

Construction and Projects: South Africa

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A Q&A guide to construction and projects law in South Africa.

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The construction sector

1. What have been the main trends in the construction sector in your jurisdiction over the last 12 months? What have been the most significant deals?

There is increased public and private sector infrastructure investment in South Africa, partly due to its hosting of the 2010 FIFA Soccer World Cup. However, the main reason for this increase is linked to public sector infrastructure upgrade and private sector capacity expansion (for which construction will continue beyond 2010). A significant part of this investment relates to increased electricity generating capacity, road upgrading and resource processing capacity.

Substantial and ongoing investment in the public sector has, to a large extent, shielded the construction sector from the full effects of the current global economic crisis. However, the construction market has been affected, for example:

- ▣ Private sector building procurement, particularly in commercial and residential property, has slowed significantly.
- ▣ Eskom Holdings Limited (Eskom), the South African electricity utility, recently announced its decision not to proceed with its second nuclear power station.

The most significant transactions in the last 12 months relate to public sector procurement and include:

- ▣ The following contracts awarded by Eskom for each of the new Medupi and Kusile power stations (each station comprising six 600 mega-watt coal-fired power generating units):
 - ▣ the design, supply and setting to work of the Boiler Works;
 - ▣ the design, supply and setting to work of the Turbine-Generator Works;
 - ▣ the construction of Main Civil Works.
- ▣ South African National Roads Agency Limited's award of various contracts for its freeway and related roads and infrastructure upgrade project.

Transaction structures and finance

2. Please briefly outline the typical transactional structures and corporate vehicles used in a construction project in your jurisdiction, such as special purpose vehicles and joint ventures.

Generally, internationally recognised transactional structures are used. These include special purpose vehicles, joint ventures and consortiums, depending on the nature of the procurement and works. International contractors often include on-shore and offshore components in their joint venture and consortium structures (particularly when partnering with a South African entity). Employers typically seek to maximise single party liability, and usually require the assurance of joint and several liability from consortium and joint venture members.

3. How are construction projects generally financed, for example through debt and equity, mezzanine finance and bond issues?

Commercial and/or residential construction projects are generally bank-financed by development loans, secured through first mortgage bonds. There is no typical finance approach for other construction or engineering projects.

Private sector procurement is usually financed by debt and equity.

Public sector procurement is generally self-funded or financed by bond issues, commercial and/or development bank or foreign Export Credit Agency loans, or is procured through private public partnership (PPP) structures.

4. What security and other contractual protections (such as step-in rights, warranties and the assignment of contractual rights) are usually required by funders?

The security and contractual protections required by funders varies according to the nature of the project. Generally, there are three categories of projects which are:

- ▣ **Financed with recourse to the employer's balance sheet.** The level of security and step-in rights funders require depends on the employer's balance sheet strength.
- ▣ **Financed by a limited recourse/project finance transaction.** Funders generally expect the following:
 - ▣ a comprehensive set of financing documents, including a fully termed common terms agreement including, among other things, all appropriate representations, warranties, positive and negative covenants and events of default;
 - ▣ security over all the project company's available assets, including:
 - ▣ mortgages over fixed property;
 - ▣ notarial bonds over movable assets;

- ▣ pledges and cessions over all the project company's rights against third parties;
 - ▣ security over all the project company's bank accounts; and
 - ▣ a pledge of all shares in the project company.
- ▣ a range of step-in rights, which are generally exercised through security granted over the shares in the project company (the funders must first be entitled to exercise those rights under the security documents before they can step in).
- ▣ **Conducted by a PPP.** Funders require:
- ▣ fully termed finance documents; and
 - ▣ security over the project company's various rights, particularly claims the project company has against the government under the PPP agreement. Further security, among other things, includes security over the shares in the project company. Generally funders cannot obtain security over the project's fixed assets, as these are usually the government's property.

Main parties

5. Please briefly outline the main parties involved in a construction project in your jurisdiction, and the most common procurement arrangements between them.

The main parties to a construction and engineering project are the:

- ▣ Employer.
- ▣ Employer's agent.
- ▣ Contractor or contractors.

The construction and engineering environment is sophisticated (both from a legal and market perspective), and therefore procurement arrangements vary.

An open or limited tender process is typically used (and generally required for public sector procurement), although negotiated procurement is not uncommon in the private sector.

