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Multi-Contract Hydrogen Projects: Avoiding Interface Risks and Leaks

*By Craig Bruce, Jon Thursby, Adam Smith, Lucy Preston and Alexander A. Witt**

In this article, the authors consider the structures that developers and lenders may expect to see on green (or blue) hydrogen projects and whether any lessons can be learned from other (more mature) technologies.

The energy transition and climate crisis continue to be a hot topic in political and economic circles. Current global events only serve to demonstrate the need for nations to diversify their sources of energy. While nuclear and traditional renewable power such as solar and onshore/offshore wind will play an important role in nations achieving their net zero goals, the energy market is also exploring new technologies such as floating wind and green hydrogen.

Although these new technologies are still developing, it is clear that the opportunities they offer market participants are significant. Floating wind projects will have the benefit of developing within a pre-existing market of offshore wind where developers and contractors are both familiar with the general technology, how to construct the project and associated contract structures. Green hydrogen project developers will however need to forge their own path and consider how best to structure project development.

This article considers what structures developers and lenders may expect to see on green (or blue) hydrogen projects and whether any lessons can be learned from other (more mature) technologies.

CONTRACT AND STRUCTURE FORM

Large scale and complex energy projects are often procured using an amended version of the FIDIC “Yellow Book,” which is a standard form of construction agreement. One would not expect that approach to differ on a hydrogen project given that a FIDIC structure offers the flexibility needed to

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easily reflect the commercial/technical needs of the technology and is familiar to lenders operating within the energy market (it is easily amendable to be in a bankable form).

Developers must then decide whether to pursue an EPC¹ wrap or multi-contract structure. In truth, no large-scale energy project is likely to be developed on a true turnkey EPC basis (i.e., where one contractor delivers the whole project under a single contract). The cost to the developer of that approach is likely to be prohibitively expensive given the premium that a contractor would attach to the offering to reflect the level of risk assumed by it (a risk which is unlikely to be commercially attractive to any contractor on the market).

Large infrastructure projects can be delivered on a limited multi-contract basis, where an EPC wrap is applied across various packages of work which results in a project being developed with 3 or 4 EPCs covering the major components. For example, in the offshore wind market, contracts may cover civils, electrical and turbine work.

Alternatively, they can be delivered on a true multi-contract basis where developers enter into tens of contracts splitting out structures into their component parts. For example, on offshore wind and nuclear projects developers may seek supply and installation agreements from each original equipment manufacturer of key components resulting in many contracts being procured for the overall project.

As the hydrogen market evolves we may see that some contractors are willing to wrap more packages into subcontracts as the risk of any technology included in those packages becomes more known and/or quantifiable.

COMMERCIAL CONSIDERATIONS

The developer will need to consider the development as a whole when determining the contracting strategy including considering technical, commercial and financing considerations. Common commercial considerations may include:

- *Price*—generally, the fewer contracts a developer enters into (on a complex infrastructure project) the more subcontracts the head contractor will need to wrap. This pushes the interface risk (both in the sense of package management and liability) from the developer onto the contractor who will in turn attach a greater premium to the overall contract price to account for such risk.

¹ An EPC contract refers to an engineering, procurement, and construction contract.

- *Management Capability*—if the developer enters into a larger number of contracts, it will need the resources and expertise to manage, on a day-to-day basis a large number of contractors.
- *Debt/Equity Funding*—traditionally, lenders were nervous of multi-contracting structures. However, multi-contracting, and the risks associated with multi-contracting, are now well understood and, provided that the developer and its advisors can guide the lenders through the structure and explain (as clearly as possible) the rationale for the chosen strategy and the relevant mitigants, lenders can and do get comfortable with funding a development constructed on a multi-contract structure.
- *Contractor Experience*—in new technologies where contractors may yet to have demonstrable market experience it may be preferable to limit the number of contracts and/or ask those larger, more experienced contractors to wrap packages of work. This offers the developer more protection from non-performance and insolvency risk of smaller entities. It may also have the benefit of involving known names in the project who may be large international contractors that are diversifying their business which can provide some comfort as to technical capabilities on key packages to sponsors and any debt providers. On the other hand, it is likely that such contractors will be less willing to negotiate on cost and may impose more onerous terms, knowing there is no reliable alternative for a developer. Although, it may be better to agree lighter contractual protections with an experienced contractor than more robust protections with an inexperienced contractor who may be unlikely to perform.
- *Insurance*—as with any new technology, insurance will be an important factor. However, as the insurance market continues to harden, contractors and developers will perhaps have to bear more risk than they have in the past where insurance providers are unwilling to step-in or the insurance premiums are too high to reflect the commercial requirements of the specific project.

LEGAL CONSIDERATIONS

Notwithstanding the commercial implications of the level of multi-contracting deployed on a project, all construction contracts should look to mitigate the interface risk inherent in such a structure.

Common pitfalls that parties may come across in a multi-contracting structure and how the legal terms can protect their interests are discussed below. These are all issues that can all be mitigated with the correct drafting.

