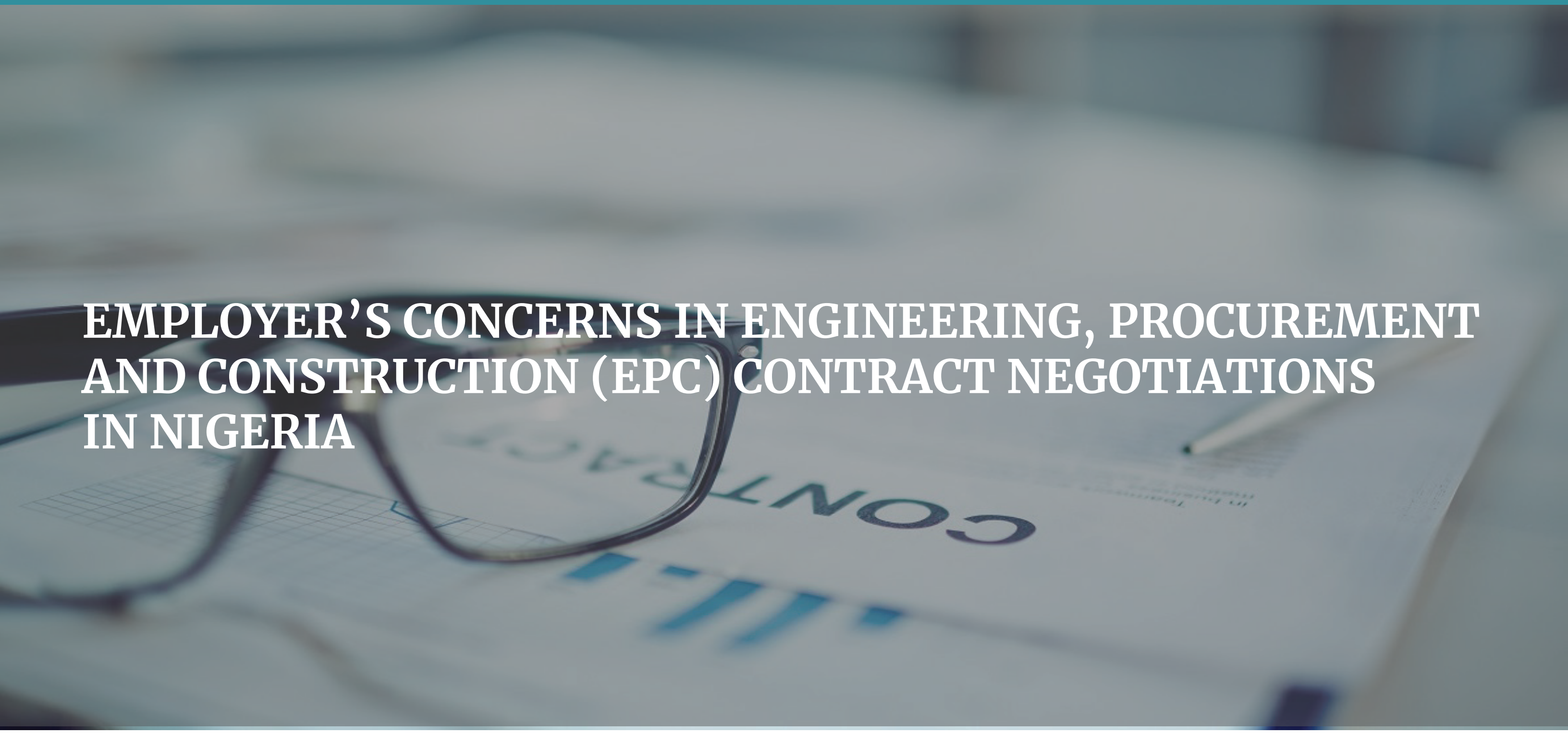

EMPLOYER'S CONCERNS IN ENGINEERING, PROCUREMENT AND CONSTRUCTION (EPC) CONTRACT NEGOTIATIONS IN NIGERIA

Introduction

Infrastructure is the backbone of every country in the world and without them, there would be no structural transformation and social amenities that are necessary for the desired development in different sectors of a country's economy. These social amenities include those related to transportation, power, ports, oil, and gas, amongst others.

