

Sharing Construction Risks: What You Need To Know

Taking a proactive approach during negotiations can increase efficiency in the contracting process and, ultimately, in the development of a wind farm.

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Despite recent economic, technical and regulatory challenges, the wind energy industry in the U.S. has grown tremendously over the past decade. Even with this growth and the accumulation of much experience, one frequent hurdle to launching new projects quickly is the lengthy and inefficient negotiation of design and construction contracts.

Parties often begin negotiations after design and/or construction work is already under way, leaving everyone in a difficult negotiating position. As a result, negotiations may produce ad hoc documents that are inappropriate for the particular project. In addition, contracts end up bearing little similarity from project to project, which can present conflicts, increase costs, and complicate efforts to obtain financing and investment. A primary roadblock to making this process more efficient is the difficulty in allocating certain risks among owners and their contractors.

Efficient and fair risk allocation can speed the development of a wind power project. In this respect, wind farm development is no different than any other complex project in any other sector, such as infrastructure, traditional power, oil and gas, transportation or telecom.

Some key design- and construction-related risks that tend to domi-



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nate contract negotiations include the following:

- Schedule and delay risk;
- Risk of variance between design/construction assumptions and reality;
- Liability/indemnity risk;
- Tax/permit risk; and
- Safety risk.

Owners and contractors address these risks in the negotiation of any design/engineering contracts for a wind project. Agreeing on fair positions quickly can speed development and save costs.

However, the array of parties performing work at each project site, including surveyors, engineers, construction contractors, electrical contractors, specialized subcontractors, turbine installers and turbine suppliers, can make this more complex.

Sometimes, construction-related tasks are performed by only one or two contractors, and in other cases, they are each performed by a separate contractor. Moreover, there is wide variation in expertise among owners. Some

owners have the know-how to perform certain major design and construction tasks in-house, while others rely almost exclusively on contracted expertise.

Because projects vary widely from one another, contractual arrangements for one project are unlikely to be a perfect fit for another project. As a result, negotiating parties must pay careful attention to the various contractors that will be working at the site and take into account the unique nature of wind projects.

Critical negotiation topics can include the following:

Schedule and delay risk. One of the most visible risk-allocation issues relates to the schedule for the development of the wind project. From the owner's perspective, timing is of course critical.

As previously mentioned, there can be many parties performing work at the project site. In most cases, the success and efficiency of the work to be performed by these parties is highly dependent upon timely completion of work performed by other parties or by the owner. One objective should be to create a schedule for the overall development of the project and identify critical milestones at the "interface points" between the schedules of each individual party.

Another concern for both owners and contractors is attaching certainty

to each party's schedule obligations. For a variety of reasons, owners want to be sure that schedules are met. Contractors want certainty to ensure that their exposure is known and limited, as well as to make sure that they are not held responsible for the delays of the owner or other contractors.

As a result, reasonable liquidated damages should be negotiated for contractor milestones that are critical to the completion of the wind power project. The amount of such damages should be carefully calculated based on projected actual harm – not simply pulled out of the air or based on dissimilar projects.

Depending on the business deal and on the value of early completion, reasonable schedule bonuses can also be an efficient way to advance the agreed-upon project schedule. Contractors should also receive an equitable schedule adjustment for any material and adverse delays directly caused by milestones missed by other parties not under their control. Due to the highly interactive nature of wind farm construction, however, immaterial delays and interactions among parties should be expected and tolerated without schedule adjustment.

Design and construction assumptions. Another key to successful wind farm development is ensuring what looks good on paper matches reality at the project site. Assumptions are often made at the planning level that turn out to differ from actual conditions at the site. This is particularly true for design and construction assumptions.

Most design and construction assumptions originate from development studies performed for the wind farm. A first step, therefore, is determining who will be responsible for performing these studies.

Site plans and archaeological and environmental studies are traditionally provided by owners, while other examinations, such as surveying and labor/materials investigations, are usually contractor-performed. In addition, there are a group of studies,

such as geotechnical investigations and wind turbine transportation studies, that may be performed by either party.

When deciding who will undertake the various studies, the parties need to also agree who can rely on whom and with what effect. In general, owners are hiring contractors as design and construction professionals. As a result, owners in these situations should be entitled to rely on contractor-performed studies and hold contractors accountable for any inaccuracies contained therein.

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Moreover, owners should also be able to require contractors to review owner-provided studies and, where necessary, conduct further investigations to confirm the assumptions contained therein. There are many circumstances, however, in which it is more efficient and appropriate for contractors to rely on owner-provided studies performed by the owner or other contractors. Regardless, the owner's expectations should be made clear in requests for bids, so that contractors know what is expected and can price and schedule for the task requested of them.

