



ORGALIME

Turnkey Contract for Industrial Works

INTRODUCTION

Introduction to the Orgalime Turnkey Contract for Industrial Works

Background

Orgalime represents the engineering industries in Europe. Its legal committee has long had as one of its main tasks to provide industry with practical balanced model contracts and general conditions for different types of contracts. The most widespread of these are Orgalime S 2000 for the Supply of Mechanical, Electrical and Electronic Products and SE 01 for the Supply and Erection of such products. To further extend the coverage for different types of contracts Orgalime now issues the Orgalime Turnkey Contract for Industrial Works.

When to use the Orgalime Turnkey Contract for Industrial Works

The heading states that this standard contract is intended for “industrial” works. By that term is meant any kind of process plant or industrial production unit. Typical examples would be a power plant, a paper machine and an automated production line for industrial products.

The contract is turnkey in the sense that the contractor’s obligations include the supply and erection of all the machinery and equipment which form part of the works and testing and commissioning of the finished works, and that the contractor is solely responsible for the functioning and the performance characteristics of the works.

The contract does not, however, have to be turnkey in the sense that the contractor must perform all the civil works and provide all the equipment and auxiliary services necessary for the erection work. In this respect the Orgalime turnkey contract is very flexible. The parties can easily adapt their contract to suit the individual situation by filling in the checklist, which is part of the contract package, and thereby make the contract more or less “turnkey”. This flexibility should make the Orgalime turnkey contract suitable for many different types of industrial works.

The flexibility in relation to civil works, erection equipment and auxiliary services is also in marked contrast to the FIDIC suite of contracts where the contractor’s obligations will include all the means necessary to carry out the work. The FIDIC approach is typically less well suited for industrial works which are more often than not installed at premises where the purchaser already is established, and therefore it is more practical and cost effective for the purchaser to provide a significant part of such work and services.

Balanced contract

The Orgalime turnkey contract is not only issued in order to extend the coverage of Orgalime standard contracts. A further reason is the intention to provide a more balanced alternative to the FIDIC EPC Turnkey Contract, the so-called Silver Book, which in Orgalime’s view is less well suited for industrial works contracts. The Silver Book places practically all risks on the contractor while giving the employer a large influence over the day-to-day performance of the contract. This combination is likely to lead to complicated and costly disputes, which is not in the interests of either party. But, above all, it contains risks for the contractor which contractors in the engineering sector are not ready to accept.

This does not mean that Orgalime has produced a contract which only looks to the interests of the contractor. First of all, many contracts of this kind will have engineering companies on both sides. Orgalime recommends that member companies use the Orgalime turnkey contract for buying its production facilities. Secondly, a contract that is too favourable to the contractor would never be used. The Purchaser will usually be able to veto conditions that he does not find acceptable. As in the work of all other general conditions and model contracts Orgalime has therefore strived to produce a balanced contract, which places risk on the party who is best placed to evaluate and control that particular risk.

A “two party contract”

The Orgalime Turnkey Contract for Industrial Works is based on a strict two party approach. A marked difference from the FIDIC contracts and other standard contracts based on Anglo-Saxon contract traditions is that in the Orgalime contract there is no “Engineer” to act as project manager and first instance arbitrator. Nor is there an “Employer’s Representative” who has a primary right to make decisions binding on the other party. There are, of course, representatives of both parties, a Project Representative and a Site Representative. But they only represent their respective parties and do not have the power to make prejudicial decisions binding on the other party. Each party must take responsibility for his interpretation of the contract and act accordingly. If, for example, the Purchaser considers that he has a claim against the Contractor, he may choose to withhold the sum he considers himself entitled to. But, if he is wrong in his assessment, he will have committed a breach of contract by not paying and is liable under the contract for that breach.

Adjudication by an independent expert

As described below there is, however, according to the General Conditions the possibility to refer disputes over variations to be settled by an independent expert. This procedure is also available if the parties disagree on work necessary to achieve mechanical completion and at termination for the Purchaser's convenience if the parties fail to agree on the percentage of the Works, which has been completed.