Often, such infrastructural projects are complex and carry enormous risks, due to the vagaries of nature, politics, technology, finance, and human error. Indeed, it is such risk-related characteristics of infrastructural developments that led to the emergence of Engineering, Procurement and Construction (**"EPC"**) Contracts.

EPC Contracts serve as the basis upon which Employers and Contractors, may have definitive agreements, that provide clear risk allocation mechanisms and certainty of key terms, to govern their relationship and for the development of the requisite project. Under it, the Contractor takes the responsibility and risks for the design, procurement, construction, commissioning, and handover of a project to the Employer. Thus, the Employer provides the Contractor with a detailed scope of work, including the technical and functional specifications of any machinery or facility to be constructed, and the Contractor develops the project from its commencement to final completion. Upon completion, the project is handed over to the Employer for operations. This article, therefore, seeks to examine key Employer concerns that would usually be addressed in such EPC contracts.

EPC Contract Models

Parties to EPC Contracts in Nigeria typically negotiate their contracts based on drafts, prepared by their lawyers. Some may also be drafted based on the template developed by the International Federation of Consulting Engineers (Fédération Internationales des Ingénieurs-Conseils) (**"FIDIC"**) and adopted by the Association of Consulting Engineers Nigeria (**"ACEN"**). Other common contract forms, used, include:

a. The Standard Bidding and Contract Documents produced by the Bureau of Public Enterprises (for public procurement works);

b. The Engineering Consultancy and Project Management Services Agreement, Charges and Conditions of Engagement produced by the ACEN, Council for the Regulation of Engineering in Nigeria (**"COREN"**) and the Nigerian Society of Engineers;

c. Standard forms of contracts prepared by the Joint Contract Tribunal (**"JCT"**);

d. Federal Ministry of Works Contract (a variant of the JCT); and

e. The General Conditions of Contract for the Procurement of Works, 2011.

Features of an EPC Contract

In any construction contract, the key considerations between the Employer and Contractor relate to costs, timelines, and quality. That said, We have set out below, some of the main features of EPC Contracts and the general terms contained therein.

a. Certainty of Price/Cost

The certainty around costs, relating to EPC-type Contracts is one of the main reasons why it is a preferred choice, when compared with traditional construction contracts, particularly in projects that will be financed via off-balance sheet limited/ non-recourse financing. The Contractor and the Employer would usually agree to a lump sum payment, prior to the start of the contract and the sum remains the same regardless of the increase in the price of materials and/or hardware. Therefore, it deters the Contractor from seeking unwarranted requests for price/fee increase notwithstanding market and price economics. That said, it is pertinent to note that, there may be change orders necessary to remedy errors and omissions. Some of these errors and or omissions may be by the Contractor or its Subcontractors, and same could lead to cost overruns. The relevant Employer should do well to exclude increases to the cost of the works or services, resulting from change orders resulting from Contractor or Subcontractor errors and or omissions.

b) Certainty of the Completion Date

Typically, lenders would be concerned about completion risks, that is, the Contractor's default in delivering the project within the agreed timelines, due to unexplained delays. The EPC Contract minimizes instances of such delay, considering that one of the key decisions to be made at the preliminary stage of negotiation, is to agree on the project delivery date. Generally speaking, change orders; especially requested by the Employer, could lead to changes in completion dates. It is germane that, the Employer bears this in mind, especially where the requisite change order does not result from a default of the Contractor.

c) Sole Responsibility

Under EPC Contracts, the Contractor assumes the sole responsibility of delivering the project in line with the contractual terms. This is irrespective of the fact that the Contractor sub-contracts some of his obligations under the contract. Thus, the Contractor undertakes an obligation to ensure that the project is delivered in time and that it conforms to the agreed standard between the parties.

d) Risk Allocation

A notable feature of EPC contracts is risk allocation. Unlike other types of construction contracts, the risk allocation under EPC contracts is usually preset in a manner that the Contractor bears most of the construction risks, thereby leaving the Employer with little or nothing to worry about, as it concerns construction quality and delivery.