- *Consistency of Terms*—perhaps the simplest mitigant available to parties is to ensure that (wherever possible) the key terms of the contracts are aligned across the packages. In particular, attention should be paid to those terms relating to program delivery, co-ordination and co-operation between contractors, information sharing, indemnities, Variations, force majeure, delay, governing law and dispute resolution. Commonality across contracts will ensure ease of delivery and operation by the developer on a practical basis as it can be sure that the project is working on a common base line. Consequently, if/when an issue arises contracts should respond in a similar manner rather than one contractor being treated out of step to the others.
- *Coordination*—it is vital in the management of interface risk to ensure that contractors are facilitating the different packages (both in allowing personnel access to the site to work and in providing for any contingent works in the relevant programs). Base FIDIC includes a co-operation provision,² although the developer may wish to make amendments to provide for a more detailed interface mechanism between the contractors. Contractors should also be required to review and comment on other contractor designs that interface with or are relevant to their works to ensure technical and design interfaces align.

Key considerations that developers may wish to address include:

- *Price Certainty*—as drafted, the contractor may be entitled to a Variation for any instructions issued as a result of co-operation with third parties. Developers may wish to consider whether such actions should be wrapped as part of the Contract Price and/or build in known interface requirements (e.g., attendance at regular project meetings or a dialogue with the project manager). Contractors are increasingly trying to limit their obligations to what is considered “reasonable,” which is vague and may open up discussions as to whether the contractor is entitled to relief or not. It is therefore vital to ensure that wherever possible, the drafting is as clear and unambiguous as possible. In addition, as discussed below, issues with supply chain or changes in regulations may mean additional contingencies need to be built in to price considerations.
- *Operational Requirements*—as mentioned above, expressly specifying any known or anticipated operational requirements as part

² See Sub-Clause 4.6 [Co-operation] of the Yellow/Silver Book, 1999 form).

of the co-operation provisions across packages will also help to facilitate a smooth delivery of the project program. To the extent that the developer requires information sharing between contractors in relation to contingent works, attendance at meetings or specific access requirements that may be key to the wider program, etc. these could be factored into the drafting and therefore into the program and price before any variation becomes available.

- *Interface Matrix*—many developers will create an interface matrix or division of responsibility which (from a technical capacity) clarifies what obligations sit with each contractor across the project. It may be helpful to append this document to the contract as an aid to explaining the obligations of the parties in relation to the interface points and/or scope of work. However, to the extent such a document is attached to the contract, it will be vital to ensure that it is sufficiently detailed and complete as to aid clarity rather than create ambiguity within the contract which can lead to greater uncertainty and disputes between the parties.
- *Employer's Requirements*—in addition to clarify the legal interfaces it will be important from a technical perspective for the scope of work of each package to be accurately defined in the technical documents to ensure that there are limited gaps between the various project packages. Ensuring a detailed review is undertaken of each package by the technical team will be vital to maintain a clearly defined technical scope. In addition, it would be prudent to ensure that sufficient technical support is available in circumstances where technology could advance during the lifetime of the project design and build. It is also worth considering how to allow for technological advances to be captured by appropriate change provisions. Finally, for any party, it is important to review whether there are any provisions relating to mistakes to technical requirements, which may be mistakes due to developments in technology down the line.
- *Delay*—where there are multiple packages of work progressing simultaneously and interweaving across a wider project program any delay is likely to impact contingent works to the extent there is not sufficient float in the program. Developers should look to ensure that contractors have sufficient float in their own program to absorb delays in other packages as well as within the relevant package itself (to the extent possible). From a legal perspective, any extensions of time should be narrowly drafted and limited wherever possible. Concurrent delay (i.e.

a scenario where there are two delay events occurring simultaneously and only one event entitles the Contractor to an extension of time and the other event is running concurrently, the Contractor shall not be entitled to any extension of time) should also be excluded. Additionally, relief should only be made available to a contractor where the time for completion is delayed (or if any key milestones are incorporated into the contract structure).

- *Variations*—one of the biggest reasons parties end up in disputes is as a result of variations. Ensuring that the terms for entitlement to time and costs for variations are clear and unambiguous will help reduce the risk of a dispute down the line. In particular, in this context, it would be prudent to carefully set out entitlement for changes to technology, design development and delays due to supply chain issues.
- *Change in Law/Regulations*—with any parties looking to contract in a developing field, it is important to consider the impact of any changes in law or regulations which may affect the existing contractual terms. It may be that provision needs to be made for the parties to renegotiate elements of the contract should regulations change and cause illegality/material changes to the risk allocation. Over the years, developers have assumed a greater share of change in law risk. However, a few years ago the general position was that contractors should know their industry and anticipate how the law may change and develop. It may be possible that hydrogen could (as a new industry) follow this approach where contractors properly bear the risk of changes in law that are reasonably foreseeable.
- *Dispute Resolution Clauses*—typically FIDIC based contracts have a tiered-dispute resolution clause. Where an expert or engineer with requisite experience forms part of that process, it is worth considering whether (1) an appropriate individual with the requisite experience exists, and (2) if there are appropriate people, whether the pool of individuals is big enough to not cause a conflict issue. It is also vital to ensure that appropriate joinder provisions are included across the suite of documents to allow related contractual disputes to be considered together.

The developer will need to balance the commercial and legal risk from the menu above to meet the practicalities of the negotiations.

A BANKABLE STRUCTURE

Although hydrogen is a nascent technology, it is likely, looking at other technologies that projects will be developed on a multi-contracting structure

(with degrees of varying package numbers). Looking at other energy technologies, we expect this will be a bankable approach provided that developers ensure the packages contain a balanced risk profile that protects against the inherent interface risk within the structure.