There may, of course, during the performance of a turnkey contract arise other disputes between the parties regarding important questions. Depending on the expert's field(s) of expertise and their trust in him/her, the parties may wish to extend the expert's powers to adjudicate such disputes. One very important question, which is sometimes in dispute, is whether the Works fulfil the contractual requirements for taking over. Other such typical areas of dispute are the right to an extension of time, the fulfilment of performance guarantees, valuation at termination, etc.

There may, however, be a downside to having the expert decide different disputes. The possibility to refer all manner of disputes to an expert may make the parties less willing to agree on compromise solutions and, as a result, the relation between the parties may become more confrontational.

A more flexible solution may be to engage the independent expert to mediate between the parties instead of making binding decisions, even if he may still have the power to make such decisions if mediation fails. The best means for settling possible disputes will very much depend on the size and type of contract.

How to use the contract documents

The Orgalime Turnkey Contract for Industrial Works consists of three integrated parts, the Main Contract Document, the General Conditions and the Checklist (Obligations of the Contractor and the Purchaser). By filling in the Main Contract Document and the Checklist the parties can adapt their contract to suit the individual situation.

This also means that the actual contract can be made more or less "turnkey". The idea behind the term turnkey is that the contractor shall provide works, which are ready for use and that the purchaser shall not be obliged to assist him in any way. But in reality most contracts are not strictly turnkey in this sense. For practical and economical reasons the parties will wish to make use of any auxiliary tools, equipment and services that are available at the site. The purchaser may also be in a better position to provide local labour and services. This means that the contract is likely to be less turnkey if the works are built at an industrial site, where the purchaser already operates. But if it is a new site the contract is likely to be more turnkey.

The Checklist allows the parties to specify in detail their obligations in respect of the performance of the works. This also means that the General Conditions are not burdened by extensive general regulation of such details.

IMPORTANT FEATURES OF THE GENERAL CONDITIONS

Variations

In any major works project there will always be variations before the works are completed. The subject is difficult and the contractual rules on variations are important to the balance of the contract. If the Contractor is obliged to carry out all variations required by the Purchaser, the latter will have the upper hand in the negotiations regarding the effects of the variation in respect of time and money. If, on the other hand, the Contractor is not obliged to carry out any variations before the parties have agreed on time and money, then the Contractor will have an advantage in the negotiations.

The Orgalime Turnkey Contract relies on neither of these principles but introduces a more balanced solution. Thus, according to Clause 8, the Contractor is obliged to carry out variations required by the Purchaser, unless they are of an extent or character, which the Contractor could not reasonably foresee. But if the parties fail to agree on time, money and/or other effects of the variation the Purchaser cannot directly order the variation, he has to refer the dispute to be settled by an independent expert. The procedure is described in Sub-clauses 8.8–8.12. Preferably the expert should be named in the contract.

The stages of execution, testing and taking over

The most important stage of the Turnkey Contract is taking over. As explained in Sub-clause 14.2 of the General Conditions taking over has a number of consequences. Besides those enumerated there will of course also be payment obligations and usually consequences for the obligation to provide financial security.

Preliminary tests and inspections

Before the Works are completed there will usually be a number of tests and inspections of different kinds at different stages of performance of the contract, such as before shipment of goods to the Site and before covering up work. Rules on these are found in Clause 11, which covers all tests and inspections except the Tests on Completion, the inspection regarding Mechanical Completion and any Tests After Completion specified in the Contract.

Mechanical Completion

The phase leading to taking over starts with the Contractor's notice that the Works are ready for commissioning (12.1). Thereafter the parties shall together check that this is also the case. The term used here is "Mechanical Completion", a term frequently used in this kind of contract. The term, however, does not have to be taken in its literal sense. The intention is that the parties should together ensure that the Works are ready for commissioning, i.e. start up procedures. The check shall include a check of whether everything to be supplied is in place and, as far as can be checked without actually taking the Works into operation, that all erection work is completed.