

Management of Environmental and Social Risks in EPC Contracts



Henry Camp
Norma Garcia
May 2012

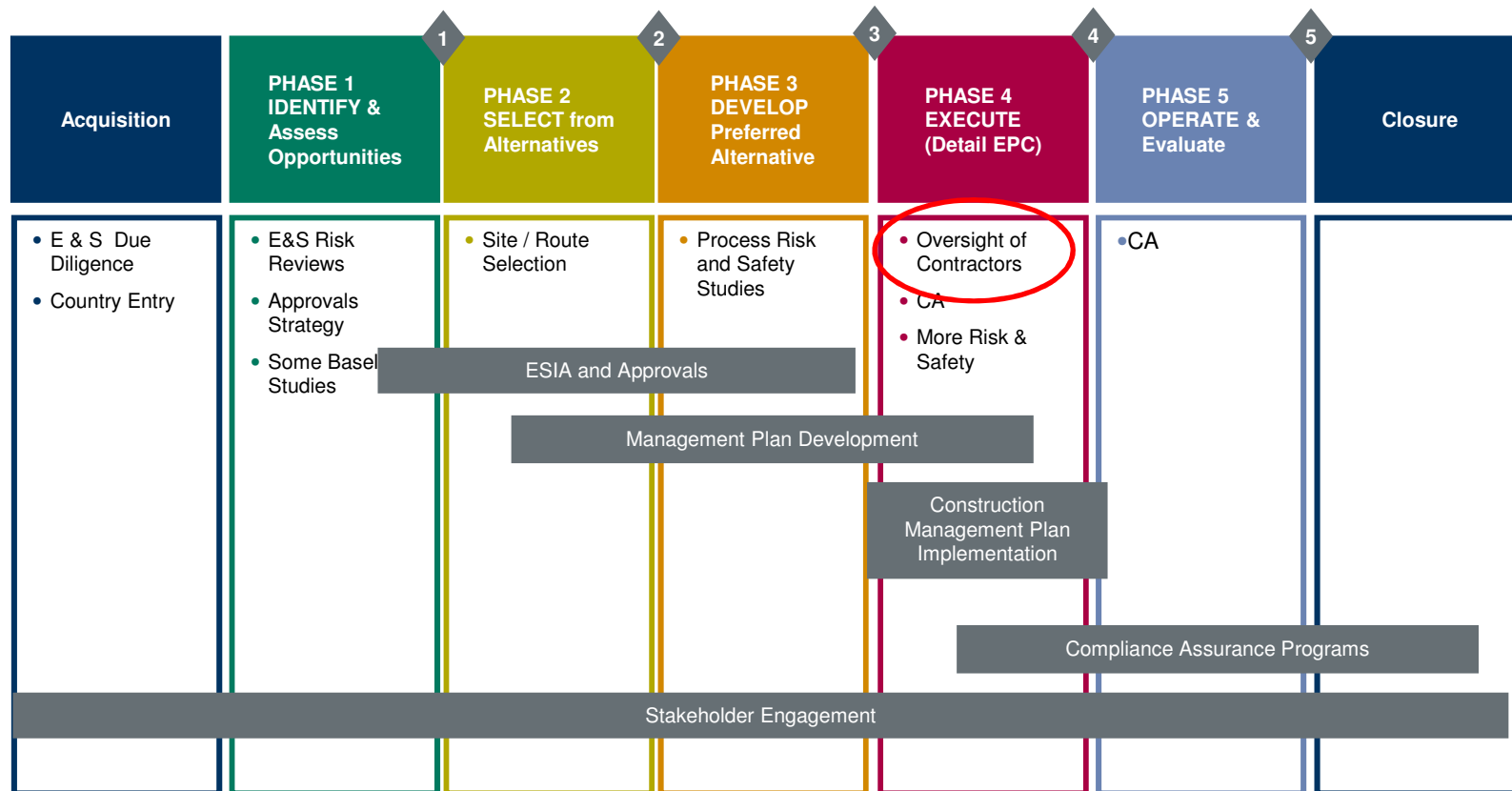
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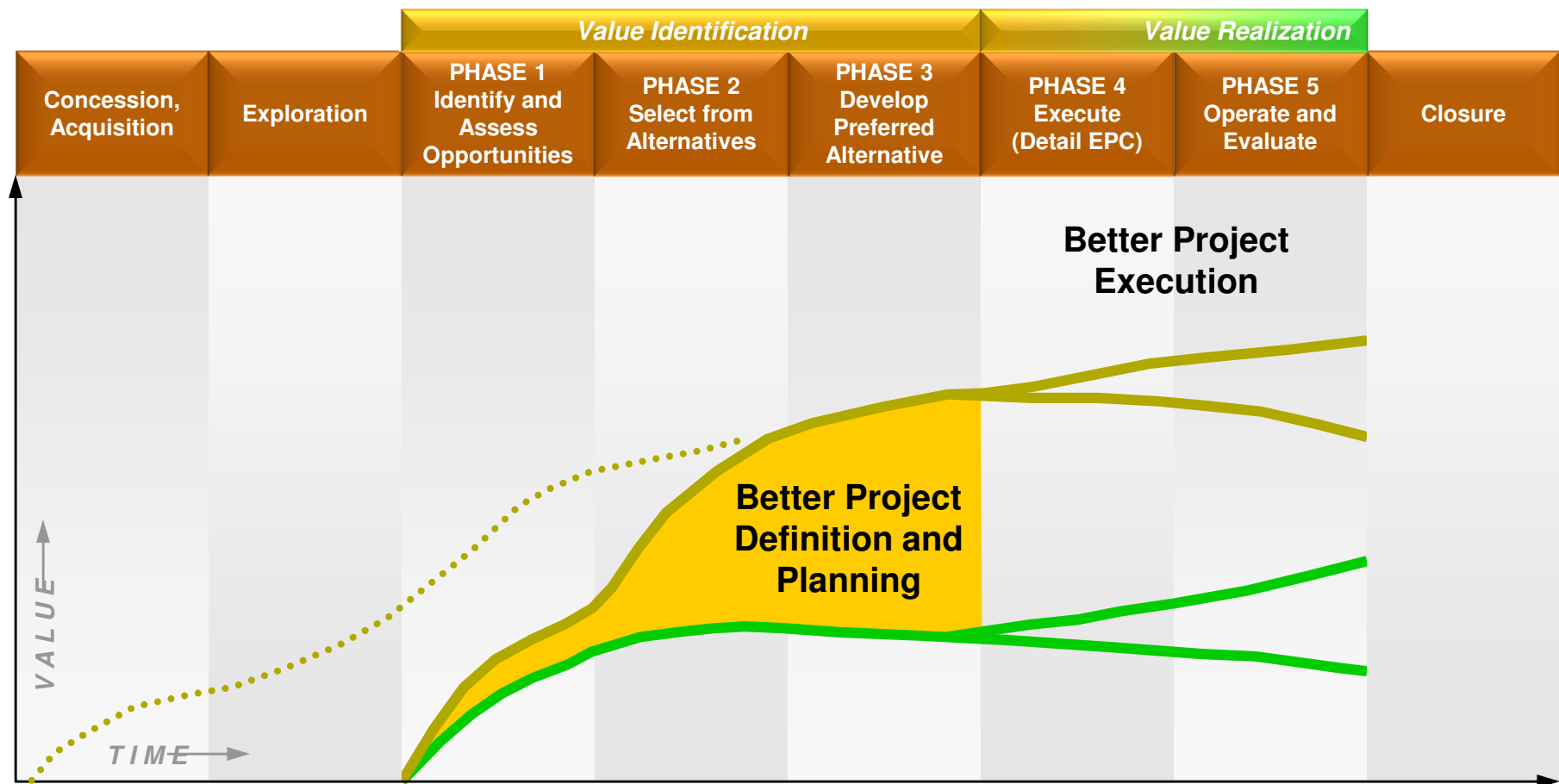
Introduction

