This Note discusses the conditions under which the contract price may be increased and the time to perform may be extended under a lump sum engineering, procurement and construction contract.

Most engineering, procurement and construction (EPC) contracts entered into as part of a project financing are structured as lump sum turnkey contracts. Under this structure, the EPC contractor receives a fixed fee in exchange for delivering by a specified date a project that has been designed and constructed in accordance with agreed specifications and performance requirements. In a project finance transaction, the costs of constructing the project have been carefully calculated and there is generally limited room to increase the contractor’s fee. The project company is also typically a party to an offtake agreement (for example, a power purchase agreement), which requires it to deliver a service or a product by a certain date. The failure to meet the start of service deadline may trigger the payment of penalties and other damages. As a result, it is critical that the project’s costs are contained and its construction schedule maintained. However, EPC contracts typically include provisions setting out the circumstances under which the EPC contractor may:

- Receive amounts in excess of the contract price.
- Request additional time to perform its obligations under the EPC contract.

Any variation in the contractor’s scope of work, the contract price and the project schedule generally requires a change order. The bases for requesting a change order are highly negotiated. Project companies (the owner of the project) and their lenders want certainty as to the project’s costs and completion date and seek to limit the bases on which the EPC contractor can receive additional amounts and/or time to perform under the contract. By contrast, EPC contractors want to ensure that they will not be required to perform additional work without additional compensation and time to perform. EPC contractors will also want to limit the circumstances under which they may be required to pay liquidated damages for not delivering the project by the completion date.

This Note discusses these provisions and certain key issues the project company (and by extension, its lenders) and the EPC contractor should consider when drafting and negotiating these provisions. For a discussion of EPC contracts generally and other EPC contract provisions, see Practice Notes:

- Understanding Project Finance Construction Contracts (http://us.practicallaw.com/1-422-1870).

**INCREASED COSTS**

EPC contracts typically provide that the contract price may be increased under a change order delivered according to the terms of the contract if any of these events occur:

- A change in law that adversely affects the EPC contractor’s:
  - costs of performance;
  - ability to perform the work according to the agreed schedule; or
  - ability to perform a material obligation under the EPC contract.
  (See Changes in Law.)
- An act or omission by the project company, the project sponsor, any lender or any of their affiliates, agents, officers or representatives that adversely affects the contractor’s:
  - costs of performance;
  - ability to perform the work according to the agreed schedule; or
  - ability to perform a material obligation under the contract.
  (See Acts or Omissions by the Project Company and its Affiliates.)
- The discovery of certain ground conditions (for example, contaminants and hazardous conditions) at the project site (see Ground or Subsurface Soil Conditions).
Suspension of work at the request of the project company or its representative (see Suspension of Work).

A force majeure event (see Force Majeure).

The project is materially damaged (see Damage to the Project).

**CHANGES IN LAW**

A change in law (such as a new permit requirement or environmental regulation) can have a significant impact on a project’s costs and schedule. The project company generally bears the risk of any changes in law that may affect the EPC contractor's performance and the costs of the project other than changes:

- In the tax laws that affect the contractor's profits and losses.
- Of which the parties are aware at the time the EPC contract is signed, even if not fully implemented. For example, it is not a change of law, if a relevant regulatory or legislative authority has been considering a new permitting requirement, even if the requirement is adopted or implemented after the contract is executed.

However, the extent to which pending legislation or regulatory requirement constitutes a change of law depends on several factors, including:

- The term of the EPC contract. The longer the term of the contract, the less willing an EPC contractor may be to accept pending legislation risk because of the concern that these issues may remain outstanding for a long period.
- The potential impact of the new regulation or legislation. If the legislation is not expected to impose considerable costs, an EPC contractor may be willing to accept it.
- The jurisdiction of the project. In certain jurisdictions, it may take years for legislation to move from the consideration stage to the adoption stage. In addition, because of political considerations (including corruption and general stalemate), the fact that legislation or regulation was proposed may not be significant.

