Construction Contracts

The 3Rs Basic Guide for SME’s

“Know your
Rights,
Responsibilities and
Risks!”

An Introduction

2nd Edition
August 2004

A cidb Best Practice Guide
What is the ci\db?  

The Construction Industry Development Board (ci\db) is a national body established by an Act of Parliament (Act 38 of 2000).  

The ci\db develops the industry for the improved delivery of infrastructure to the South African public. It works with all stakeholders for the sustainable growth of construction enterprises and the best practice of employers, contractors and the professions.  

The ci\db identifies best practice and sets national standards. It promotes common and ethical standards for construction delivery and contracts.  

To implement these objectives, the ci\db is mandated to establish:  
• a Code of Conduct for all parties engaged in construction procurement;  
• a Standard for Uniformity in Construction Procurement based on best practice;  
• a national Register of Projects; and  
• a national Register of Contractors.  

Background  

The 3Rs Basic Guide for SME's is a response by the ci\db to some of the problems raised by emerging contractors. Access to contract opportunities has been widely promoted by most public sector agencies but the sustainability of small contractors is jeopardised by the following issues that have been raised by the sector:  

Procurement procedures and delivery management  
• Some public sector employees are not committed to procurement reform.  
• Some consultants show a poor attitude to emerging contractors.  
• Complicated tender documentation and lack of standardization within the public sector.  
• Nepotism and favouritism in the award of contracts.  
• Delayed payment by clients (employers) affects the cash flow and credit worthiness of contractors.  
• No monitoring of performance, development and sustainability of SME's.  
• Award of contracts to the lowest tenderer affects the sustainability of real contractors.  

Access to finance  
• Inability to raise sureties and bridging finance. Lack of plant and equipment.  
• Material suppliers do not give the necessary credit to emerging contractors.  
• Emerging contractors cannot grow, because they are confined to small contracts.  

Capacity to perform  
• Inadequate management skills and lack of training opportunities.  
• Emerging contractors who front for established contractors give the sector a bad name. Employers and consultants fail to monitor this.  
• Joint ventures with established partners should promote management skills transfer.  
• Emerging subcontractors are exploited and often have no contracts.  
• Emerging contractors who expect everything on a silver platter do not live up to their responsibilities.  

Best practice  

This publication is a contribution to best practice and the sustainable development of construction enterprises. It has been developed and refined by a Focus Group of leading practitioners.  

The ci\db is cooperating with government departments, local authorities and public enterprises on the distribution of the 3Rs series so that emerging contractors can understand their Rights, Responsibilities and Risks  

The ci\db promotes Development through Partnership  

ISBN number 0-621-35406-6  
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1. Introduction

This guide provides help on the basic issues around contracts. It is an overview of the contracting process, and does not carry all the small details. It will help contractors become aware of all stages of the process and warn of the possible dangers and risks. The highlights some of the most common problems which can confront contractors who do not understand how a contract works.

CONGRATULATIONS!
Your tender has been accepted
You have guarantees of an insurance company or bank in place
You have organised bridge financing
You have lined up plant, equipment and credit for materials
You have received a signed copy of the form of offer or a letter of acceptance.

AND YOU ARE NOW READY TO SIGN THE CONTRACT – BUT BEFORE YOU DO SO YOU NEED TO FULLY UNDERSTAND YOUR RIGHTS, YOUR RESPONSIBILITIES AND THE RISKS THAT LIE AHEAD.
2. What is a contract?

A contract is an agreement between two or more people that is enforceable in law. In construction it is an agreement between an employer (sometimes referred to as client) and a contractor to construct, repair or renovate something, in an agreed time, for an agreed price and to agreed standards.

The contract describes:

- what will be done;
- how long it will take to complete;
- how much and when the employer will pay;
- what will be done if there are delays and changes in the work, and
- what work methods and quality will apply.

The contract is signed by both the employer and the contractor. Once it is signed, both the contractor and the employer must keep to the terms of the contract or face possible legal action.

3. Different ways of contracting

There are different ways in which the contractor can participate in a project. Each way has different rights and responsibilities.

