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## LUMPSUM TURNKEY CONTRACTS: AN OVERVIEW

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### ABSTRACT

The concept of Construction Contracts is a growing phenomenon in the legal sphere of India and all around the world. Due to the large complexities involved in the industry, the contracts are modified to customise and fulfil the need of the contracting parties. However, the provisions of the Indian Contract Act, 1872 have to be strictly adhered to. Additionally, the large conceptual framework provides certain broad categories which include unit price contracts, Lump-sum Turnkey (LSTK) Contracts etc. The most widely used form is the LSTK Contract form which has been discussed at length in this paper. It has certain distinctive features pertaining to the costing and pricing of these contracts along with the sphere of the work involved. The various resources relied on for the purpose of this write up highlight the various aspects of LSTK contracts. Furthermore, several precedents have been laid down discussing the scope and nature of this form of contracts due to the significant impact of the industry in the country. These case laws, adjudged by eminent authorities also lay down the imperative features of LSTK contracts thus providing an explicit understanding of the same. Mainly used for large scale projects and heavy industries such as mining and oil and gas sector, a good formation of such contracts has proved to reduce disputes thereby facilitating grave ways of economic development globally. Thus, this growing concept under the Contract Laws may be critically analysed from this paper.

**KEYWORDS:** Lump-sum Turn Key, Construction, Contracts, Pricing, Economic.

### *A. Introduction*

The field of construction has been a paramount development for the economic spheres not just in India but all over the world. It is the one industry that has grown against all odds and circumstances and is considered 'essential' for economic growth. Thus, over-time, the laws governing this industry have also

evolved. Howbeit, the very *foundation* of this field (like all other industries) lies under the modulation of *Contract Laws*. It is the very basis for any supplemental procedures. This paper shall extensively deal with Construction Contracts and further elucidate on its most important form, popularly known as the *Lumpsum Turnkey Contracts*[hereinafter referred to as '*LSTK*' ].The features, nature and scope of the same will also be highlighted. It shall also be further illustrated by eminent Indian and International precedents.

### ***B. Construction Contracts***

The term 'construction' is widely used for the assembly or building of immovable properties, however this is not a static concept and extends to many other spheres<sup>1</sup>. The Accounting Standard (AS) 7 defines a '***construction contract***' as a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.<sup>2</sup>

It is imperative that these contracts are closely and finely drafted due to the wide range of persons, technicalities and procedures involved<sup>3</sup>. Thus, the main parameters and conditions such as the chronology of procedures, pricing, conditions etc. must be present.

Most disputes that arise under construction laws are due to the poor formation of the contracts, therefore the very first essential is to make sure that a valid contract is formulated<sup>4</sup>. In India, the governing law for the same is the Indian Contract Act, 1872. Amongst others, there must be a valid and unambiguous offer and acceptance<sup>5</sup>, no vague provisions, clarity of intention and consent<sup>6</sup> of the parties and other essentials under §10 of the Act should be met for it to be legally binding<sup>7</sup>.

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<sup>1</sup>SWEET & MAXWELL, CHITTY ON CONTRACTS, VOLUME II, SPECIFIC CONTRACTS 710 (31<sup>ST</sup>ED.).

<sup>2</sup> Accounting Standard (AS), MINISTRY OF CORPORATE AFFAIRS (August 23, 2019), [http://www.mca.gov.in/Ministry/notification/pdf/AS\\_7.pdf](http://www.mca.gov.in/Ministry/notification/pdf/AS_7.pdf).

<sup>3</sup>JUSTINE SWEET, STANDARD CONSTRUCTION CONTRACTS: ACADEMIC ORPHAN, BERKELEY LAW SCHOLARSHIP REPOSITORY 31 CONSTR. LAW. 38 (2011).

<sup>4</sup> Ove Arup & Partners International Ltd. vs. Mirant Asia- Pacific Construction (Hong Kong) Ltd. [2003] EWCA Civ 1729.

<sup>5</sup>Sec.2, Indian Contract Act, 1872.

<sup>6</sup>Sec. 13, Indian Contract Act, 1872.

<sup>7</sup>Sec. 10, Indian Contract Act, 1872.

Since there is an involvement of numerous parties, documents, tenders and procedures, these contracts are divided into standard forms on the foundation of which other individual contracts are customised. The most widely used form<sup>8</sup> is the *turnkey* model of contracts also known as ‘design- build’ contracts which covers the design, constructing, equipping and complete preparation of a facility for operation<sup>9</sup>. These are based on a *lumpsum* or a ‘fixed pricing’ method<sup>10</sup>. The common practice in these forms is an invitation for bids by a party for the project under the Contract on a turnkey basis, subsequent to which the parties enter into a *Lumpsum Turnkey Contract*. In addition to this, the ‘contract price’ is also agreed upon by the parties on LSTK basis as per the provisions of the contract.

