

Risk allocation in recent construction projects in Russia

The past few years have seen a shift in the way contracts for construction projects in Russia have been drawn up and scrutinized in response to growing awareness of risk.





By Chris Duncan and Daria Plotnikova

Contracts in the construction industry in Russia have long involved striking a balance between the legitimate expectations and interests of the owner and the contractor. Russian industrial projects are commonly developed using a range of procurement structures. These include single engineering, procurement and construction (EPC) turnkey contracts as well as more complex multi-package arrangements in which the owner, typically a Russian entity, separately contracts the construction works with one or more local contractors.

When engaging international contractors in Russia, owners often seek to maximize risk transfer to the contractor within the limits of the selected procurement model. This can be due to the requirements of financing banks, or simply results from the expectations of stakeholders and investors, and their experience of market practice in Russia.

English law contracts are commonly used by international parties for Russian projects, as this allows a level of freedom of contract that would be difficult to achieve under a contract governed by Russian law.

From a contractor's perspective, English law provides a neutral choice of governing law and may be welcomed by the contractor. However, it can prove to be a double-edged sword if, as is often the case, the

owner's proposed contract terms prove to be onerous for the contractor.

Increased owners' demand under FEED and EPC contracts

In recent years, front-end engineering and design (FEED) and EPC contracts proposed by owners for large industrial projects in Russia have generally become more demanding in terms of the requirements and risks placed on the contractor. In some cases, this is because contracts are becoming longer and more detailed. This is a natural development, as clauses are refined and lengthened over time in an effort to protect the owner's position and deal with every eventuality.

That said, the extent to which contractors are willing to take on these risks will of course depend on the specific circumstances of the project, and such additional risks may result in further contingencies being included in the price.

One potential area for negotiation relates to which party assumes or retains responsibility for obtaining approval of the design documentation by the relevant Russian authorities, and linking payment of final installments of the contract price to obtaining such approvals. It is common for an international FEED contractor to engage a Russian Design Institute as a subcontractor to confirm



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that the design documentation complies with Russian laws and regulations, and to secure approval of the design documentation.

However, the FEED contractor may propose that any deadlines—and associated delay liquidated damages—under the FEED contract relate to delay in completing the FEED package, not delay in acceptance of the design documentation by the relevant Russian authorities.

Similarly, contractors frequently propose that any performance bond under the FEED contract will be reduced upon completion of the FEED package and its acceptance by the owner, not approval by the relevant authorities. On the other hand, from an owner's point of view, it is important to ensure that the contractor is incentivized to prepare design documentation strictly in compliance with Russian laws and regulations and promptly procure the relevant approvals, as failure to do so could delay the project.

Another key issue is the EPC contractor's liability for claims incurred by the owner from other contractors. It is common for large industrial projects in Russia to involve multiple contractors and complex interfacing requirements. In such cases, defects in the contractor's works may potentially result in modifications to other parts of the project, causing the owner to incur additional costs. Some owners of recent projects have tried to pass this risk, either entirely or in part, on to the contractors.

It can be difficult for owners to persuade a contractor to accept full liability for claims by other contractors. Liability for claims under third-party contracts is sometimes excluded under EPC contracts, as such claims

are difficult for contractors to predict. Where a contractor does agree to undertake this risk, it may only agree to be liable for a portion of any claims by other contractors and require its overall liability in respect of such claims to be capped.

Force majeure

Another topic of significance at present for English law-governed FEED and EPC contracts in Russia is force majeure. Owners typically seek to define force majeure relief very narrowly, particularly with respect to any right of the contractor to claim additional costs or terminate the contract for extended force majeure

While this is not a new development, the COVID-19 pandemic has caused force majeure clauses to be more closely scrutinized. For large Russian projects in the petrochemical

and industrial sectors, the time from contract signature to completion of the project can be significant, with the most potential for COVID-related disruption occurring during the construction phase.

Given the current level of day-to-day uncertainty, it is hard for contractors to plan so far ahead and adapt their commercial proposals to deal with any potential disruption. However, given that many construction sites in Russia remained active throughout 2020, owners have not been terribly sympathetic to granting widely defined relief for COVID-19 and some may seek to exclude COVID-19 claims relating to home office or design works, particularly if they are performed outside Russia.

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