

# Inform Practice Note #30

May 2013

## Blacklisting of Contractors for Non-Performance

cidb's Inform Practice notes provide guidance and clarity in achieving client objectives in construction procurement and delivery. Practice notes inform clients and practitioners on how to embrace best practice and how to deal with issues that may arise. They are aligned with, but do not replace regulation.

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### Synopsis:

This Practice Note discusses actions that organs of state can take against contractors for non-performance by a contractor. The Practice Note concludes that all issues of non-performance of contractors on contracts issued by organs of state should first be dealt with in terms of the contractual procedures between the employer and the contractor, and should thereafter be referred to the cidb in terms of a potential breach of the cidb Code of Conduct.

It is preferable that non-performance of contractors is dealt with directly in terms of a breach of the cidb Code of Conduct, and not as blacklisting of the contractor on the National Treasury database of restricted suppliers in terms of Section 13 of the Preferential Procurement Regulations (June 2011).

## 1. Background

This Practice Note discusses actions that organs of state can take against contractors for non-performance by a contractor, where non-performance includes:

- Abandoning of a contract in whole or in part before practical completion;
- Failure to comply with the conditions of contract and non-achievement of practical completion other than due to reasons caused by the client; or
- Failure to rectify major construction defects after practical completion but within the defects liability period so as to comply with the conditions of contract.

Actions that can be taken, or are required to be taken, include:

- a) Recovering all costs, losses or damages incurred or suffered as a result of poor performance;
- b) Blacklisting the contractor on the National Treasury database of restricted suppliers, and restricting the contractor from obtaining business from any organ of state for a period not exceeding 10 years; and
- c) Convening an inquiry into any breach of the cidb Code of Conduct, and impose sanctions which can include:
  - Removing the name of a contractor from the cidb Register of Contractors;
  - Issuing a warning, which can remain valid for a period not exceeding one year;
  - Downgrading the contractor's contractor grading designation by a maximum of two grades;
  - Imposing a fine not exceeding R100 000.00; and
  - Restricting or prohibiting the contractor from participating in public sector construction works procurement for a maximum of 10 years.

Note that the term contractor here refers to a person or organisation that contracts to construct, refurbish, rehabilitate, extend, alter, repair, maintain or demolish or components thereof.

The Practice Note concludes that all issues of non-performance of contractors on contracts issued by organs of state should first be dealt with in terms of the contractual procedures between the employer and the contractor, and should thereafter be referred to the cidb in terms of a potential breach of the cidb Code of Conduct.

The Preferential Procurement Regulation requires that an organ of state must take action against a contractor that does not comply with the conditions of contract.

## 2. The Preferential Procurement Policy Framework Act

### 2.1 Legislative Framework

Section 13 of the Preferential Procurement Regulations (June 2011) states that:

1. Where any of the conditions of the contract have not been fulfilled, an organ of state must take action against a contractor; and
2. In addition to any other contractual or other remedy that it may have against the contractor, an organ of state may:
  - a) Disqualify the contractor from the tendering process;
  - b) Recover all costs, losses or damages it has incurred or suffered as a result of that contractor's performance;
  - c) Cancel the contract and claim any damages which it has suffered as a result of having to make less favourable arrangements due to such cancellation;
  - d) Restrict the contractor, its shareholders and directors from obtaining business from any organ of state for a period not exceeding 10 years, after the audi alteram partem (hear the other side) rule has been applied; and
  - e) Forward the matter for criminal prosecution.

### 2.2 Taking Action Against a Contractor

*(This section is adapted from National Treasury's Practice Note Number SCM5 of October 2006 and MFMA Circular No. 43 of May 2007.)*

Guidance on procedures that an organ of state should follow in order to restrict a contractor from obtaining business from any organ of state are given in National Treasury's Practice Note Number SCM5 of October 2006 and MFMA Circular No. 43 of May 2007, namely:

- a) Inform the contractor or person(s) by registered mail or by delivery of the notice by hand of the intention to impose the restriction, provide the reasons for such decision and the envisaged period of restriction;
- b) Allow the contractor and/or person(s) fourteen (14) calendar days to provide reasons why the envisaged restriction should not be imposed;
- c) If requested, allow the contractor and/or person(s) the right to present evidence in person;
- d) Consider any reasons submitted by the contractor and/or person(s); e) impose the restriction or amended restriction;
- f) Inform the contractor and/ or person(s) of the decision; and
- g) Inform the National Treasury within five working days of such restriction, particulars of the person(s) to be restricted, (including, where applicable, names of the restricted persons, identity

Where a contractor is restricted from obtaining business with the public sector, National Treasury must be informed within five working days.

numbers, trade name of enterprises, company registration numbers, income tax reference numbers and vat registration numbers), the reason(s) for the restriction, the period of restriction and the date of commencement of the restriction.

