
- Retention, setoff, disputed items—lenders want many O remedies
- Final payment after completion tests and guaranties met

Changes & Delays



Time &
Money

- Owner directed changes
- EPC identified (“constructive”) changes
- EPC proposes cost and schedule impact, parties negotiate
- O right to dictate a change, resolve later, pay certain amounts pending resolution
- Pricing, especially of markups on subcontractor and EPC prices; use of contingency
- Schedule impacts, use of float

Completion



Completion

- *Substantial Completion*—ready for revenue! Impacts warranties, insurance, risk of loss, operation/maintenance, site security
- *Final Completion*—everything is done. Impacts lien exposure, payment of retention. Don't confuse SC with FC
- Performance tests—facility meets all requirements, or for certain items, compensate O for shortfall.
- Delayed completion—usually liquidated damages of \$/day, sometimes terraced, sometimes grace periods. Usually delay LD-specific cap. Designed to cover debt service, take away any profit incentive for delay
- Performance shortfall—sometimes liquidated damages of \$/underrun on facility output or \$/overrun on emissions. Usually performance LD-specific cap. Intended to achieve model's goal of debt coverage and profit.

Completion



Completion

- *Mechanical warranty*—against defects in design, material and workmanship. Often 12 months after Substantial Completion. Extended warranties for major equipment, proprietary tech.
- *Correction*—right (or right and duty) of EPC to come back and repair an item.
- Disclaimer of consequential damages (what is a consequential damage? Third-party indemnity claims, LDs excluded?)
- Passage of title (as you go, or on completion?)
- Risk of loss (usually all on Substantial Completion)
- Completion of segments of the work

Liability



Liability

- Indemnities
 - EPC indemnities (include lender?)
 - O indemnities (e.g., often for existing hazmats)
- Liability Insurance
 - Workers' compensation, employers' liability, commercial general liability (CGL), auto/vehicle, pollution legal liability (PLL), professional liability, ...
 - Additional insureds—O, in some cases lenders
- Property Insurance
 - Builders' All Risk (BAR), business interruption, delay in completion, deductible coverage
- Controlled insurance programs (OCIP, CCIP, Subguard, ...)

Liability



Liability

- Security for performance
 - EPC furnishes parent guaranty, letter of credit, securities, surety bond
 - O furnishes evidence of financing, now and later?
- Releases of liability
- Confidentiality obligations
- Ownership of work product, licenses to use non-owned IP
- Global liability ceiling

Defaults & Disputes



Defaults &
Disputes

- Definition of default (*occurred or potential? notice, cure opportunity?*)
- Remedies (withhold payment, suspend, self-help, terminate)
- Force majeure excuse, suspend, ultimate termination right?
- Dispute resolution (usually discussion, mediation; sometimes technical expert resolution; Dispute Review Board; litigation vs. arbitration) *check for consistency across project agreements*
- ○ right to assign (*so long as creditworthy*)
- ○ right to assign for security (*direct contract, often with greater rights for lender than for O*)

Key project finance takeaways



- Are the price and schedule satisfactory to start with? Does the client understand the escape hatches? Is the information provided to the EPC reliable? Is there float in the schedule, contingency in the price, owner contingency above the price?
- Are the remedies (especially LD rates and caps) sufficient? Delay LDs cover debt service for X months, and LDs remove profit and overhead coverage to EPC
- What is Plan B if the contractor defaults? Are replacements available? A lawsuit is not a remedy—need setoff, recoupment, liquid security
- Can O get out—are there suspension, termination and assignment rights, and a likely purchaser of the contract or the work in progress?
- Have you implemented the specific lender requirements in the EPC contract and the direct contract?
- AND has your EPC team done the blocking and tackling—protecting against liens, excluded site conditions, and a hundred other things?

CLE program code



2020-xxx

Thanks!



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