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Managing Supplier-Direct Agreements

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Session Title: Managing Supplier-Direct Agreements

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I. Introduction

Government regulations, supply chain disruptions, COVID-19 (the "pandemic"), and the war in Ukraine ("Ukraine war") have challenged everyone in the construction industry. These challenges must be managed in an environment with labor shortages, cybersecurity risks, a struggling real estate market, inflation, and rising interest rates. The construction industry also must anticipate and plan for the influence of evolving technology and on its use on capital facilities.

The design-build approach, which is used for all types of construction, falls between design-bid-build and EPC with respect to risk allocation. Under a design-build contract, the contractor agrees to design and build the desired construction project using owner-provided design parameters. The design-build contractor has flexibility with respect to procurement to the extent that the items procured accomplish the objectives set forth in the design parameters. Similar to an EPC contract, if the owner decides to procure a specific item, it assumes responsibility for that item. Again, this decision can impact many elements of the design and construction process.

Hybrid contracting models also influence risk with respect to supplier-direct procurements. For example, the wind industry uses multi-contract strategies with up to eight to ten packages for design, manufacturing, and installation. In fact, some project developers in the wind industry leverage their competitive advantage by dealing directly with the supply chain (through supplier-direct agreements) to drive down project costs.[3] Other wind developers opt to work with a few large suppliers, limiting exposures to lower tiers of the supply chain.[4] While the solar industry has relied heavily on EPC delivery in the past, labor shortages for EPC professionals may bring owners and contractors to consider different forms of project delivery in coming years.[5] This variety shows how different project delivery systems span

Supplier-direct agreements also present risks for suppliers and vendors. Depending on the terms of its underlying contract, the supplier or vendor may become directly or indirectly at risk to the contractor, owner, and other entities. This risk

2026.[15] The geopolitical and logistical implications of this situation are significant. Additionally, global and regional disruptions like pandemics, natural disasters,

In theory, direct purchasing using an EPCM benefits the owner by providing greater flexibility. Owners who chose this approach believe it reduces owner costs by providing the owner with the ability to work directly within the supply chain, choose the most cost-effective supplier, negotiate favorable pricing, and avoid contractor markup. However, the owner assumes significant management risks under this model. For example, the owner must negotiate with manufacturers and suppliers, take responsibility for risks associated with loading, shipping and schedule and performance risks it did not anticipate in the supplier-direct agreement.

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Because BR, BI, and CGL insurance collectively cover physical losses and injury suffered by the insured and third parties, and TD and SCR insurance insulate the insured from cost related to external, nonphysical, defined disruptions in a project's progress, owners and contractor should contact an insurance professional to provide advice on each of these policies in the context the project for which insurance is required. They should also require suppliers to furnish proof of insurance in negotiations and consult well-versed brokers to determine whether their project requires special coverage. Consideration should also be given to project specific needs. Discussing with brokers whether other insurance policies, like marine cargo policies or civil authority coverage, may also help fairly allocate risk.

Specific consideration should be given to coverage provided from insurers in foreign countries that have not consented to jurisdiction in the United States. While principles of comity may apply, attempting to enforce insurance rights in a foreign jurisdiction can be time consuming and expensive. Also, attempting to enforce such rights in some jurisdictions or take too long to be a practical remedy. Therefore, consideration should be given to requiring the supplier to obtain insurance from reputable insurer in the United States or requiring a letter for credit issued by a financial institution in the United States.

b) Letters of Credit

Letters of credit are typically on-demand instruments that secure the performance of a specific act or acts. A letter of credit serves as a guarantee of payment where the bank issuing the letter of credit is substituted for the guarantor's credit risk.[41] The issuing bank will perform due diligence on the guarantor and require some form of security to be sure that the bank will not incur a loss if it honors a draw on the LC.

From the creditor's standpoint, letters of credit are preferable to bonds or insurance because fewer prerequisites need to be established to draw on letter of credit. While banks issuing a letter of credit may have documentary conditions that trigger payment,[42] the creditor is not required to establish liability or overcome defenses presented by the bank before making a draw. This stands in stark contrast to bond or insurance claims, which are typically subject to bond and insurance defenses, policy exclusions, and extensive investigations before payment is made.

If a letter of credit cannot be obtained, certain alternatives are available that may require the supplier, contractor or owner to bear more risk. For example, under cash-in-advance payment terms, the supplier receives payment before material

[41] Ezgi Aysima Kır, *COVID-19: Letter of Credits in the Wake of Covid-*

transfer to the customer, making the customer face the risk of never seeing the