### C. *Lumpsum Turnkey Contracts (LSTK Contracts)*

A Lumpsum Turnkey project refers to a contract where the entire execution responsibility, right from the initial stages to the stage of completion lies with the contractor. On completion, the project is handed over only after it is in a ‘ready to use’ condition.

The nature of these projects arises from two contractual concepts namely-

- i) **Lumpsum**- wherein a specified contract amount is agreed upon by both parties *and*
- ii) **Turnkey** - which indicates that only the final and ready product is to be handed over to begin the project.

The Hon’ble Courts in India<sup>11</sup> have considered several definitions to form their ratio on issues pertaining to LSTK projects which, amongst others include-

- Law Lexicon by P. Ramanatha Aiyar (2010: Lexis Nexis) has defined a **Turnkey contract as A contract under which the contractor assumes responsibility to the client for constructing productive installations and ensuring that they operate effectively before turning them over to the client. Contract, found especially in the computer and construction industries, in which a supplier**

<sup>8</sup> StandardFormConstructionContracts, SUB- COMMITTEE OF THE INTERNATIONAL BAR ASSOCIATION (Pg. 1-2), <https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3DE2E811DA-E906-493D-89D1>.

<sup>9</sup> SPIC SMO, A Division of Southern Petrochemical Industries Corporation Ltd. v. Tamil Nadu Electricity Board MANU/TN/2167/2012 (India). ¶71

<sup>10</sup> VOL I, JANE JENKINS, INTERNATIONAL CONSTRUCTION ARBITRATION LAW : ARBITRATION IN CONTEXT SERIES 14 (2<sup>nd</sup> Ed.).

<sup>11</sup> Lanco Infratech Limited and Ors. v. CC, CE & ST MANU/CB/0011/2015 (India).

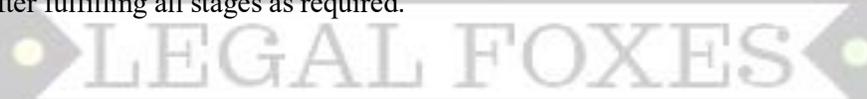
*provides a complete customised package to a client (who has merely to "turn the key" and take over the package)<sup>12</sup>*

- Additionally, the Black's Law Dictionary (Fifth Edition) defines **Turnkey contract**: *Term used in building trade to designate those contracts in which builder agrees to complete work of building and installation to point of readiness for occupancy. It ordinarily means that builder will complete work to certain specified point, such as building a complete house ready for occupancy as a dwelling and that builder agrees to assume all risk.<sup>13</sup>*

Lastly, it is essential to note that eminent jurists and judges have drawn an analogy to such a project which explains that the party to whom the asset is to be delivered to, may simply 'turn-the-key' and the product would be in a ready condition for immediate use, like a vehicle ignition.

i) *The Nature And Scope Of LSTK Contracts*

The fundamental rule of a turnkey contract is that the project is handed over only when it is completed in its entirety. As stated by the Hon'ble Court in Lanco Infratech Limited and Ors. Vs. CC, CE & ST<sup>14</sup>, *the scope of the contract commences from the engineering or design stage on to completion of the project in its entirety and is normally for a lumpsum, with full responsibility on the contractor for effective execution of all stages thereof*, thereby indicating that it is the duty of the contractor to produce a 'ready to use' project after fulfilling all stages as required.



LSTK projects have to be completed in their entirety by the contractor and are based on a fixed sum agreed upon by the parties as per their contractual terms. The nature of such projects forms the foundation of the contract and has to be adhered to by all parties. Furthermore, apart from construction projects such as buildings, highways, dams etc., these are popularly found in the oil and gas sector, mining sector and even for other goods and services<sup>15</sup>.

<sup>12</sup> P. Ramanatha Aiyar, Law Lexicon (2010).

<sup>13</sup> Black's Law Dictionary (5<sup>th</sup> Ed. 1981).

<sup>14</sup> Lanco Infratech Limited and Ors. v. CC, CE & ST MANU/CB/0011/2015 (India).