<table>
<thead>
<tr>
<th>As a Main Contractor</th>
<th>The contractor by himself, makes an agreement with an employer to build something. Example: Speedy Builders, the contractor, contracts with Mr Cele, the employer to build his house.</th>
</tr>
</thead>
<tbody>
<tr>
<td>As a Subcontractor</td>
<td>A subcontractor has an agreement with the prime or main contractor to do part of a project or building. The subcontractor does NOT have a contract with the employer. Example: Speedy Builders, the main contractor, chooses to contract with Modern Masonry, a subcontractor, to do all the blockwork on the house for Mr Cele. Sometimes the employer wants to use a subcontractor of his choice who is known as a &quot;nominated subcontractor&quot;. Example: Mr Cele, the employer, wants Sparks Electrical to wire the house as a nominated subcontractor. Speedy Builders, the main contractor, is required by the contract to subcontract this work to Sparks Electrical.</td>
</tr>
<tr>
<td>As a Joint Venture Partner</td>
<td>The contractor makes an agreement with one or more other contractors to work together. They then jointly sign a contract to build all or part of a project. The Joint Venture (JV) can be for a main contract or for a sub-contract. Example: Speedy Builders, Modern Masonry and Sparks Electrical make an agreement to work together to build a new supermarket for Cele MaxiMart. They jointly sign a contract with Cele MaxiMart.</td>
</tr>
</tbody>
</table>
4. Rights and responsibilities of the main contractor

Different employers use different forms of contract. Many employers use forms of contract developed and published by industry-based organisations. These contracts have been negotiated over several years between different stakeholders and are fair to both the parties who have signed the contract. Some public sector employers at the municipal, provincial and national levels and some parastatals, have developed other forms of contract, which do not comply with good practice.

Look in any standard tender or contract document – you will see that it is divided into different parts with different headings. In the section called Conditions of Contract or Contract Data, you will find your rights, responsibilities and risks.

This booklet only looks at your rights, responsibilities and risks. It does not deal with technical details like specifications and drawings, which are explained in other parts of the contract document.

Many Conditions of Contract documents are used in the construction industry. Some are suitable only for particular sorts of projects. The rights and responsibilities are different in each.

A cidb Focus Group of specialists and stakeholders has examined the forms of contract in use in South Africa. In declaring procurement best practice the cidb recommends the use of the documents listed below. The cidb’s Standard for Uniformity in Construction Procurement further limits the range of forms of contract used by the public sector to the following:

- FIDIC (French Initials for International Federation of Consulting Engineers) (1999) Short contract and Red, Yellow and Silver Books
- The Joint Building Contracts Committee (JBCC series 2000) (Principal Building Agreement and Minor Workers Agreement)
- New Engineering Contract (NEC) (Engineering and Construction Contract and Engineering and Construction Short Contract)

The rights and responsibilities of contractors, which are described in this booklet, are based on the recommended documents.

The standard forms of contract can be changed to fit the different requirements for different projects or to suit the requirements of a particular employer. These conditions may change the rights and responsibilities of the contractors from those in standard contracts and may also change the risks the contractor faces.
5. Rights of the main contractor

Forms of contract recommended by the cidb provide the following rights to the main contractor:

On-time
The contractor is entitled to receive payment from the employer. Payment is usually handled through the employer’s representative on a monthly basis for the value of the work done and materials on site, or when a specified part of the contract is complete. This is called a progress payment.

The contractor will only receive payment if he has followed the necessary administrative procedures such as sending in statements of account in the correct format. The contract will state how much time the employer can take before he pays the contractor. If the employer takes longer, the contract should state what interest will be payable by the employer.

The payments received by the contractor often include a percentage of the money paid out by the contractor for materials delivered to the site even if they have not yet been used in the works but they must be on site.

Variations or alterations
If the employer (or his representative) orders any changes to the job, he must pay the contractor the costs of these. If the alterations ordered by the employer mean that the job takes more time, the employer must also pay for costs that arise because of the delay.

Extension of time
The contractor may be allowed to have more time to complete the contract if the employer orders variations to the work. The contractor may also be allowed extra time if the work takes longer because of problems which he cannot control such as unusually bad weather.