**ACTS OR OMISSIONS BY THE PROJECT COMPANY AND ITS AFFILIATES**

The acts or omissions of the project company, project sponsor, lenders and their respective affiliates, agents or representatives that may entitle the EPC contractor to submit a change order include:

- Failing to obtain a required permit.
- Providing inadequate access to the project site.
- Changing the scope of work.

**Permits**

The EPC contractor is generally required to obtain all permits required for the construction of the project other than those that must be in the project company’s name under applicable law. Depending on the nature of the permit and its purpose, the failure to timely obtain and maintain a required permit can have a material effect on the project’s cost and schedule.

**Lack of Access**

The EPC contractor may not have adequate access to the site because:

- There are other contractors involved in the project. Although turnkey EPC contracts are intended to cover all matters related to the design and construction of the project, depending on the project and the contractor's scope of work, there may be other contractors that need access to the site.
- The site is being inspected by environmental and other regulatory agencies.
- Lenders and their technical advisors and government officials are visiting or auditing the project.
- In the case of projects that have significant community opposition, of demonstrations and protests at the site.

To limit the likelihood of triggering a change order on this basis, the parties should:

- Carefully analyze the risk of disruption and, to the extent possible, build that into the project schedule and requirements from the outset.
- Identify clearly the party responsible for work stoppages and under what conditions.

For example, if the project is one that is vulnerable to picketing or vandalism, the parties may need to:

- Implement security protocols that limit protesters’ access to the site (for example, by erecting a fence or establishing one point of entry to the project).
- Limit access to the site.
- Coordinate with the local police to limit these disruptions.

The project company, to the extent possible, should also require the EPC contractor to:

- Provide security for the project.
- Manage and supervise any other contractors involved in the project.

If this is not possible, the project company should at a minimum include a provision in the contract requiring the EPC contractor to coordinate its work and access to the site with the other contractors.

**Changes in the Scope of Work**

While the parties generally try to set out the project’s requirements before signing the EPC contract, project companies often change the scope of the project. However, before any change can be implemented, the parties must agree on:

- The costs of the change.
- The impact of the change on the project's performance and schedule.

If the parties cannot agree, the issue is typically referred to the parties’ officers or a mediator for resolution. To the extent possible, the EPC contractor must continue working on the project pending resolution of the issue.

**GROUND OR SUBSURFACE SOIL CONDITIONS**

Liability for adverse ground conditions at the project site must be allocated in the contract because cleaning up or fixing a site to ensure that the project can be safely constructed on it can be expensive and time-consuming. EPC contractors generally want to allocate liability for these conditions to the project company because:
The project company selected the site and usually conducts preliminary site analysis to assess whether the site is appropriate for the project. For example, in the case of a wind project, the project company analyzes the proposed site to determine whether the location is appropriate for the project (see Practice Note, Wind Energy Project Development Issues: Preliminary Considerations: Topography Analysis (http://us.practicallaw.com/9-521-9174)).

The EPC contractor does not normally have the time before it begins the work to conduct an extensive analysis of the site. This is especially an issue if the contractor was awarded the contract as part of a public bidding process.

By contrast, the project’s lenders do not want the project company to accept this risk because it creates uncertainty as to the costs of the project and the project schedule.

To address these issues, EPC contracts often require:

- The EPC contractor to acknowledge that it has some understanding of the project site and that the conditions will not prevent it from performing its obligations under the agreement or result in an adjustment of the contract price. To do so, the contractor must:
  - be allowed to conduct an analysis of the site; and/or
  - have received reports from technical experts regarding the condition of the site.
- The project company to bear the risk of any conditions the contractor uncovers that are materially different from those set out in the technical reports.