<sup>15</sup> Nishith Desai Associates, CONSTRUCTION DISPUTES IN INDIA (Apr. 2020),

[http://www.nishithdesai.com/fileadmin/user\\_upload/pdfs/Research\\_Papers/Construction-disputes-in-india.pdf](http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Construction-disputes-in-india.pdf)

The most essential element of these Contracts is that this *nature* has to be expressly mentioned in the Contractual provisions. This means that the clause for the contract pricing must include that the agreement in question is of the LSTK nature. This ensures that the essentials of a valid and legally binding contract are fulfilled, by proving the consensus of mind on the same thing at the same time.<sup>16</sup> This is essential since the buyer agrees to pay a 'set-price' for the project which cannot be deviated from<sup>17</sup>. The scope and schedule has to be clearly laid down and agreed upon by both the parties to the contract.

Thus, in an LSTK contract agreed upon by both the parties, the contractor is under an obligation to carry out the work right from the initial stages of surveying and designing to the final stages of testing and commissioning. It is the duty of the claimant to carry out all the work under the scope of the contract, in the price agreed upon by the parties.

ii) No Additional Costs

The most important feature of LSTK contracts is the fixed price methodology. Thus, no additional amounts can be claimed over the Lumpsum price as agreed upon by the parties through the contract in an LSTK project, *if the work is in the scope of the contract*. Being a turnkey contract, the scope extends from the initial stages to the finished- 'ready to use' stage of the project.

Additional claims may be incurred by the claimant *only* if there is new work beyond the scope of the LSTK contract. In such instances, the conditions stated in the contract for additional work shall be met. These include certain variations mentioned in the contractual clauses<sup>18</sup>. Furthermore, if the contractor observes that any additional work is required beyond the scope of the LSTK contract, 'Change orders', in writing<sup>19</sup>, shall be issued indicating the extra work and also the extra costs that come with it<sup>20</sup>. However, any work which falls within the ambit of the LSTK contract is inclusive of the amount agreed on by the parties. No additional costs or claims can be inferred for these.

<sup>16</sup>Sec. 13, Indian Contract Act, 1872.

<sup>17</sup>Hudson's Building and Engineering Contracts, Atkin Chambers, Sweet & Maxwell 6-051 (13<sup>th</sup> Ed).

<sup>18</sup>Dodd v. Churton[1897]1Q.B.562.

<sup>19</sup>WormaldEngineeringLtdv. ResourcesConservationCo(1992)8 BCL 158.

<sup>20</sup>Smithv.SaltLakeCity104Fed.Rep.457(1900). ; WatsonLumberCo.v. Guennewig,226NE(2d)270(1967).

Due to the wide scope of the Construction industry in India, the Hon'ble Courts have addressed the scope and ambit of LSTK Contracts at several instances.

One of the most renowned precedent for this concept was laid down by the Delhi High Court in the case of – *Delhi Jal Board Vs. Kaveri Infrastructure Pvt. Ltd. and Ors.* The project in this matter had been conceived on Turnkey project basis as mentioned in their contractual agreement. The arbitral award which allowed additional costs over the contractual price was challenged. It was held by the Hon'ble Court that the spirit of the contract lies in the nature of the contract, which in this case was a Turnkey project. The contractor was under the obligation to design and execute the work as per the requirement of the petitioner which had been set out in the agreement as the contract in question was of a turnkey nature.

It was further held that the Arbitrator had totally ignored stipulations in contract and had forgotten the basic and fundamental terms of contract. The character of the original contract cannot be altered, damaged or modified. Likewise, in the present matter the contractual nature is of a Lumpsum Turnkey project which forms the basis of the contractual agreement and cannot be altered with. It is a settled position in law that terms and conditions of contract between parties have to be strictly adhered to. Being a turnkey contract, no additional claims could be entertained as the contractor was not entitled to any extra costs. Therefore, the Respondent was not entitled to any claims and the arbitral award was set aside.

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Similarly, it was held in the case of *SPIC SMO, A Division of Southern Petrochemical Industries Corporation Ltd. Vs Tamil Nadu Electricity Board*<sup>22</sup> that a turnkey contract means the entire work should be done by the contractor for the price stipulated in the contract.

Likewise, in the case *Central Government Employees Welfare Housing Organisation Vs. Labh Construction & Industries Ltd*, the parties entered into a turnkey contract and a dispute arose when the contractor made several additional claims over the agreement as per contractual terms. The arbitration award which granted these claims were set aside by the Hon'ble Court on the basis that *the entire purpose*

<sup>21</sup>Delhi Jal Board Vs. Kaveri Infrastructure Pvt. Ltd. and Ors. MANU/DE/4466/2013 (India).