The most common procurement arrangement for road works, or commercial or residential building works is for an appointed single main contractor to construct the works. The contractor assumes full responsibility for all construction activities and the supply of all labour and materials (whether supplied by the contractor or by subcontractors). The contractor carries out the works according to the employer's design, under the direction of the employer's agent. The employer appoints the

design team.

For other projects, procurement arrangements vary from turnkey (that is, handing over the project in a ready to use condition)/engineering procurement and construction (EPC) contracts, to multiple contractor arrangements (with or without the employer appointing an engineering, procurement and construction management (EPCM) contractor or one or more external professional consultants as the employer's agent). Multiple contractor arrangements typically include mixed design-build and construct-only or erect-only contracting arrangements.

Standard forms of contracts

6. What standard forms of contracts are used for large construction projects in your jurisdiction? Which construction organisations typically produce them?

The most common standard forms of contracts used for large construction and engineering projects are:

- ▣ The *Fédération Internationale des Ingénieurs-Conseils* (FIDIC) Conditions of Contract (produced by the International Federation for Consulting Engineers):
 - ▣ Plant and Design-Build, First Edition, 1999 (Yellow Book);
 - ▣ Construction, First Edition, 1999 (Red Book); and
 - ▣ EPC/Turnkey Projects, First Edition, 1999 (Silver Book).
- ▣ The New Engineering Contract (NEC) Engineering and Construction Contract (NEC3) produced by the Institution of Civil Engineers through its NEC Panel.
- ▣ The Joint Building Contracts Committee (JBCC) 2000 suite of contracts (last updated in 2007) produced by the JBCC.
- ▣ The General Conditions of Contract for Construction Works 2004 (GCC) produced by the South African Institute for Civil Engineering.

Public sector construction procurement must be undertaken on the above standard form contracts (and certain other standard form contracts approved or prepared by the Construction Industry Development Board (CIDB) (*CIDB Act 38 of 2000 (CIDB Act) Regulations (CIDB Regulations)*). The CIDB encourages using these standard form contracts for private sector construction procurement to promote efficiency.

7. Do construction contracts for international projects differ? If yes, please give brief details.

Construction contracts do not differ for international projects from the standard form contracts in *Question 6*.

8. Do contracts for engineering projects differ? If yes, please give brief details.

Contracts for engineering projects do not differ from the standard form contracts in *Question 6*.

Contractual issues

9. What risks are typically allocated to the contractor? How are these risks (such as material price escalation and ground conditions) offset or managed?

Risk allocation typically follows international trends and is largely determined by the nature of the works and the procurement methodology. Generally, the FIDIC or NEC risk allocation regimes is typically used in the construction market.

Fixed and firm price contracts (particularly where the contract period is more than 12 months) are used exceptionally. This is largely because of relatively high interest and inflation rates. Construction and engineering contracts typically include change-in-cost provisions linked to acceptable indices. Contractors are not usually required to assume the risk for changes in the cost of labour, materials or other inputs except for a pre-determined fixed portion (usually between 5% and 15%). Employers similarly avoid unnecessary price premiums, which are otherwise associated with a fixed and firm price, and retain the benefit of downward price movements for these input costs.

Procurement arrangements and risk allocation are also influenced by the volatility of the Rand and by the Exchange Control Regulations. The Exchange Control Regulations both:

- ❑ Prohibit payments in foreign currency by South African persons and entities, except with the prior approval of the Exchange Control Department of the South African Reserve Bank (Exchange Control).
- ❑ Regulate the receipt of foreign currency payments by South African persons and entities.

Typically, as a result:

- ❑ Foreign or multiple currency contracts are only appropriate where the contractor is a foreign entity or comprises a joint venture or consortium with one or more foreign entity members (in which case the employer can, subject to prior Exchange Control approval, make foreign currency payments to these foreign entities). The employer then assumes the risk of currency fluctuation and obtains forward cover (that is, secures foreign currency at a pre-determined rate, in advance) to mitigate this risk.
- ❑ Contracts with local contractors or between local entities are denominated and paid in Rand. The contractor assumes the risk of foreign currency-related input cost changes (and usually obtains forward cover to mitigate this risk).

10. How can liability be excluded? For example, can the contractor exclude liability for indirect or consequential loss, and loss of business or profits?

Parties can contractually:

- ❑ Limit or exclude liability for consequential and indirect loss.
- ❑ Limit or exclude liability for negligence.