Access to the employer
The contractor may meet the employer or his representative at any reasonable time to resolve project-related problems.

Settling disagreements or dispute resolution
If there is serious disagreement between the contractor and the employer or his representative, the contractor may ask for the matter to be referred to a rapid and cheap means of dispute resolution such as mediation or adjudication. If this approach fails, the disagreement would have to go to arbitration or to court for a final decision, which is very expensive.

Termination of contract (ending the contract and stopping work)
- If the employer has not done what he agreed to do in the contract, and
- if he still has not performed after the contractor has given him the extra time allowed by the contract,

then the contractor can terminate the contract and stop work and he has the right to receive compensation for losses and costs and payment for work done.

- If the employer terminates the contract without the agreement of the contractor, and
- if the contractor has not broken any agreements,

then he is entitled to compensation for losses and costs and payment for work done.

Subcontractors
The contractor has the right to appoint subcontractors of his choice provided they are qualified for the job. He must be free from undue pressure by the employer or his agent.
6. Responsibilities of the main contractor

We have discussed the contractor’s rights, but with rights come responsibilities - the other side of the coin.

Completing and maintaining the work
The contractor’s main responsibility is:
• to finish the work in the time and to the standard agreed in the contract, and
• to maintain the work in good condition during the defects liability period.

Guarantees and insurances
The contractor has the responsibility:
• to provide the employer with the guarantees required in terms of the contract within the time agreed, and
• to take out and keep up the insurance policies which the contract requires, such as insurance for persons injured or property damaged during construction.

Administrative procedures
The contractor has the responsibility to follow all the administrative requirements in the contract, including:
• reporting on the progress of the project;
• giving notices;
• keeping to the progress chart;
• backing up claims for payment with the correct documents, invoices, and other information.

Early warning to the employer
The contractor has the responsibility to report immediately to the employer on anything which could affect:
• the time to finish, and
• the costs of the work.

Security
Taking possession of the site brings with it the responsibility for the security of the property while it is under construction.

Instructions
The contractor must follow all legitimate instructions given by the employer or his representative. This must be done promptly even if the contractor thinks the instructions are unfair or not sensible. Remember that the contractor has the right to appeal such an instruction.

Subcontracts
The contractor is responsible to enter into fair and proper contracts with subcontractors, including those nominated by the employer in terms of the contract.

Compliance with all applicable laws
Contractors must be familiar with laws on employment, health and safety, skills development, taxes, and levies. In preparing a tender price, the contractor must take into account the cost of compliance with all these laws as he is required to pay his workers the wages that they are due in terms of the law, make UIF (Unemployment Insurance Fund) contribution, pay workmen’s compensation, skills development levies and taxes. The employer may ask the contractor to prove that he has done so.
7. Risks of the main contractor

A contractor operating as a main contractor faces several possible risks. Some risks can be insured, in the normal way, for example:

- damage from flood, storms and fire;
- accidental damage to vehicles and plant;
- employee and third party accidental injury claims.

But there are other risks that cannot be insured:

Financial loss
The contractor risks losing money, which can arise from:
- errors in estimating costs when tendering, or
- poor management of staff and materials, or
- poor cash-flow management.

Even at an early stage of the contract, if the contractor realizes there will be losses, he must still complete the contract. If he does not complete the contract he risks losing the guarantee which he provided and may face bankruptcy.

Penalties
Most construction contracts make the contractor pay penalties if the work is not finished on time. The contractor must watch this from the beginning of the contract and claim an extension of time for each delay for which he was not responsible.

Insolvency of the employer
If the employer goes bankrupt during the contract, the contract is usually ended and the contractor becomes a creditor of the bankrupt employer and will eventually get his share of the insolvency along with others making claims. Insolvency is not usually an issue in the public sector.

Termination of contract
Earlier we dealt with the rights of the contractor when the employer terminates a contract. It works both ways, so that if the contractor fails to carry out work or fails to correct problems when instructed to do so, the employer can terminate the contract.