<sup>22</sup>SPIC SMO, A Division of Southern Petrochemical Industries Corporation Ltd. v. Tamil Nadu Electricity Board MANU/TN/2167/2012 (India).

of the turnkey contract is to bind the parties to the initial terms of the contract. It was held that since the contract is a turnkey project, the payment of amounts not contemplated in the contract is not tenable.<sup>23</sup>

iii) The Provision for Liquidated Damages in LSTK Contracts

Naturally, since all the responsibility of the project lies in the hands of the contractor, he also bears the risk for the same. Therefore, certain *contingency allowances* shall be included depending on individual agreements<sup>24</sup>. This may include contractual provisions of 'early warnings' to intimate the parties of any likely events.<sup>25</sup>

Similarly, the nature of these contracts is highly based on their scope and schedule which suggests that time is the essence of such contracts<sup>26</sup>. Therefore, along with the contingencies, these contracts may include penalties for delays in the form of Liquidated damages<sup>27</sup> and even incentives for early completion.

At times there may also be concurrent delays, wherein both parties would be equally responsible for the same. In India, there is no definite approach to concurrent delays yet however it was seen in the case of *Essar Projects (India) Ltd. & Ors. vs Gail (India) Ltd.*<sup>28</sup>, wherein, due to delay caused by the parties, the contractor was not granted any additional cost nor did it allow the employer to charge any liquidated damages.

Additionally, in India the buyer has to prove the actual loss suffered to be entitled to these damages<sup>29</sup>. However, this view has been now overruled in several judgements based on individual facts and circumstances, wherein proving the actual loss suffered was not considered imperative for claiming damages<sup>30</sup>.

#### ***D. Conclusion***

<sup>23</sup>Central Government Employees Welfare Housing Organisation Vs. Labh Construction & Industries Ltd 2019 (3)Arb LR 271(Delhi) (India). ¶133

<sup>24</sup>Johnathan Hosie , TURNKEY CONTRACTING UNDER THE FIDIC SILVER BOOK (2007). 10.1002/9780470697641.app3.

<sup>25</sup>NILIMA BHADHBADE, THE INDIAN CONTRACT AND SPECIFIC RELIEF ACTS, 848 (14th ed. 2014).

<sup>26</sup>NSrinivasa v. KattukaranMachineToolsLtd,AIR2009SC2217 (India).

<sup>27</sup>Sec.73, Indian Contract Act,1872.

<sup>28</sup>RoyalBromptonHospitalNHSTrustv. FrederickHammond& Ors. No. 7 [2001] EWCA Civ 206.

<sup>29</sup>Union of India v. Raman Iron Foundry AIR 1974 SC 1265 (India).

<sup>30</sup>RahejaUniversalPvt.Ltd.v.B.E.Bilimoria&Co.Ltd.,2016(5) MahL.J.229 (India). See also,ONGCv.SawPipes(2003)5SCC705 (India). ;MayaDeviv.Lalta Prasad (2015) 5 S.C.C. 588 (India). ; A.S. Motors (P) Ltd. v. Union of India (2013) 10 SCC 114.

To sum up, it may be asserted that the cardinal features of LSTK contracts reckon on the responsibility laid on the contractor to complete the work in entirety, in a timely manner and to a necessary performance level, for which the employer shall pay a fixed price<sup>31</sup>.

This form of Construction contracts highlights the *priority to responsibility*<sup>32</sup> of work allocated as per the contractual provisions. It leaves no room for any ambiguity since every criteria, starting from the work involved to the price methodology is laid down in detail. However, it is not simple as it may theoretical sound, since these contracts are most often than not drafted for projects with large complexities<sup>33</sup>. Thus, it may be analysed that LSTK Contracts are evolving with the law and being widely acknowledged all over the world, which makes it a growing and paramount field of study.



<sup>31</sup>Chern, Cyril. (2008). Appendix 3: FIDIC (SILVER BOOK) CONDITIONS OF CONTRACT FOR EPC TURNKEY PROJECTS. 10.1002/9780470697641.app3.

<sup>32</sup>LEONASUSTINOVICHUS , MULTICRITERIA VERBAL ANALYSIS FOR CONSTRUCTION CONTRACTS, (Jan. 2008 ) ISBN 978-9955-28-283-9.

<sup>33</sup>Johnathan Hosie , TURNKEY CONTRACTING UNDER THE FIDIC SILVER BOOK (2007). 10.1002/9780470697641.app3.