However, a party cannot exclude its liability for intentional loss or damage.

11. Do the parties usually agree a cap on liability? If yes, how is this usually fixed?

Contracts typically exclude liability for consequential and indirect loss (*see Question 10*), and cap the contractor's liability for direct damages. The cap is usually determined as a percentage of the contract price and is subject to negotiation. The cap often depends on the nature of the works. Civil engineering contracts typically have a lower cap than design-build contracts.

Generally, the following are not taken into account to determine limitation of liability:

- ❑ Proceeds from principal-controlled insurances (that is, where the building contract parties are automatically covered under a blanket insurance policy, for all approved works).
- ❑ Liability from the annulment of principal-controlled insurance policies.
- ❑ Delay damages.
- ❑ Low performance damages.

However, this is subject to negotiation and depends on the level of the cap.

12. Are force majeure exclusions available and enforceable in your jurisdiction?

Force majeure exclusions are available and enforceable.

Common law recognises force majeure exclusions. Construction and engineering contracts typically expressly regulate the parties' rights and obligations with force majeure events. For the common law exclusion to be effective and to discharge the contract, the "supervening impossibility" must be absolute (as opposed to probable and relative) and must not be the fault of or under the control of either party. The courts do not recognise commercial impracticability as a supervening impossibility.

13. How are construction professionals usually appointed and how are their liabilities dealt with in the contract?

Construction professionals are typically appointed using industry standard agreements, although

bespoke agreements are also widely used. Standard form contracts include the NEC Professional Services Contract, the FIDIC Client/Consultant Model Services Agreement and various standard forms, prepared and distributed by various professional organisations and associations, for example, standard appointment contracts for architects, engineers, quantity surveyors and project managers. Bespoke agreements are usually used for more complicated EPCM-type arrangements. However, the CIDB Regulations require public sector procurement for construction-related professional services to be undertaken using the NEC Professional Services Contract or the CIDB Professional Services Contract.

Professional liability is subject to negotiation, but is usually capped and limited to damages arising from negligence. Liability to re-perform defective services is, however, usually not limited. Specific performance is available as a legal remedy under common law.

Limitation of liability is usually determined with reference to the value of the fee to be charged (not the value of the resulting works) and available professional indemnity insurance. Professional indemnity insurance is often limited to insurance arranged through the relevant professional association (although larger consulting companies usually have self-standing professional indemnity insurance).

14. What are the usual methods of payment for construction work? Are there ways to secure payment or mitigate risks of non-payment?

Payment methods are negotiated and usually arranged to keep the contractor cash flow neutral or positive. Payments are typically structured as progress payments, as certified by the employer's agent, according to the value of work completed or to agreed milestones, and are typically subject to limited retention. Contracts often allow an advance payment as an interest free loan, which is paid and secured against an on-demand bond. The advance payment is amortised and repaid against future payments.

Common law allows a contractor, unless otherwise agreed, to obtain a lien (right of retention) over the works, to secure payment of a claim relating to works' expenditure. It is, however, typical for an employer/funder to require a contractor to waive this lien. In building contracts, contractors usually only waive their lien because alternative security for payment is provided.

The risk of non-payment is mitigated by contractual rights of suspension and termination, an obligation to pay interest (at sometimes punitive, but lawful rates) and/or security in the form of a letter of credit or other payment guarantee.

15. What contractual provisions are typically negotiated to cover material delays to the project?

Liquidated damages for delay and the employer's right to terminate are typically negotiated to cover delay attributable to the contractor.

The following are typically negotiated to cover delays which are not attributable to the contractor:

- ❑ Contractual time extension and additional cost entitlements (typically subject to time barring).

- ❑ The right to terminate for prolonged suspension (and consequently the right to receive payment for expenses incurred and work done).

- ❑ Limitations on the ultimate duration of defect or warranty periods.

Early warning provisions and comprehensive progress reporting requirements are often included to manage the risk of delays.

16. How are material variations to the works usually dealt with in the contract (for example, the effect on timing and cost)?

Employers (through the employer's agent) can typically instruct the contractor to carry out a variation, subject to the contractor's entitlement to claim an extension of time and additional costs. This entitlement is usually subject to time barring.

The right to instruct a variation in design-build contracts is, however, usually subject to the contractor's right to resist it if the resulting change affects the suitability (unless the employer accepts the risk) or safety of the works.