8. How to work with an employer

Employers usually work through a representative who may be an architect, an engineer, a project manager or a quantity surveyor. The employer gives his representative the authority to act on his behalf in all matters on the project.

The representative will oversee the contract and can be very helpful to the contractor. That is why it is important to develop good working relations with the employer or his representative.

A contractor always benefits from trust and co-operation between himself and the employer or his representative and there are some important steps a contractor can take to develop this.

The contractor must:
- Make sure to report all problems to the employer, through the appointed representative, as quickly as possible. This is most important if the problems could cause cost increases or delay completion.
- Hand over in good time, all notices, advices, time delay claims, bad weather reports, certificates for payment, invoices, lists of workers and plant on site.
- Make sure claims are submitted in writing within the period stated in the contract. Failure to do so may result in the claim being forfeited.
- Only make reasonable claims for additional payment. Inflated or silly claims will be rejected.
- Carry out all legitimate instructions. If the instructions are difficult, talk to the person who issued the instructions as soon as possible to see if they can be done in a different way – do not delay.

In this way you will avoid disputes. Should a disagreement actually arise, it is best to look for possible compromises to resolve the dispute.

Remember! Penalties can eat up your profit - Time IS money! Finish on time and win!
9. Rights and responsibilities of the subcontractor

There are many different forms of subcontract in use. The Conditions of Contract in subcontracts vary a lot between each other. Only the JBCC and NEC documents have standard forms of subcontract. Most contractors use special forms of subcontract written by their own lawyers and for this reason contracts for subcontractors vary a lot - and often they are not very satisfactory. Subcontractors are advised to read such contracts very carefully.

As the rights and responsibilities of subcontractors are different in many ways from those of main contractors, the responsibilities and risks of the subcontractor should not be as heavy as those of the main contractor.

The subcontractor must try to ensure that the contract provides adequate protection because a subcontractor is often in a weaker position than the main contractor. The subcontractor should try to get into his own contract, similar rights to those in the contract between the employer and the main contractor.

Subcontractors should look out for the following unfair conditions of subcontract:

- provisions for the main contractor to reduce the subcontractor’s payments to cover amounts which may be owed to him by the subcontractor from other projects;
- provision for settling disputes only through the courts with no provision for adjudication or mediation;
- payment procedures in which the subcontractor only gets paid after the main contractor has been paid for the work;
- unreasonable retention percentages and periods of retention after practical completion.

The cidb recommends that the following forms of subcontract be used:

- BIFSA Non-Nominated Subcontract for use with the JBCC Series 2000 Principal Building Agreement
- BIFSA Standard Subcontract Agreement 1995 edition (Amended 2000), for use with Principal Building Agreements other than the JBCC Principal Building Agreement
- BIFSA Labour-only sub-contract
- CIDB Standard subcontract (labour only)
- JBCC 2000 Nominated/selected Subcontract Agreement
- NEC Engineering General Conditions
- NEC Engineering and Construction Subcontract and Short Subcontract
- SAFCEC General conditions of subcontract (2003 edition)

10. Joint venture partners

A joint venture (JV) can be entered into for either a main contract or a subcontract which means that the relevant points in previous paragraphs will apply. In choosing JV partners remember that the employer does not have separate agreements with each of the partners in the JV and will hold all JV partners liable and responsible for the execution of the contract or subcontract. Choose your partners wisely!

The contract between the partners in the JV is as important as the contract between the employer and the JV. As there are no standard documents for joint ventures, it is sensible to get legal advice or to use one of the following documents:

- cidb Joint Venture Agreement
- SAFCEC Joint Venture Agreement

A JV will only be successful if there is a fair and reasonable agreement which all the partners support. The JV agreement should where possible, assign risk, responsibility and reward, fairly between the partners.

The partners in the JV may pool their resources to carry out the contract or break the work down into separate sections and make a partner responsible for each section. Usually a mixture of the two approaches is followed.