e) Caps on Liability

Generally, EPC Contractors negotiate to take up limited liability for projects and seek to cap their liability at a percentage of the contract price. There are normally sub-caps on the Contractor's liquidated damages liability, such as, delay liquidated damages (**"DLDs"**) and performance liquidated damages (**"PLDs"**).

f) Performance Guarantee

The project company's revenue will be earned by operating the project and it is part of the revenue generated from the project, that will be used to pay back the off-balance sheet/ non/limited recourse financing obtained for constructing the same, in the first instance. Therefore, it is vital that the project performs, as required in terms of output, efficiency, and reliability. Thus, EPC contracts contain performance guarantees given by the Contractor and backed by PLDs payable by the Contractor, where there is a failure to meet such guarantees.

Contractor General Obligations

Irrespective of the model of contract developed for engaging the Contractor, the Contractor's obligations are usually similar and generally provide that "***the Contractor shall execute the works in accordance with the Contract. When completed, the works (or Section or major item of plant, if any) shall be fit for the purpose(s) for which they are intended, as defined, and described in the Employer's Requirements or, where no purpose(s) are so defined and described, fit for their ordinary purpose(s)***". [1]

The above obligation of the Contractor speaks for itself and requires that the Contractor strictly complies with the provisions of the EPC contract. The Contactor is guided by the terms of the contract for the fulfilment of his obligations and the completed works must be fit for the desired purpose(s), or when there is none, for their ordinary purpose(s).

The provision provides further that the "***Contractor shall provide the plant (and spare parts, if any) and Contractor's documents specified in the Employer's requirements, and all Contractor's personnel, goods, consumables and other things and services, whether of a temporary or permanent nature, required to fulfil the Contractor's obligations under the Contract***", and that "***The Contractor shall be responsible for the adequacy, stability and safety of all the Contractor's operations and activities, of all methods of construction and of all the works. The Contractor shall, whenever required by the Employer, submit details of the arrangements and methods which the Contractor proposes to adopt for the execution of the works. No significant alteration to these arrangements and methods shall be made, without this alteration having been submitted to the Employer.***"

The above closing portion of the said provision further reinforces the point that the responsibility to procure materials that fulfil the Contractor's obligation squarely rests on the Contractor and must, be in line with the Employer's requirements.

Employer's Concerns in EPC Contracts Negotiations

Based on the general requirements of an EPC contract, the issues which an Employer would seek to address, during negotiations with the Contractor are as follows:

a) Commencement, Delay and Suspension

Usually, unless the commencement date is stated in the contract, the Employer would be required to give notice to the Contractor stating the same, days ahead of such commencement date. However, considering the understanding that delays may arise, the contract would normally provide that where such delays arise, an extension of time may be assessed in accordance with the rules and procedures stated in the contract.
The Contractor usually agrees to commence the execution of the works on, or as soon as is reasonably practicable, after the commencement date, and shall then proceed with the works with due expedition and without delay. It is important to note that the Employer retains the right to, at any time, instruct the Contractor to suspend the progress of part or all works, which instruction shall state the date and cause of the suspension. During such suspension, the Contractor would be required to protect, store, and secure such part or all the works (as the case may be) against any deterioration, loss, or damage.

b) Staff, Labour and Equipment

Usually, the Employer will want to ensure that the Contractor takes responsibility for the provision of staff, labour, and equipment. Likewise, the Contractor takes sole responsibility for the employment, payment of wages and provision of facilities to work with, amongst other things. It is important to the Contractor that the Employer complies with the necessary obligations as it concerns subcontractors engaged in respect of the project.

c) Price

Usually, the Employer ensures that the Contractor bears the risk of contract price sufficiency. This refers to the agreed amount stated in the contract for the design, execution and completion of the works and the remedying of any defects or adjustments if any. This is important because most project finance contracts which are structured as EPC, are usually financed by lenders and it will be comforting for lenders to be aware that the price is fixed and shielded from any consistent requests for price change during the project.