In common law (unless specifically provided for in the agreement or otherwise agreed, and depending on the circumstances), an employer cannot omit part of the works with the intention of giving it to another contractor to complete. The extent of the works that can otherwise be omitted is arguably limited.

17. How do the parties typically manage their relationships with subcontractors?

Between the employer and the contractor, the contractor generally assumes full responsibility for the performance of all subcontractors. This position can, however, be modified contractually, so that the employer assumes certain risks (or so that the contractor's responsibility therefore is otherwise limited). The standard form JBCC building contract, for example, provides that responsibility for design undertaken by a nominated (or so-called selected) subcontractor does not fall on the contractor. Instead the contract allows the subcontractor's design liability to flow through to the employer.

The relationship between the contractor and a subcontractor is subject to negotiation and is usually managed on a "back-to-back" basis with the main contract. The back-to-back arrangement often extends to the subcontractor's right to receive payment which, unlike the situation in, for example England and Wales, is permitted in South Africa.

18. Please briefly outline the other main contractual provisions that are usually heavily negotiated by the parties.

There are additional matters which are often heavily negotiated by the parties, including both the:

- ❑ Contractor's liability for latent defects in the works.

- Governing law and dispute resolution provisions, where one of the parties is foreign. South Africa is a signatory to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention) and public sector construction contracts are typically regulated by South African law, with South Africa as the dispute resolution forum.

Licensing requirements

19. Please set out what licences and other consents are required by contractors to carry out construction work in your jurisdiction.

The CIDB Regulations provide for the establishment of a register of contractors, and require that any enterprise tendering or entering a construction works contract with the public sector must be registered in the appropriate grading and designation. Contractors tendering or entering a construction works contract with the private sector are not restricted in this way. In addition, all home builders must be registered with the National Home Builders Registration Council (NHBRC). Contractors registered with the NHBRC do not also have to register with the CIDB, if the public sector procurement relates to the construction of a home.

Apart from these registration requirements, there are no specific licences required by contractors for construction work. There are, however, various works specific approvals or consents, required under applicable legislation (including environmental, and health and safety legislation and regulations), and relevant municipal or other building regulations.

Insurance

20. Please set out what types of construction-related insurance have to be maintained by law. Are other non-compulsory types of insurance maintained under contract?

There is no specific construction-related insurance that must be maintained by law. Construction contractors, as with all employers (in the context of an employer/employee relationship) must register with the Compensation Fund for the Compensation for Occupational Injuries and Diseases Act 130 of 1993, or with a licensed compensation insurer. Under the Construction Regulations 2003 (Construction Regulations), prescribed in terms of the Occupational Health and Safety Act 85 of 1993 (OH&S Act), employers must ensure Principal Contractors (appointed under the Construction Regulations) are registered and in good standing with the compensation fund or a licensed compensation insurer, before construction work starts.

Contract Works Insurance, Public Liability Insurance and Marine Insurance (as applicable) are typically procured by the employer or the contractor, and the contract typically regulates the obligation to procure and maintain insurance. Insurance for physical loss or damage arising from strike, riot, civil unrest and/or terrorism is provided by the South African Special Risks Insurance Association (SASRIA). A SASRIA coupon is typically procured together with (and linked to) Contract Works Insurance.

Labour laws

21. Please briefly set out the labour law requirements to hire construction employees. In particular, what authorisations (such as work permits) do foreign nationals require to work in your jurisdiction?

There are no specific requirements related to the hire of construction sector employees.

The Basic Conditions of Employment Act 1997 (BCEA) prohibits employment of any child under 15 years of age or who is under the minimum school leaving age. For foreign nationals who have not been granted permanent resident status in South Africa, they must obtain work permits under the Immigration Act 13 of 2002. It is an offence to employ a foreign person in violation of the Immigration Act.

22. Please briefly set out any labour laws relevant to construction projects, such as minimum wage laws or restrictions on working hours.

Sectoral Determination 2: Civil Engineering Sector, South Africa (Sectoral Determination) applies to all civil engineering sector employers and employees, and regulates wages. The provisions of the Sectoral Determination regulating the following do not apply to employees whose earnings exceed an amount determined by the Minister of Labour in terms of the BCEA (the current earnings threshold being ZAR149,736 (about US\$11,431) per annum):

- ❑ Ordinary hours of work.
- ❑ Overtime.
- ❑ Payment for overtime.
- ❑ Meal intervals.
- ❑ Rest periods.