Joint ventures may be formed for a number of reasons, the most common being:

- The project is too large or complex for a single contractor to undertake with his available resources.
- The project requires specialist skills or abilities, which the contractor is unable to provide on his own.
- Management skills and technical expertise of emerging contractors can be developed through their association in JVs with well-established, large and more experienced companies.
The story of two contractors

**SPEEDY BUILDERS**

- submitted a low but realistic tender;
- had guarantees and bridging finance lined up;
- quickly received a letter of acceptance and signed the contract;
- took possession of site and started work;
- wrote a letter claiming for an extension of time because of bad weather;
- reported regularly on progress;
- completed the snag list;
- completed the work, and
- received final payment.

Because the progress payments were made quickly by the employer, the contractor was able to pay for materials on time. He now has a good credit record for the next contract, and he

- **MADE A PROFIT**

**HAPPY CONTRACTOR**

Good prospects for future projects

**HAPPY EMPLOYER**

No prospects for future projects

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**BUSY BUILDERS**

- submitted the lowest tender;
- ran around looking for guarantees and bridging finance;
- eventually received a letter of acceptance and signed the contract;
- took possession of site but could not start work because they had no credit for materials;
- started off behind schedule;
- forgot to report flooding on site to the employer in writing and lost the extension of time claim;
- thought double time would make up for lost time, and because of poor money management they could not pay wages and there was a work stoppage;
- suffered heavy penalties for late completion;
- had to fix leaking roofs and sagging pathways during the defects liability period, and he

- **MADE NO PROFIT**

**UNHAPPY CONTRACTOR**

No prospects for future projects

**UNHAPPY EMPLOYER**

No prospects for future projects
12. Phases of a contract

Tendering & contract award
- The tender is advertised by the employer or his representative.
- Contractors submit their tenders by the required date.
- The tenders are evaluated and a tender evaluation report is produced recommending the best tender.
- The employer reviews the tender evaluation report and awards the contract.
- The contract is signed by both the contractor and the employer.
- The contractor is responsible to provide insurance and the surety/guarantee as stipulated in the contract.
- The site is officially handed over to the contractor.
- The contractor establishes his camp and site office and orders the materials required to start construction.
- The contractor sets out the work and starts construction.

Monthly activities during the contract
- Monthly site meetings between the employer and the contractor and inspection of the work by the employer’s representative to ensure quality.
- Preparation of monthly payment certificate by the contractor.
- Review and certification of the payment certificate. Queries are referred back to the contractor.
- The certified payment certificate is submitted for payment by the employer.
- Payment is made to the contractor within the period specified in the contract.

Handover procedure
- The contractor requests the employer to inspect the completed project prior to handover.
- The employer inspects the project, identifies outstanding items to be completed by the contractor prior to the handover of the project and issues a "snag list" to the contractor listing the outstanding items.
- The contractor completes the outstanding items and notifies the employer that the project is complete and ready for a final inspection.
- The employer carries out a final inspection. If he is satisfied that the project is substantially complete, he issues a practical completion certificate to the contractor, which states that the project is now substantially complete and is ready to be handed over.
- The contractor hands the project over to the employer.

Final account
- The contractor or the employer (as required in terms of the contract) prepares the final account during the handover period, and submits it to the employer.
- The final account is certified and issued to the employer once the employer has issued the practical completion certificate.
- The employer pays the final account less the retention money. This money is paid out at the end of the defects liability period.

Defects liability period and final completion
- The contractor is responsible for making good items which are defective during the defects liability period.
- Near the end of the defects liability period, the contractor requests the employer to inspect the project and identify any defective items which the contractor is responsible for making good in terms of the contract. The money held in retention by the employer will only be paid when the contractor has properly completed the list of defects.
- Once the employer has issued a copy of the final completion certificate he is required to pay the retention money due to the contractor.

The project is now complete.
- The contractor is still liable for the repair of latent defects for several years.
Code of Conduct

for all parties in construction procurement

In the interest of a healthy industry that delivers value to clients and society; the parties in any public or private construction-related procurement should in their dealings with each other:

- Behave equitably, honestly and transparently.
- Discharge duties and obligation timeously and with integrity.
- Comply with all applicable legislation and associated regulations.
- Satisfy all relevant requirements established in procurement documents.
- Avoid conflicts of interest.
- Not maliciously or recklessly injure or attempt to injure the reputation of another party.