**Suspension of Work**

EPC contracts typically give the project company the right to suspend work on the project for convenience. In this case, the project company becomes liable for any costs incurred by the contractor as a result of this suspension. This right is not unfettered, however, as EPC contracts typically limit the number and length of the suspension. Although the contractor is compensated for the added delays, excessive delays may interfere with other contracts and projects it may have. As a result, EPC contractors often have the right to terminate the contract for suspensions that last in excess of an agreed period (either as a result of one suspension or multiple suspensions).

**Force Majeure**

EPC contracts typically allow a contractor to request a change order if certain events beyond its control occur. These events include:

- War or acts of terrorism.
- Act of god.
- Acts of governmental entities.
- Blockades and other work stoppages.

The mere occurrence of these events does not automatically excuse performance, however. The parties, depending on the event, must take actions to mitigate the effects of these events. For more information on force majeure issues in construction contracts, see Practice Note, EPC Contract Drafting Considerations: Force Majeure Provisions (http://us.practicallaw.com/5-518-2224).

**Damage to the Project**

Any damage that happens to the project until title is transferred to the project company is generally for the account of the EPC contractor. However, the project company bears the risk of damage to the project caused by:

- Acts of god.
- War or acts of terrorism.

If the project company elects to rebuild the project it must compensate the EPC contractor and give it additional time to perform.

**Extensions of Time**

Negotiations for additional compensation often go hand in hand with negotiations for additional time to complete the works. If one of the conditions discussed above occurs and the contractor is entitled to submit a change order for an increase in the contract price (for example, if the parties agree to change the scope of work), then the completion date for the project usually also needs to be changed.

Most contracts include a built-in cushion (or float) to take into account delays that might occur. The float allows the schedule to be maintained despite:

- Weather delays.
- Minor construction delays.
- Other minor delays caused by a contractor default.

For example, most agreements include a target completion date and a guaranteed completion date. Generally, contractors are not required to pay liquidated damages unless the guaranteed completion date is not met (subject to excepted delays and owner-caused delays).

**Who Owns the Float?**

During negotiations for additional time, the parties must agree on how to use the float. EPC contractors generally like any additional time they are granted to perform for a permitted delay to push back the guaranteed completion date. This preserves the float and still gives the EPC contractor time to perform if an event occurs that delays the target completion date.

By contrast, some project companies want to preserve the guaranteed completion date and require the contractor to use the float. Meaning, the time to perform will not be extended for excused events, unless the event causes the EPC contractor to miss the guaranteed completion date. In practical terms, the cushion that is built into the project schedule is used for these delays. EPC contractors generally resist this approach because:

- Although the delay is caused by an excused event, it does not in fact receive any additional time to perform.
- It results in less flexibility for the EPC contractor to deal with unexpected delays.

Many EPC contractors also think this approach is unfair because if no excused event had occurred, they would have had the cushion between the target completion date and guaranteed completion date.
AMOUNT OF TIME TO BE GRANTED

EPC contractors like to receive additional time to perform equal to each period of delay caused by an excused event. However, depending on the event, all the time may not be required. In certain cases, however, the EPC contractor may be asked to provide an estimate of the amount of time it requires to perform.

ALLOCATION OF RISK

In project finance transactions, project sponsors and lenders try to allocate as much of the construction risk to the EPC contractor (see Practice Note, Identifying and Managing Project Finance Risks: Construction Risk). They are often successful in doing so by paying the EPC contractor a premium. However, their ability to allocate this risk to the EPC contractor and the contractor's willingness to assume this risk depends on several factors, including:

- The nature and location of the project.
- The construction market.
- The contractor's negotiating strength.

For more on these issues, see Practice Note, Understanding Project Finance Construction Contracts: Minimization of Project Company Risk and Understanding Project Finance Construction Contracts: Selecting an Appropriate Contract.

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Topics
- Project Finance and Development: Project Finance and Development
- EPC Contract Drafting Considerations: Limitations of Liability
- Identifying and Managing Project Finance Risks
- O&M Agreements: Issues to Consider
- Understanding Project Finance Construction Contracts

Practice Notes
- Advantages and Disadvantages of Project Financing
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