Finally, once these issues have been negotiated or clarified, the parties should determine how to handle situations where actual site conditions differ from the base assumptions. Contractors should generally be entitled to an equitable schedule

and/or cost adjustment for the impact of the difference unless the difference should have been reasonably foreseen. Otherwise, contractors will need to correct any work at their own cost and schedule risk.

Indemnifications and liability caps. A goal of each party involved with a wind farm design or construction contract is to limit its risk exposure. Two ways of doing so are indemnifications and liability caps.

The appropriate scope of indemnifications is dependent upon the nature of work to be performed and the various roles of parties working at the site. Indemnifications for wind projects usually cover a wide variety of topics, such as those relating to third-party bodily injury and property damage, intellectual property, hazardous materials and titles/liens. These indemnifications should allocate risk to the party in the best position to minimize such risk, thereby reducing the overall risk profile of the project and heightening the chances of success.

All too often, however, indemnification provisions are seen as boilerplate language that cannot or should not be changed, regardless of the circumstances on the ground. A more efficient approach would be to recognize the fact-specific nature of these indemnifications and their exclusions and to carefully allocate risk in a way best suited to the individual project.

In addition, risk exposure is often limited by liability caps. These caps can be, for example, sub-limits on certain liquidated damages or can provide an overall limit on all liability under the contract. Whatever the commercial decision on the amount of a liability cap, the key legal issue is which types of liabilities should properly be excluded from such a cap.

In other words, while liability caps enhance certainty by limiting exposure, there are still some risks for which a party should nevertheless remain fully responsible. At a minimum, for example, parties should not be entitled to limit liability stemming from fraudulent or unlawful acts, gross negligence or willful misconduct, or acts

that are covered by their indemnification obligations relating to third-party bodily injury or property damage.

In many cases, depending on the outcome of the aforementioned indemnity discussions, it may be appropriate and fair to exclude additional indemnities from the overall liability cap. Negotiating which risks can be limited and which should remain

with sales tax exemptions, use tax exemptions and/or enterprise zone programs.

The procedures required to secure such exemptions can often be detailed and, in some cases, difficult to identify with full certainty. This is particularly true if the exemption is provided to the owner of the project but it is a contractor that is procuring relevant

ate remedies are negotiated for missed deadlines.

Safety. Allocating responsibility for site safety is a key issue for ensuring the successful completion of a wind project. Safety responsibility can give rise to both contractual and regulatory consequences. As mentioned previously, there are often multiple entities engaged in construction or development activities at the site.

At any given time, there could be construction activity at the site by the owner and its subcontractors, the turbine supplier, the turbine erector, the transportation company, the utility or the balance-of-plant (BOP) contractors.

Primary safety responsibility can rest with one party or can be divided among multiple parties. The BOP contractor should take responsibility for the entire project, including developing (with owner review) and implementing a site safety plan. In such an instance, the owner should require its employees and any separate contractors (including the turbine supplier) to follow such a plan.

If the project work is instead divided among multiple contractors, each should be required to cooperate at the owner's direction and devise a plan for allocating safety responsibility and control across the site at different times in the project schedule. Either way, there should be clear terms in all applicable contracts that ensure the allocation of safety responsibility and compliance with federal, state, local, and project site safety regulations. **ENR**

Allocating tax responsibility is important in wind projects due to the myriad of applicable taxes.

unlimited can be a difficult task, but one that is necessary to successfully allocate and mitigate risk.

Taxes. Another important contracting element in wind farm development is allocating the responsibility for taxes. Although tax responsibility is an issue in many types of contracts, it is of particular importance in the wind sector due to the myriad of applicable taxes, exemptions and credits, particularly at state and local levels.

First, contracts (and bid requests, to the maximum extent possible) should identify and allocate responsibility for anticipated taxes and remedies associated with an inability to achieve expected tax benefits and treatments.

Failure to openly discuss and allocate taxes can result in a contract price that does not reflect the true cost of performing the work. In some instances, this can be a significant and costly oversight, leading to disputes.

Second, all relevant tax exemptions should be disclosed as early as possible and, at a minimum, should be clarified in the relevant contracts. Taxing authorities frequently encourage renewable energy development

exempt materials. If materials are not purchased using the appropriate procedures and documents, the exemption may be permanently waived.

To avoid this, the relevant contract should clearly list the exemptions and required procedures. If work begins before a contract is signed, such exemptions and procedures should be disclosed in writing to the contractor. If the contractor follows the procedures, it should not have any liability for the owner's failure to secure the exemption for any other reason. If not, however, the contractor should bear the financial responsibility for any lost exemption.

Finally, in addition to typical taxes and tax exemptions, any tax credits or other incentives should be addressed in a proactive manner. It is important to recognize the conditions surrounding tax credits and incentives and how each party's obligations are tied to such conditions. In particular, careful attention should be paid to scheduling so as to ensure construction has commenced and/or wind turbines are placed in service before any relevant federal incentive expiration date. Also, make sure that proportion-

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