

Managing interface risk in a multi-contracting approach to construction

Today, the gold standard for bankable, project-financed construction contracts remains the “full-wrap” EPC contract, under which the contractor assumes, as a single point of responsibility, all the engineering, procurement, technology, construction and testing risks relating to the project.

There may be valid reasons however to deviate from this approach. The tax treatment of imported equipment in certain jurisdictions may justify splitting the single EPC contract into onshore and offshore portions. In some circumstances, the premiums charged by contractors for a full-wrap EPC contract may be uneconomic, and the risks of procuring supply and installation from separate contracts relatively low given the technology and geography of the project. Or full-wrap EPC contracts may simply be unavailable or extremely rare for a given plant or technology, as is usually the case for nuclear or offshore wind.

Moving away from the full-wrap, single point of responsibility model necessarily creates interface risk, that is the risk of incompatibilities between two or more works packages or the risk that a contractor blames or “finger points” another contractor for delays, defects or failings in the performance of its own works. This may result in increased liabilities at the employer level that cannot be fully passed through to another contractor in the structure. Properly managing interface risk is essential to minimise these types of claims and ensuring the project can attract project financing from institutional lenders.

How can I manage interface risk in a multi-contracting structure?

It is firstly important to have clarity on the reasons for the multi-contracting approach. If an offshore/onshore EPC split is driven by tax reasons, but the supply and installation of the plant will be performed by companies within the same construction group, the employer should ideally enter into a “bridging”, “coordination” or “umbrella” interface agreement with the offshore supplier and the onshore contractor (tax laws permitting), to ensure that the same construction group cannot exploit the split to discharge itself of liability. The responsibility for the construction and commissioning of the entirety of the works should be wrapped by the more creditworthy company under the umbrella agreement. The onshore and offshore contracts should furthermore include express and reciprocal waivers of claims in respect of interface risk between the supplier and the installer.

If the split is driven by other reasons, for example to avoid the premium of a full wrap EPC, the scenario is more delicate. There will presumably be no single company to assume all of the construction risk, as the supplier and the installer (and the contractors of other works packages) will not belong to the same construction group. Employers nonetheless have several options to manage this:

- the employer and all contractors could enter into an “integration” or “interface” agreement with all contractors to facilitate interfaces and control claims. Delays, defects or modifications to certain scopes of works that cause delays, damages or result in variations to other scopes of works should be passed through by the employer on a back-to-back basis to the relevant contractor, through indemnity claims or variation

orders. The offending contractor may wish to have certain visibility and a role to play in such claims or variations, to control its own liabilities;

- interface milestones could be clearly defined in each contract with liquidated damage payments attached. This may reduce the risk of snowballing cost claims for delays and give all parties certainty on their cost liabilities/entitlements in the event of delays to interface milestones;
- an interface schedule could be appended to each contract (and any interface agreement agreed) with clear allocations of responsibility between contractors. This will minimise the risk of scope gaps in the different works packages and give the employer and the contractors better visibility on their respective responsibilities in the works as a whole; and/or
- the employer, if insufficiently experienced in such structures, could hire a third party construction manager to manage interfaces on a daily basis and anticipate and manage claims relating to interface.

The multi-contracting structure, whilst increasing in popularity in some sectors and countries, remains relatively novel and subject to change and innovation in a project finance context. Convincing lenders that interface risk is under control and minimised remains key to banking such contracts.