

A COMINDIS Feature: Top 10 Project risks in Plant Engineering and Infrastructure Projects

Top 5: Deficiencies in commercial implementation of (EPC) contracts (weak contract management, lack of notifications, and lack of collecting evidence)¹

- Top 1 Unclear scope of works.
- Top 2 Miscalculation and cost overrun.
- Top 3 Design problems & defective works.
- Top 4 Extension of time & delay LD's / liability, costs of prolongation and inefficiencies due to disturbances and variations.
- Top 5 Deficiencies in commercial implementation of (EPC) contracts (weak contract management, lack of notifications, and lack of collecting evidence).
- Top 6 Lack of experiences and resources (technical and staffing).
- Top 7 Contractual ambiguities (gaps, different interpretation of clauses, new clauses).
- Top 8 Difficulties in enforcing claims (absence of a neutral court, long and costly proceedings).
- Top 9 Relying on co-operation with weak third parties (e.g., planner, sub-contractor, or consortium partner).
- Top10 Compliance, unknown markets, customers & contractors.

¹ Please be aware that this publication shall not be taken as a legal advice. Any project requires intensive legal review and negotiations with the contractual partner.

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Deficiencies in the commercial implementation of (EPC) contracts belong to the most important risks in (EPC/turnkey) plant engineering projects. In plant construction projects disturbances happen very often due to several reasons. As a result, from these disturbances, there are ways for both parties to assert claims:

The client requires delay damages as LD's ("liquidated damages") or technical LD's, whereas the contractor, on the other hand, claims for an extension of time (EoT), costs of prolongation and inefficiencies due to disturbances or variations.

However, such mutual claims revolve often around evidential (not directly legal) problems. It is therefore of utmost importance to install right from the beginning a proper and efficient contract and claims management system. This applies both for the client and the contractor. And it applies further for an active claims management, but also for claims prevention.

Key Takeaways

- The success of a complex (EPC) project correlates with a professional and efficient contract and claims management on the commercial terms of the contract.
- Losses are avoidable if the contractual parties involve early a professional and efficient contract and claims management.
- The Parties to a complex (EPC) project should early evaluate the appropriateness and effectiveness of its contract and claims management functions.

What are the requirements on a well-designed and efficient contract and claims management system?

There is certainly no general answer to this question because it depends on the size and complexity of the project, on the experience of the technical and commercial project team and on several other internal and external factors. However, there are a few key elements which must always be observed:

- *First*, there must be sufficient and experienced staff (either internal or external) to handle the contract and claims management. This means the contractor must consider already in its estimate a certain number of employees or external contract and claims manager, who manage the (EPC-) contract formally and commercially. We have seen a couple of cases, where the importance of a contract and claims management was either underestimated or due to some cost-cutting measures the relevant function was reduced or abolished.
- *Second*, an efficient contract and claims management system operates over the full project circle, it starts already during the tendering phase (to incorporate best practise and lessons learned) and it does not disappear

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during the implementation of the project. It is constantly available as a gate keeper and “project memory”.

- *Third*, already on the start of a project there must be a preparation/review of major contract terms and conditions of the Customer’s contract and a kick-off meeting. The contract and claims management team and the other project members need to understand the contract and its mechanisms, e.g. for milestones, notifications, variations, bonds, payment instalments and dispute resolution. This is of utmost importance since the contract is the backbone of the project. Surprisingly the contract itself is sometimes “forgotten” or considered to be a playing field for lawyers only. This is a big misunderstanding.
- *Fourth*, the contract manager administers the contract (i.e. change orders/variations, contract amendments, notifications of disturbances, submission of claims, correspondences, issuance of invoices, issuance of bonds or requiring back bonds, take-over-certificates (PAC and FAC)).
- *Fifth*, the contract management system shall compile, submit and follow up incoming and outgoing claims (customer, subcontractors and consortium partners).
- *Sixth*, the contract and claims management provides coaching and training in contract and claims management, lessons learned and best practise feedback
- *Seventh*, the contract and claims management uses electronical tools both to administer the correspondence and claims, but also to have a proper record of proof for any details needed later, in case of a dispute.

What are the interfaces of contract and claims management within a project?

- There must be a close connection to all project members (i.e. the technical and commercial project manager and director, the customer’s and subcontractor’s representatives).
- There must be internally a close connection to the Legal department as well as other central departments, such as technical project departments, treasury, accounting and IT.
- It is further advisable to grant the Head of contract and Claims Management (if such function is available) access to the upper management, to allow an early warning function in case of threatening derailing of a project.

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What are the consequences of deficiencies in contract management?

Deficiencies in contract and claim management might lead to significant losses.

Many EPC/EPCM contracts foresee certain deadlines for the notification and substantiation of any claim relevant circumstances. In many contracts (e.g. FIDIC Yellow Book 2017) the claiming party loses its claims if it fails to give a notice of claim within a specific period (FIDIC = 28 days). In such case, the claiming party shall not be entitled to any additional payment, the contract price shall not be reduced (in the case of the employer as the claiming party), the time for completion (in the case of the contractor as the claiming party) or the DNP² (in the case of the employer as the claiming party) shall not be extended, and the other Party shall be discharged from any liability in connection with the event or circumstance giving rise to the claim.

Furthermore, even if the notification of claim relevant circumstances was made in time, deficiencies in proper documentation and collecting appropriate evidence of disturbances might lead to the result that the claiming party, having the burden of prove, cannot substantiate its claims in the required level of detail at ordinary courts or in arbitration. Alone for this risk it is worth to engage an experienced and efficient working contract and claims management.

Finally, deficiencies in contract management might even have a significant impact on cash-flow and securities / (first demand) guarantees. An efficient contract and claims management ensures that invoices were issued just in time as soon as milestones are reached in an ordinarily manner accompanied by the contractually required documentation. A rejection of invoices due to formal reasons is avoidable. Furthermore, in plant engineering projects it is important for the employer to require the agreed securities (advance payment, performance and warranty guarantees) and vice versa for the contractor to require such securities back if the contractual preconditions / milestones were met.

COMINDIS is a specialized Boutique Law firm in plant engineering, insurance and compliance. If you need legal support in your project, please approach us.

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² Defects Notification Period

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