COVID-19: EPC AND EPCM IN LARGE CONSTRUCTION PROJECTS POST COVID-19

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Construction Alert

By: Paweł Piotrowski, Nicola J. Ellis

COVID-19 has highlighted some of the existing problems in the construction market such as fragmentation, low profitability and often low satisfaction for both owners and contractors (due to time and budget overruns and lengthy claims procedures and disputes). In this article, we consider the choice of the procurement method for large construction projects and issues and risks raised by COVID-19.

EPC

Owners often procure major construction projects on a fixed price, lump sum turnkey contract whereby the contractor is responsible for all engineering, procurement and construction (EPC) aspects of the development by a specified date (subject to a limited number of circumstances which will provide the contractor with relief). Under this arrangement, the EPC contractor directly engages the supply chain and takes responsibility for building and delivering the project so that the owner simply has to 'turn the key'. Any changes or variations that the owner may require to the original scope provided to the EPC contractor will be at the owner's risk and therefore it is important to have a high degree of certainty and detail as to the scope of works, and often a detailed design provided by the owner to assist the EPC contractor in providing an accurate price.

The EPC has many advantages for the owner, including that it places lower management burden on them. It provides a single point of responsibility for the project to the owner and gives the owner and any lenders a high degree of certainty as to the time and cost of the development. Since the owner has recourse against a single contractor rather than having to pursue multiple contractors and suppliers, the dispute resolution process is usually less complicated. The EPC contractor should therefore seek to pass down all main obligations from the EPC contract onto its subcontractors to mitigate its liability position.

In return for taking on a high amount of risk as to time and cost, contractors may reflect this in their pricing and may include a substantial risk premium in the contract price. Owners can mitigate this to some degree by procuring EPC contracts in competitive tenders where the lowest price is often the decisive factor. That, in turn, often results in EPC contracts carrying a risk of change orders / variations which can become very costly to the owners if agreed or potentially catastrophic to those contractors who haven't included a sufficient risk premium when submitting a low price proposal, leading to a focus on cost control by the contractor.

In these unprecedented times, the risk of force majeure events, effects of a change in law, risk of supply chain disruptions and the risk of integrating the performance of the entire supply chain have posed a particular challenge for contractors. As a result, contractors may become more reluctant to take on some of these risks and may seek to exclude or set parameters around their liability for such risks or owners may see tenders with higher risk premiums.

EPCM

Where the owner wishes to retain greater control over the project, the owner may opt for an EPCM contracting structure.

The EPCM or 'engineering, procurement and construction management' contract is a construction management agreement whereby the EPCM contractor is responsible for advising the client on the design and procurement of the project but also for overseeing and managing all construction and supply contracts. An EPCM contract can therefore be seen more as a professional services contract in contrast to EPC contracts which are design and construction contracts. The EPCM contractor does not perform construction work. It is the owner who directly enters into numerous contracts with various contractors and suppliers.

EPCM has many advantages for owners, including greater flexibility allowing projects to be tailored to current conditions as owners can modify the design or procurement plan mid-project and negotiate directly with the relevant contractors or suppliers. This can mean early engagement of certain packages prior to finalising the scope of work which may result in an earlier completion date.

The overall price of the project under an EPCM arrangement may be lower as most of the risk priced for in EPC contracts sits with the owner and the owner is able to negotiate with the supply chain itself.

EPCM also has disadvantages. The administrative burden of the owner directly negotiating and contracting with each of the contractors or suppliers is far greater than under EPC and significant demands are placed on the owner's skills and resources (although the EPCM contractor may be able to ease this burden). Interface risk and coordination between each contractor or supplier needs to be managed and this often sits with the owner. Where a dispute arises, this is also more complex for the owner due to difficulties in allocating fault and risk amongst multiple contractors, rather than having a single point of responsibility as under EPC contracts.

However, from our experience, most of these disadvantages can be reduced by way of proper implementation strategy, planning, contracting and management.

Both EPC and EPCM have advantages and disadvantages but can be beneficial when used in the right circumstances. The objectives, scope of work and risk profile should be clearly understood in choosing which method to use as the cost implications of choosing the incorrect form can be substantial for both parties.

KEY CONTACTS

PAWEŁ PIOTROWSKI
PARTNER

DOHA
+974.4.424.6109
PAWEL.PIOTROWSKI@KLGATES.COM

NICOLA J. ELLIS
PARTNER

LONDON
+44.20.7360.8261
NICOLA.ELLIS@KLGATES.COM