According to SCM Regulation 38(1)(c) the Accounting Officer must check the National Treasury's database prior to awarding any contract to ensure that no recommended bidder or any of its directors is listed as a person prohibited from doing business with the public sector.

The names of such contractors will also be reflected in the cidb Register of Contractors by means of a link to the National Treasury database, but these contractors will not necessarily be deregistered from the cidb Register of Contractors unless the cidb institutes a formal investigation which results in the contractor being restricted from doing business.

Contractors restricted from doing business with the public sector will also be identified on the cidb Register of Contractors.

### 2.3 What Action Should be Taken?

The Preferential Procurement Regulations, National Treasury's Practice Note Number SCM5 of October 2006 and MFMA Circular No. 43 of May 2007 do not give guidance on what action should be taken under what condition. However, the general principle is that the action should be commensurable with:

- a) The consequences of non-compliance with the contract conditions;
- b) The cost of rectifying the non-compliance with the contract conditions; and
- c) Any costs associated with court proceedings and for the cost of any decision that may result in the event of an appeal by the contractor.

Examples of actions that should be considered for non-performance with the contract conditions on construction works contracts are given below:

| Non-Performance  | Actions to be Considered  |
|--|---|
| Abandoning of a contract in whole or in part before practical completion | <ul style="list-style-type: none"> <li>• Restrict the contractor, its shareholders and directors from obtaining business from any organ of state for a period not exceeding 10 years.</li> <li>• Recovery of all costs, losses or damages that have been incurred or suffered.</li> </ul> |

| Non-Performance  | Actions to be Considered  |
|--|---|
| Failure to comply with the conditions of contract and non-achievement of practical completion other than due to reasons caused by the client                     | <ul style="list-style-type: none"> <li>Restrict the contractor, its shareholders and directors from obtaining business from any organ of state for a period not exceeding 10 years.</li> <li>Recovery of all costs, losses or damages that have been incurred or suffered.</li> </ul> |
| Failure to rectify major construction defects after practical completion but within the defects liability period so as to comply with the conditions of contract | <ul style="list-style-type: none"> <li>Restrict the contractor, its shareholders and directors from obtaining business from any organ of state for a period not exceeding 10 years.</li> <li>Recovery of all costs, losses or damages that have been incurred or suffered.</li> </ul> |

### 3. The cidb Code of Conduct

#### 3.1 The Code of Conduct and Non-Performance

The cidb Code of Conduct was published by cidb Notice No 127 in Government Gazette No. 25656 of 31 October 2003, and it states that:

In the interests 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:

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

The cidb Code of Conduct includes examples of acceptable action of contractors, including:

The contractor or his employees should:

- Undertake the contract with the objective of satisfying the requirements of the employer by observing the spirit as well as complying with the letter of the contract and, in pursuit of this objective, co-operate with all other parties in the procurement process.

- Aim to meet all statutory and contractual obligations fully and timeously in regard to conditions of employment, occupational health and safety, training, fiscal matters etc.

Section 28 of the cidb Regulations require that if there are reasonable grounds to suspect that a person has acted contrary to, or has omitted to act in terms of, the cidb Code of Conduct, the cidb must appoint an investigating officer to investigate that complaint or suspicion. Such reasonable grounds for an investigation can be brought to the attention of the cidb by employers or any member of the public.

The investigation procedures are set out in the cidb Regulations, and the investigations committee has the power to, amongst others:

- Remove the name of a contractor from the cidb Register of Contractors;
- Issue a warning, which can remain valid for a period not exceeding one year;
- Downgrade the contractor's contractor grading designation by a maximum of two grades;
- Impose a fine not exceeding R100 000.00; and
- Restrict or prohibit the contractor from participating in public sector construction works procurement for a maximum of 10 years.

There are very clear overlaps between the blacklisting of non-performing contractors on the National Treasury database (Section 2) and breaches in the cidb Code of Conduct by non-performing contractors. However, in instances where an employer terminates the contract due to default by the contractor in whole or in part, it is preferable that such non-performance is referred directly to the cidb to be investigated in terms of a possible breach of the cidb Code of Conduct.

### 3.2 Taking Action Against a Contractor

Taking action against contractors for non-performance must first be dealt with in terms of the contractual obligations and contractual procedures between the employer and the contractor, and should thereafter be referred to the cidb in terms of any breach of the cidb Code of Conduct. The process for instituting action against a contractor in terms of a possible breach of the cidb Code of Conduct is summarised below:

- a) The organ of state must in writing, notify the contractor of non-performance and order specific performance from the contractor to remedy the non-performance;
- b) The contractor must be given a reasonable period of not less than 14 days working days to remedy such non-performance;
- c) In the event that the contractor fails to remedy non-performance within a prescribed period, the organ of state must issue a notice of its intention to terminate the contract;

Non-performance of contractors must first be dealt with in terms of the contractual procedures between the employer and the contractor, and should thereafter be referred to the cidb in terms of any breach of the cidb Code of Conduct.