Employers outside the civil engineering sector, whose activities fall within metal and engineering industries are subject to the Main Agreement concluded at the Metal and Engineering Industries Bargaining Council. The Main Agreement is binding on employers and employees within its scope and is valid for a fixed period, after which, it is renegotiated.

The BCEA, which sets basic conditions of employment and the Labour Relations Act 66 of 1995 (LRA) also apply. The LRA, among other things, provides that every employee has the right not to be unfairly dismissed and subjected to unfair labour practices.

On major construction projects, employer organisations increasingly negotiate with trade unions to sign a Project Labour Agreement (PLA). A PLA can include a productivity bonus and can also regulate matters not covered under any industry level Sectoral Determination or Collective Agreement, and provide for expedited dispute resolution procedures.

23. Are there any labour law considerations at the end of a construction project, such as

termination payments?

An employee employed on an indefinite basis by a contractor can be redeployed to another construction project by the employer without his employment terminating at the end of a construction project. Employees can be employed under a fixed term contract for the duration of a particular project or for the duration of certain work on the project. At the end of the fixed term contract, the employment of the employee terminates automatically.

For employees employed on an indefinite basis and who are not redeployed to another project site, their services must be terminated because of the employer's operational requirements. Operational requirements are requirements based on the economic, technological, structural or similar needs of the employer (*LRA*). The *LRA* provides a specific procedure which must be followed for a dismissal for operational reasons. An employer must consult with employees or their representatives on issues specified in the *LRA*. Failure to do so can result in the dismissal being found to be unfair.

On termination of employment, an employer must give the employee notice. The employer can require the employee to work the notice or pay the employee in lieu of notice. On termination of employment, an employee can also be paid all accrued leave.

Health and safety laws

24. Please outline the health and safety legislation that applies to construction projects in your jurisdiction.

The OH&S Act and the Construction Regulations (as well as various other regulations promulgated under the OH&S Act) regulate the health and safety of all persons (subject to certain minor exceptions) involved in construction work, other than construction work which is regulated under the Mine Health and Safety Act 29 of 1996.

The Construction Regulations impose obligations on employers (owners), contractors and designers. The obligations relate principally to the management of health and safety by the employer and designer through the design and procurement phase of the project, and by all parties on the construction site itself. The management of health and safety on the construction site must be undertaken under pre-formulated and agreed health and safety plans, setting out specific minimum safety requirements for various construction activities (*Construction Regulations*). These include minimum requirements for:

- ❑ Work at elevated positions.
- ❑ Formwork and support work.
- ❑ The use of cranes and mobile plant.
- ❑ Transport of construction personnel.
- ❑ General housekeeping.

- Welfare.

Environmental issues

25. Please briefly set out local legislation regulating the impact of construction projects on the environment, in particular in the areas of:

- Air.
- Water.
- Waste.
- Environmental impact assessments.
- Sustainable development.

Air

The National Environmental Management: Air Quality Act 39 of 2004 provides measures for the prevention of pollution and ecological degradation, particularly for the control of emissions, and securing ecologically sustainable development. The Act sets out national norms and standards regulating air quality monitoring, management and control by all spheres of government.

Water

The National Water Act 36 of 1998 gives effect to a public rights system under which water is allocated on an administrative licensing basis. This Act contains stringent polluter-pays provisions in the event of on- and off-site water contamination.

Waste

The Environment Conservation Act 73 of 1989 provides for waste management, requiring permits for the establishment or operation of a waste disposal site.

Hazardous substances are regulated by the Hazardous Substances Act 15 of 1973, which provides for the control of hazardous substances which can cause injury, ill-health or death to human beings. A licence is required to supply, let, use, operate or apply a hazardous substance as identified in the Act.

The law relating to waste is expected to be amended in the near future (*see Question 37*).

Environmental impact assessments

Environmental impact assessments (EIAs) are provided for in regulations to the National Environmental Management Act 107 of 1998 (NEMA). NEMA provides that Listed Activities (as defined in NEMA) cannot commence without environmental authorisation from the competent

authority. The Listed Activities were published in the *Government Gazette* on 21 April 2006. The Listed Activities are divided into a Basic Assessment List and a Full EIA List. Activities in the Basic Assessment List require submission of an application for environmental authorisation with a basic assessment. A full scoping report and an EIA must be submitted with an application for an environmental authorisation for any Listed Activity in the Full EIA List.

