Written By: Ivie Ehanmo
Contact: ivie@geplaw.com

WHAT IS AN ENGINEERING, PROCUREMENT AND CONSTRUCTION CONTRACT?

An Engineering, Procurement and Construction [EPC] Contract is a form of contracting arrangement within the construction industry. EPC contracts are also prevalent in the oil and gas industry. Under such contracts, the contractor designs the installation, procures the necessary materials and builds the project either directly or by subcontracting part of the work. In certain circumstances, the contractor bears the project risks (e.g. financial risks) including the budget in return for a fixed price commonly known as lump sum (which is paid as a fixed sum for the delivery) or lump sum turn key [LSTK].

The contractor may subcontract any portion of the work to one or more subcontractors and suppliers for the implementation of the project. However, the contractor remains solely responsible for the engineering, procurement and construction of the work. The EPC contractor would agree to deliver the keys of a commissioned plant to the owner for an agreed amount.

For large projects, the contractor usually splits the work scope into phases and agrees on a fixed price at the start of each project phase. This therefore reduces the overall project risk taken on by the contractor at the start of the project and also brings about increased flexibility for the project owner in terms of the ability to adapt the project to changing circumstances.

The project can be restricted to only engineering and procurement (EP) and this is usually done in situations where the contractor cannot bear the construction risk because of the magnitude of the risk or in situations where the owner undertakes the construction.

The typical terms of an EPC contract includes: scope of services, contractor's rights and responsibilities, owner' rights and responsibilities, cost of the work, terms of payment, tax provisions, indemnification, limitation of liability, price oscillation, exchange rate oscillation, warranties, commencement and performance of work, performance guarantees, completion guarantees, ownership of assets, addenda and change orders, compliance with laws, completion, startup and validation, defaults, remedies, termination, dispute resolution, etc.

An EPC contract usually has no price escalation clause and this can affect the contractor's performance because of possible variation in prices from the contract stage.

The benefits of an EPC contract to the owner includes: reduced stress as the owner does not bear the project risks, the owner is protected against changing prices for materials, labor, etc, cost can be ascertained at the start of the project, etc.

EPC is gaining importance on a global scale. However, it requires a good understanding by the EPC contractor to return a profit. It is therefore important for owners to define guarantees well, scope and quality, milestones, specific payment terms and penalty clauses in order to ensure the success of the EPC project(s).