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Why It is Important to Distinguish Contracting Strategy and Commercial Approaches

A confusion often arises between the scope covered by a contract and the associated commercial approach. Specifically, EPC contracts are not always lump sum! In this White Paper, we aim to clarify that issue as overcoming this preconception often opens the field of possibilities in terms of contractual strategy

Two dimensions for contractual strategies

First dimension: scope

The first dimension of a contract is its scope. It can be purely engineering (E), procurement (P), installation(I)/construction (C) or commissioning (C), or any combination of those. Therefore, in project we can typically find, in combination:

- Single E, P, I, C, or C contracts for specialised contractors
- EP contracts – typically for technology suppliers; generally, they also include some supervision services during construction and commissioning
- EPCm contracts – typically for a main contractor, covering engineering, procurement of main equipment and construction management. Construction itself is then performed by one or several construction contractors directly contracted with by the Owner
- PC or PCC contracts – typically for construction yards and construction companies that can also deal with the supply of required material, and possibly equipment
- EPC or EPCC contracts (including I for offshore projects) that cover an integrated scope from end to end. Commissioning can be partial of full; overall system commissioning must be dealt with at the overall system level

Scope and commercial approach should always be considered to be different dimensions that can be combined to suit the particular situation of the project.

Second dimension: commercial approach

The commercial approach spans between the extremes of reimbursable and lump sum. Typical commercial approaches used in project companies include:

- Reimbursable
- Re-measurable or rate-based, where the contractor takes risks on productivity and quality while the client takes the risk on the scope
- Lump-Sum

All may also include some sort of bonus and penalty mechanisms.

These commercial approaches can be mixed in the same contract. For example, a lump contract may include some reimbursable or re-measurable elements for scopes that are not fully defined, or which bear

a significant risk at the onset which would not be relevant to cover by a too high contingency.

How those two dimensions are independent

It is important to realise that both dimensions of contract scope and commercial approach are quite independent. Therefore, in particular, an EPC contract is not necessarily lump sum (which is often presupposed when using the “EPC turn-key” terminology).

It is quite interesting to explore the possibilities offered by this dimensional space and examine when combinations of scope of commercial approach are relevant. This is of course a simplified vision as a single contract can contain

Commercial approach	Reimbursable	Re-measurable	Lump-Sum
Scope			
Single E,P,C, or C	Scope subject to evolution, innovative technology, non mature supply-chain	Scope subject to evolution, mature technology and supply-chain	Well-defined scope, mature technology and supply-chain
EP	Innovative technology, interfaces subject to significant changes	Well defined and mature technology, interfaces subject to change	Well defined and mature technology, well defined interfaces
PC	Scope may evolve, non-mature supply-chain	Scope may evolve, mature supply-chain	Well-defined scope, mature supply-chain
EPC or EPCI	Scope under development, substantial interfaces, Non-mature / innovative supply-chain	Scope subject to evolution, substantial interfaces, mature technology, contractor, supply-chain	Well defined scope, limited interfaces, mature technology, contractor, supply-chain

several commercial approaches for different sub-scopes. In the following analysis it should also be reminded that the choice on the scope dimension will generally be very dependent on the actual track record and capability of the contractor, and not only on the scope to be performed in an ideal approach.


Thus, the recognition of the two dimensions of scope and commercial approach opens the field of possibilities particularly for situations that include innovative technologies, or for contractors that have to work closely together because of a significant amount of interfaces and interference (for example, for projects involving very

dense and compact spaces such as nuclear, submarines etc.).

Summary

Scope and commercial approach should always be considered to be different dimensions that can be combined to suit the particular situation of the project. In a single contract, different sub-scopes can also be subject to different commercial approaches. This realisation opens the door to contracting strategies that are better suited to the specific challenges of the project.

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