- Importance of contractor management on EPFI financed projects in developing countries
- Risks that result from the delegation of environmental and social management tasks to contractors such as EPC firms
- Case study as example
- Suggested solutions

Phases of project development



Better planning for better execution



Common EPC contract problems

- Pushes cost and responsibility to EPC contractor
- Focuses primarily on limiting liability
 - ◆ Falls short on the active/effective implementation of the environmental and social protection measures
- Poorly defined environmental and social requirements
 - ◆ *'Contractor shall comply with all the applicable EHS regulatory requirements'*
 - ◆ Limited detail on environmental and social requirements
 - ◆ Vague wording and reliance on assumptions
- Lack of connection to mitigations and controls determined in the ESIA process

Case Study

A US-based developer (Buyer) of a power plant in South America financed by an EPFI engaged with a China-based EPC firm (Contractor)

- Contractor agreed to contract terms
- Majority of Contractor workforce (including local management) was from China
- Local firms subcontracted to carryout sub-tasks

Case Study (cont.)

Contractor failed to implement many of the environmental and social requirements and over time, numerous non-compliances were recorded

- Buyer's corporate parent empowered (funded) the local unit to intervene and take control
- Buyer began process of documenting non-compliances and taking corrective action with objective to recover cost through re-negotiation and contract penalties
 - ◆ On the basis of costs incurred by Buyer to correct deficiencies
- Still in dispute with resultant delays, risks of environmental and social consequences

Attitudes to environmental and social compliance differ across business cultures

- In a 2009 empirical study of 35 China-based construction firms operating in Africa:
 - ◆ 17 applied the international standards as required under financing agreements
 - ◆ 15 applied local standards
 - ◆ 9 applied Chinese standards (eg design standards) to the local situation
- Some respondents were not even clear on the connection between planning (ESIA) and execution and how/when international standards are applied
 - ◆ Based on experience in home country

Lessons

- Understand the business culture and adapt the approach
 - ◆ eg Chinese firms are generally cost driven and generally organized in a highly hierarchical manner
 - ◆ Do not underestimate language barriers
- Need to better connect *planning* (ESIA) to *implementation* (EPC contract)
 - ◆ Include EHS requirements (and ideally ESIA outputs) in contract
 - ◆ Ensure that contract specifications are clear, complete and understood
- Facilitate implementation
 - ◆ Consider means for bridging ESIA and ESMP
 - ◆ Workshops and training
 - ◆ Consider the use of specialists
- Consider the possibility of non-compliance and build in contingencies
 - ◆ Specify monitoring and reporting requirements for early warning
 - ◆ Link performance to payment milestones