

## WHAT IS A TURNKEY CONTRACT?

A Turnkey Contract is one under which the contractor is responsible for both the design and construction of a facility. The basic concept is that in a Turnkey Contract the contractor shall provide the works ready for use at the agreed price and by a fixed date. The reality is that the employer wants to be and should be actively involved in the project at all stages. The term is used more or less synonymously with expressions as "package contract", "design and build" or "design constructor". In French one uses the expression *clé en mains*, in Spanish *llave en mano* and *schlussfertig* in German. This type of contracts are also known as EPC Contracts (Engineering, Procurement and Construction).

### COMPONENTS OF A TURNKEY CONTRACT

Turnkey contracts include at least three components:

- The design of the facility by the contractor. This does not exclude that certain aspects of the design are already defined in the contract or that the preparation of the design forms the object of a separate, preliminary contract. In any event, even where the contract is only for the construction of the facility, the contractor normally has to prepare the detailed design.
- The technology component, i.e., patents, know how, etc., in so far as it concerns the completed works, can be seen as incorporated already in the design. However, in certain cases the contractor uses the technology of their parties by virtue either of his own contractual arrangements or as requested by the employer or his engineer.
- Supplies, construction and erection, form also part of contractor's obligations. Even in the more restrictive definition of a turnkey contract, the contractor owns the construction of the complete facility ready to be operated. Nevertheless is not infrequent for the employer to require from the contractor that he retains specified subcontractor or to limit the choice to certain supplies. In this manner the employer may wish to assure himself of the quality of certain components or negotiate directly the price of certain subcontractors.

### OBLIGATIONS OF EMPLOYER AND CONTRACTOR

Any turnkey contract contains a detailed description of the general obligations imposed to the purchaser (referred to as the "employer") and the contractor.

The main obligations of the employer are:

- Giving the contractor access to the site.
- Assisting the contractor with obtaining licenses and permits.
- Paying the contract price.

The contractor's main obligations are:

- To obtain the necessary permits and licenses.

- To carry out the design of the works.
- To provide the Employer with the required operation and maintenance manuals.
- To provide the works on a turnkey basis and remedy defects in accordance with the contract.

## **MAIN CLAUSES OF A TURNKEY CONTRACT**

Turnkey contracts often seek to regulate in great detail all issues which possibly might arise between the parties. The main clauses of a turnkey contract are: design of the project, the construction site, time for completion, price and payments, performance guarantees and the law governing the contract.

### **Design of the project**

In principle it is the contractor's responsibility that the design of the project is complete, sufficient and adequate and assures the facility meets the contractually required performance guarantees. If one were to consider the design obligations as distinct from those of construction, the nature of these obligations and the question whether they have been performed properly might have to be determined independently of the quality and performance of the finally constructed plant.

### **The construction site**

The choice of the site, access to it and frequently also availability of utilities during the construction period, normally are an obligation of the employer. The contractor has to specify the corresponding requirements. Particularly difficult problems arise where an appropriate site cannot be found or where the site retained at the time when an appropriate site cannot be found or where the site retained at the time when the contract was concluded turns out to be unsuitable.

### **Time for completion**

The contractor's principal obligation is that of meeting the completion date or, if the installation is taken over in stages, the successive completion dates. However, where the construction programme has become part of the contract, the purchaser may require that the contractor adheres to this programme. On the one hand, this assures the purchaser that the progress of the works is sufficient in order to meet the completion date. On the other hand, the purchaser's own production programme and the co-ordination of the contract works with other work may require strict adherence by the contractor to his programme.

### **Price and payments**

The price for turnkey projects normally is a lump sum. While it is conceivable to express prices in a turnkey contract in the form of unit prices or by cost reimbursement, such arrangements seem to be rare. Nevertheless it is not infrequent the turnkey lump-sum contract contain a list of unit prices or prices for certain parts or components of the works. Such unit and partial prices then serve for the valuation of variations and possibly also for progress payments.

Where the works are for any importance, the contract provides for partial payments. In case of lump-sum turnkey contracts, it is hardly possible to fix progress payments by

reference to measurement of quantities. Thus partial payments in these contracts normally are made on the basis of milestones such as dates of placing orders to suppliers, achievement of certain stages in the process of manufacturing, packing of equipment, shipment, arrival at site, etc.

### **Performance guarantees**

It is the contractor's obligations to meet these guarantees. Where his failure to do so is due to defects in approved design or variations ordered by the purchaser, the contractor is not relieved of this obligation unless an exoneration has been agreed, expressly or by implication. The performance guarantees undertaken by the contractor are based on certain assumptions with respect to the quality of raw materials used and the operating conditions such as climatic conditions, availability and regularity on supplies, etc.

### **The law governing the contract**

This law determines the contractual rights and obligations of the parties, the interpretation of the contract and subject to some reservations, its formation and validity. The principle of party autonomy recognized for most types of contracts also applies to turnkey contracts. Consequently the parties are free to choose the law governing their contractual obligations, subject to certain restrictions resulting from rules of public policy. Such rules may relate to certain subject matters of the contracts (e.g., intellectual property rights) or to certain aspects of the transaction (e.g. rules on interest and rates, competition and antitrust, etc.).

The applicable law to dispute settlement procedures normally is the law of court or arbitration procedure at the place where the project take place. It is determined independently. In some cases it can be the law of a country different from that whose law governs the contract itself.

In conclusion, a model of Turnkey Contract should be based on an equilibrium of the rights and obligations between the employer and the contractor, and a balance risk allocations. Also the Contract must provide a clear and compact structure that facilitates its administration. Finally the contract should be suitable for use in civil and common law and other jurisdictions as arbitration courts.



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