- d) The termination of the contract as a result of non-performance by the contractor must be done in accordance with the provisions of the contract;
- e) The project manager employed by the organ of state must issue a report on the status of the works executed by the contractor; and
- f) The organ of state must register the termination of the contract on the cidb Register of Projects.

## **4. Augmentation of Tender Notices and Contract Documentation**

To align with National Treasury's Practice Notes (Section 2) and the cidb Code of Conduct (Section 3), the tender notice or contract documentation should include the sub-paragraphs below:

1. Where the employer terminates the contract due to default of the contractor in whole or in part, the employer may decide to:
  - a) Refer the breach in contract to the cidb for investigation as a breach of the cidb Code of Conduct in terms of the cidb Regulations; or
  - b) May impose a restriction penalty on the contractor in terms of Section 13 of the Preferential Procurement Regulations.

The outcomes of such investigations in terms of both the cidb Regulations and the Preferential Procurement Regulations may prohibit the contractor from doing business with the public sector for a period not exceeding 10 years.

2. If the employer intends imposing a restriction on the contractor or any person associated with the contractor in terms of Section 13 of the Preferential Procurement Regulations, the contractor will be allowed a time period of not more than fourteen calendar (14) days to provide reasons why the envisaged restriction should not be imposed. Should the contractor fail to respond within the stipulated fourteen (14) days the employer may regard the contractor as having no objection and proceed with the restriction.
3. Any such restriction imposed on any person by the employer will also be applicable to any other enterprise or any partner, manager, director or other person who wholly or partly exercises or exercised or may exercise control over the enterprise of the first-mentioned person, and with which enterprise or person the first-mentioned person, is or was in the opinion of the employer actively associated.
4. If such a restriction is imposed, the employer must, within five (5) working days of such imposition, furnish the National

Organs of state should ensure that all tender and contract documentation includes amended clauses relating to regulation 15 of the Preferential Procurement Regulations and to the cidb Code of Conduct.

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**Pretoria Head Office**

+27 12 482 7200/+27 86 100 cidb

**Gauteng Provincial Office**

Pretoria

0861 428 222 • cidbgp@cidb.org.za

**Western Cape Provincial Office**

Cape Town

0861 927 222 • cidbwc@cidb.org.za

**Eastern Cape Provincial Office**

Bisho

0861 222 327 • cidbec@cidb.org.za

**Northern Cape Provincial Office**

Kimberley

053 861 9631 • cidbnc@cidb.org.za

**Free State Provincial Office**

Bloemfontein

0861 377 222 • cidbfs@cidb.org.za

**KwaZulu-Natal Provincial Office**

Durban

0861 596 222 • cidbkzn@cidb.org.za

**Limpopo Provincial Office**

Polokwane

0861 222 765 • cidblimpopo@cidb.org.za

**Mpumalanga Provincial Office**

Nelspruit (Mbombela)

0861 678 222 • cidbmpumalanga@cidb.org.za

**North West Provincial Office**

Mahikeng

0861 243 222 • cidbnw@cidb.org.za

**Anonymous Fraud Line**

0800 112 432

**Call Centre:** 0860 103 353

**email:** cidb@cidb.org.za

**www.cidb.org.za**

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Treasury, with the following information:

- i) The name and address of the contractor and/or person restricted by the purchaser;
- ii) The date of commencement of the restriction;
- iii) The period of restriction; and
- iv) The reasons for the restriction.

These details will be loaded in the National Treasury's central database of suppliers or persons prohibited from doing business with the public sector.

5. If such a restriction is imposed, the contractor will also be identified on the cidb Register of Contractors for the duration of the suspension by means of a link to the National Treasury database.

## 5. Summary and Conclusions

In a survey undertaken by the cidb<sup>1</sup>, around 12% of projects surveyed had levels of defects which are regarded as inappropriate. It is estimated that this translates into a cost of around R3,5 billion per year. It is incumbent on organs of state to minimise this cost of poor quality, and to recover these costs wherever it is practical to do so. It is also incumbent of organs of state to take action against contractors where the employer has terminated the contract due to default of contractors who terminate contracts (in whole or in part).

This Practice Note first summarises the legislative framework that requires organs of state to take action against non-performing contractors. The Practice Note then summarises actions that organs of state can take for non-performance, and key amongst this is that in instances where an employer terminates the contract due to default by the contractor in whole or in part, such non-performance should be referred directly to the cidb to be investigated in terms of a possible breach of the cidb Code of Conduct.

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<sup>1</sup> cidb (2011). Construction Quality in SA; A Client Perspective, Construction Industry Development Board, July 2011. [www.cidb.org.za](http://www.cidb.org.za)