1. Clause 4.1 of the FIDIC Silverbook. FIDIC Suite of Contacts, Available at https://www.fidic.org/sites/default/files/FIDIC_Suite_of_Contracts_0.pdf accessed on June 14, 2022.

d) Variations and Adjustments

It is imperative that the Employer properly negotiates a contract that gives him the right to order variations and agree to variations from the Contractor. Where variation is not intended, it is important that the wordings of the EPC contract reveal that the agreed design and scope of work are cast in stone and cannot be varied. A properly drafted variation clause should make provision for how the cost of a variation is to be determined. Where parties do not reach an agreement on the cost of a variation, the Employer may determine the cost subject to the dispute resolution provisions. In addition, the variation clause would detail how any impact on the performance guarantees is to be treated. For larger variations, the Employer may also wish to receive additional security and negotiate the same in the variation clause.

e) Employer's Personnel

There are many instances where the Employer provides support to the Contractor by providing for the Contractor's use, during the pendency of the contract, of some of its personnel. It is important that such personnel cooperate with the Contractor's efforts and adhere strictly to the health, safety, and environmental standards of the Contractor. Where necessary, the Contractor may require the Employer to remove any Employer's Personnel or the Employer's other Contractors (if any) who are found based on reasonable evidence to have engaged in corrupt, fraudulent, collusive, or coercive practice.

f) Design

The liability for the design of the works rests solely with the Contractor and is usually required to be in line with the Employer's requirements, the accuracy of which the Contractor shall be responsible for. The Employer, in negotiating an EPC contract, must in line with the specifications for the project, ensure that the sole responsibility and liability for the correctness or otherwise of the project design lies on the Contractor in all instances, except for as it relates to the intended purpose. This is important, considering that lenders usually require a single point of responsibility for the design and the construction of the works.[2]

g) Indemnity and Liability

A limitation of liability clause operates to limit the Contractor's total exposure up to a specified percentage of the contract sum. Usually, the contract would provide that the Contractor shall be liable for any loss or damage caused by the Contractor to the works, goods, or Contractor's documents after the issue of a Taking-Over Certificate[3], or which arose from an event which occurred before the issue of the Taking-Over Certificate, for which the Contractor was liable. Such liabilities are however generally subject to certain exceptions, such as the use or occupation by the Employer of any part of the permanent works. In such instances, the Contractor may not be liable and as such, the Employer must acquaint himself with same to know the extent of the liabilities of each party.

Furthermore, the Contractor usually indemnifies the Employer for all bodily injury, sickness or death, or loss of or damage to property, occasioned by reason of the Contractor or his agent's execution of the works, and against all acts, errors, or omissions by the Contractor in carrying out the Contractor's design obligations that result in the works. Conversely, the Employer indemnifies and holds harmless the Contractor, the Contractor's Personnel, and their respective agents, against and from all third-party claims, damages, losses and expenses (including legal fees and expenses) in respect of any bodily injury, sickness, disease or death, or loss of or damage to any property other than the works, which may be attributable to any negligence, wilful act or breach of the Contract by the Employer, the Employer's Personnel, or any of their respective agents.

h) Assignment

The general understanding is usually that neither party shall assign the whole or any part of the Contract or any benefit or interest in or under the Contract. However, there may be instances where either party may assign their rights or obligations in whole or part, such as:

i) Assignment with the prior agreement of the other Party and at the sole discretion of the other Party;

ii) Assignment as security in favour of a bank or financial institution, a Party's right to monies due, or to become due, under the Contract without the prior agreement of the other Party.

However, the Employer may reserve the right, for reasonable cause and in good faith, to object to the intended assignment by the Contractor. Hence the need for the Employer to pay attention to this clause during the negotiation of an EPC contract to understand the extent to which the Contractor may rightfully assign its obligations thereunder.

i) Claims and Dispute Resolution

Disputes mostly arise out of time delay, quality, or cost overruns in respect of deliverables under the Contract. This is so because the Contract defines the obligations of parties to meet project performance and the requisite recourse where such agreed obligations are not or are under-performed. Thus, when the implementation of a project differs from the parties' expectations and agreements, either party may present claims, the Contractor, for additional payments, or the Employer, for a price reduction. Where the Employer is dissatisfied with the Contractor's performance, the Employer may withhold payments on grounds of liquidated damages or raise a counterclaim to the Contractor's claims for payment. Whichever the case, such situations may inadvertently lead to a dispute. The dispute resolution clause sets out the mode(s) of dispute resolution and the procedure by which the parties will resolve any disputes arising from the Contract. Modes of dispute resolution include negotiations, mediation, conciliation, court proceedings, adjudication, and arbitration.

j) Risk Allocation

The assessment of which party would be affected by a particular risk is a major concern and often brings about complications where not specifically laid out. It is important that parties specifically spell out each other's risk and where not expressly provided for, the language of the contract imply the same. The Employer should in all instances be certain as to who bears what risk at the point of negotiation.

