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The adversarial nature of EPC contracts in construction projects

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There are several contracting models used in construction projects. This blog covers the Engineering, Procurement, and Construction (EPC) contracting model, which is widely used for large-scale infrastructure projects. Its appeal is due to the turnkey approach, which places the responsibility for design, procurement, and construction on a single contractor.

An EPC contract aims to streamline project delivery, reduce interfaces, and allocate risk to the party best positioned to manage it. However, the adversarial nature of EPC contracts often leads to significant challenges and disputes, impacting project success.

5 key factors contributing to adversarial relationships in EPC contracts

Generally, from the owner's perspective, EPC contracts are intended to incentivise efficiency and innovation, however, this contracting model often leads to conflicts and disputes when unforeseen issues arise, as discussed below.

Risk allocation

The fundamental premise of EPC contracts is that the contractor assumes most of the project risks, including design errors, cost overruns, and schedule delays.

The extensive risk transfer to contractors can lead to defensive behaviours and a focus on risk mitigation at the expense of collaboration. Contractors will usually react by adopting a highly conservative approach, which then leads to overpricing their bids, or they include extensive contingencies to manage potential risks.

Fixed-price structure

One of the key characteristics of EPC contracts is that they are usually fixed price, meaning that the contractor bears the cost of any overruns.

When faced with the pressure of higher-than-anticipated costs, this can result in cost-cutting measures that compromise quality or scope, leading to disputes. Disputes can also arise when the contractor is motivated to only do the minimum required to complete the project within the budget.

Uncertainty

Large-scale EPC projects are inherently complex and subject to numerous uncertainties, such as regulatory changes, site conditions, or other stakeholder requirements. These uncertainties can lead to scope changes, claims, and disputes regarding which party or stakeholder should bear the responsibility for those uncertainties.

Performance metrics

EPC contracts will usually contain strict performance metrics and liquidated damages clauses. The purpose of such clauses is to incentivise contractors to meet deadlines and performance standards, but these clauses typically lead to conflicts when targets are missed due to factors beyond the contractor's control.

Strategies to mitigate adversarial relationships

To address the adversarial nature of EPC contracts, several strategies are suggested as follows:

Collaborative contracting models

On the wide spectrum of collaborative models of contracting, Alliance Contracting would emphasise shared risk and reward mechanisms, collective decision-making, and open communication. A collaborative contracting model can reduce adversarial behaviours by aligning the interests of all parties and fostering a culture of collaboration.

Early contractor involvement (ECI)

As the name suggests, ECI requires involving contractors early in the project lifecycle.

ECI allows contractors to contribute to design development, risk assessment and value engineering, leading to more realistic project plans and better alignment of expectations. ECI can

enhance collaboration and reduce project delays and cost overruns in the construction or infrastructure project.

Clear and equitable risk allocation

Clear and equitable risk allocation within a contract is key to reducing adversarial behaviours. Contracts should clearly define the responsibilities and liabilities of each party, ensuring that risks are allocated to those best able to manage them.

This approach can prevent disputes over scope changes and unforeseen conditions. For instance, the use of risk registers and risk workshops can facilitate a mutual understanding of project risks and promote proactive risk management.

Effective communication and dispute resolution

In any construction or infrastructure project, open communication channels and robust dispute resolution mechanisms are critical for managing conflicts and fostering collaboration.

While this is not always the case, EPC contracts should include standard provisions for regular progress meetings, issue resolution protocols, and alternative dispute resolution (ADR) methods, such as mediation and arbitration. Within the construction and infrastructure industry, ADR has been effective in resolving disputes in construction projects without resorting to costly and time-consuming litigation.

Performance-based incentives

Incorporating performance-based incentives into EPC contracts can align the interests of all parties and promote collaborative behaviours. These incentives can include bonuses for early completion, shared savings clauses, and rewards for meeting sustainability targets.

Other contracting models for construction and infrastructure projects

While the EPC contracting model is the focus of this blog, it is important to note that several popular contracting models are commonly used in Australia for construction and infrastructure projects.

Design and construct

The contractor is responsible for both the design and construction of the construction project. This type of contract has many similarities with the EPC contracting model because of its integrated

approach. Under this model, the main goals include streamlining the interfaces between the project owner or principal and the contractor, and to improve project delivery times.

Traditional lump sum contract

Also known as a fixed-price contract, this model involves a single lump sum payment for the entire project. The contractor agrees to complete the work for a set price, bearing the risk of cost overruns.

Cost plus contract

Under this model, the contractor is reimbursed for all construction costs plus a markup which is usually defined as a predetermined fee or percentage. This approach is used when project scope is not well-defined. Although it offers flexibility there is less cost certainty.

Public-private partnerships

This arrangement is a collaborative type of contract, typically between public sector authorities and private sector companies. The private sector typically finances, designs, builds and operates infrastructure projects, while the public sector provides oversight and regulatory support.

Alliance contracting

This construction contract model brings together the client and one or more key stakeholders into a single integrated team. All parties share the project's risks and rewards. The goal of alliance contracting is to achieve the '*best for project*' outcomes.

Get help from a construction lawyer with EPC experience

Selecting an appropriate contracting model for a construction or infrastructure project requires careful consideration at an early stage.

Wambeti Legal works with clients who are involved in EPC projects with a specific focus on businesses that contract under the Tier 1 project owner. We can assist with the detailed and often complex negotiations required in EPC contracting.

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