Typically, in most projects, the following risk allocation operates; market risk would be borne by the Employer; design, construction and commissioning risk would be borne by the Contractor; while maintenance and operation risk would be left to the operator.[4] It is important that the Employer is mindful of the risk allocation clause because, by the nature of EPC contracts, Employers are more disposed to reducing the risks that tilt towards them, to the barest minimum.

k) Contracting and Sub-Contracting.

Typically, EPC Contracts allow the Contractor to subcontract some of its obligations to third-party subcontractors,

2. Huse, Joseph A. Understanding and Negotiating Turnkey Contracts. Sweet & Maxwell. 1997. 48

3. A certificate issued by Employer evidencing successful and satisfactory completion of the awarded work per the EPC Contract.

4. Ibid 2, page 46.

especially upon notification of the Employer of such intention to appoint a subcontractor and to obtain the Employer's approval for the purpose. However, the Employer may reserve the right, for reasonable cause and in good faith, to object to the intended appointment of the subcontractor. Regardless of the appointment of a subcontractor, the Contractor remains fully responsible for the works performed by the subcontractor and for any act or omission of the subcontractor. This is so because, in principle, the Contractor is fully liable to the Employer for the proper performance of its obligations, including those fulfilled through subcontractors and suppliers.

Generally, contracts may provide that guarantees and warranties of subcontractors must be passed on to the Contractor. This is to serve as additional security for the Employer, rather than to limit the Contractor's guarantees. Except otherwise agreed by the parties, the Contractor remains obliged to give the Employer his own guarantee and that of his subcontractors.

l) Performance and Employer Take Over

Upon the completion of a section of the work by the Contractor, he transfers responsibilities relating to the completed work, to the Employer. This transfer is referred to as "Employer Take Over". This concept of takeover is of fundamental importance, given the turnkey aspect under an EPC contract. Thus, testing and commissioning are usually the Contractor's responsibilities, before the completion and takeover of the project. Clauses pertaining to testing, commissioning and takeover will set out the procedure for the Employer to take possession of the constructed facility. It is important for the Employer to expressly agree to whether liability for risk passes when a section of work is completed and taken over by the Employer, or after the delivery of the entire project. Depending on the particular transaction, the Employer, may, in his negotiations, preclude his obligation until all parts of the project have been taken over, or he may immediately assume responsibility upon takeover of each completed portion.

Upon takeover, it is important that the section handed over by the Contractor performs up to the set standard in the Employer's requirement. Thus, a "Tests after completion" clause would usually be provided, to stipulate that after taking over, the tests after completion would be carried out to ensure that the works perform up to the level required by the Employer's requirements before the issuance of taking-over certificate by the Employer.

Where the works or a section fails to pass the test on completion, the Employer may reduce the contract price by a pre-agreed amount.

CONCLUSION

Essentially, EPC contracts are forms of construction contracts, where the risks and responsibilities of a project are transferred from the Employer to the Contractor, usually from design to completion. Considering that the essence of negotiating contracts is for parties to minimize their risks to the barest minimum by assigning to the Party best able to deal with such risks and maximize profits, as much as they can, contracting parties should consider negotiating on the relevant terms and ensuring that the project's milestones are clearly set out in the EPC Contract. Although, there are various standard forms of contract that may serve as the templates for EPC Contracts, parties may negotiate peculiar risks to cater for their respective unique business needs and requirements. A carefully drafted and reviewed EPC Contract will minimise the risks of future disputes between the parties. Hence, it is best practice for Employers to understand the implications of such risks before executing the EPC contract.

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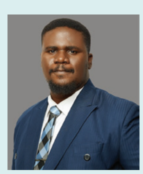

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