Sustainable development

NEMA sets out a National Environmental Management Principle that development must be socially, economically and environmentally sustainable. This includes:

- ❑ Avoiding pollution and degradation of the environment.
- ❑ Managing waste.
- ❑ Responsibly using and exploiting non-renewable natural resources.

Authorisations granted under this Act are subject to this principle.

26. Are there any regulations requiring contractors to make buildings comply with carbon emissions or climate change targets?

South Africa is a party to the United Nations Framework Convention on Climate Change and the Kyoto Protocol. South Africa is classed as a developing country under the Kyoto Protocol and therefore does not have specified commitments to reduce and/or cap carbon emissions. Guidelines published by the South African government are expected in the next few years.

Corrupt practices

27. Please briefly set out any rules in your jurisdiction that prohibit corrupt business practices and bribery affecting construction projects, and any civil and criminal penalties that apply.

The Code of Conduct for all Parties Engaged in Construction Procurement published under the CIDB Act (Code) provides a framework under which an action or default by any party to the procurement process may be assessed. An agent, contractor, employer or employee, or subcontractor must not accept gifts, favours, or anything of more than token value from another party to the procurement process, and must not engage in unfair or unethical practices (*Code*).

The CIDB can convene and conduct an inquiry into breaches of the Code and can issue fines or warnings for breaches, referring the matter to the relevant authority in the circumstances, or deregistering contractors for a period of time.

The Prevention and Combating of Corrupt Activities Act 12 of 2004 (Corrupt Activities Act) identifies various specific corrupt actions and corrupt practices. It is an offence for any person who corruptly gives or agrees to give any person any undue gratification as an inducement or reward to do or not to do anything, in carrying out or performing his duties or functions (*section 3, Corrupt Activities Act*). Specific offences apply to specific circumstances, including matters involving public

officials, tenders and contracts.

A person who is convicted of any of the above offences may be liable to imprisonment or fines, with a maximum penalty of life imprisonment (*section 26, Corrupt Activities Act*). In addition to any fine, a court can impose a fine equal to five times the value of the gratification involved in the offence (*section 26(3), Corrupt Activities Act*).

A court can order the particulars of a conviction and sentence of any person convicted of an offence to be endorsed on a register (*section 28, Corrupt Activities Act*). If the party convicted is an enterprise, the particulars of that enterprise, as well as the particulars of any partner, manager, director or other person who wholly or partly exercises control and was involved in or knew about the commission of the offence, can be recorded with the conviction and sentence.

Endorsement on the register allows the National Treasury to terminate any agreement with the person or entity convicted subject to certain restrictions. The register is open to the public (*section 32, Corrupt Activities Act*).

Insolvency

28. If a contractor becomes insolvent, what rights will the client and funder typically require (for example, to terminate the construction contract and hire a new contractor)?

Insolvency is regulated by the Insolvency Act 22 of 1936 (Insolvency Act) and the Companies Act 61 of 1973 (Companies Act). The insolvency of the contractor affects all executory (partly performed) contracts it is party to at the time. The contractor's insolvency does not, however, give the employer an option to terminate the contract.

Generally (subject to specific exclusions in the Insolvency Act) insolvency neither suspends nor terminates a contract. Instead, the trustee or liquidator, being bound to do whatever is in the best interests of the group of creditors (*concursum creditorum*), can generally choose whether to abide by the agreement or repudiate.

Repudiation by the contractor can usually be countered with an order for specific performance. However, this option is unavailable to an aggrieved employer (no matter how fully it has fulfilled its obligations) when the trustee of an insolvent estate repudiates. If the contractor's liquidator repudiates further performance under the contract, the employer is left with an unsecured concurrent claim for damages (for example, for the additional costs of getting a new contractor to complete the works at a higher cost than the original contract).

Alternatively, the trustee can elect to complete the contract and step into the shoes of the insolvent contractor (thereby becoming entitled to any performance owed by the employer and being bound to carry out the insolvent contractor's obligations).

The effect is that a clause designed to protect the employer's interests if the contractor becomes insolvent (for example, by conferring a preference or modifying the legal consequences of the *concursum creditorum*), is void against the trustee. A clause that allows termination on the basis of the insolvency of a party is also unenforceable, since this denies the trustee the right to elect to continue with the contract, if the creditors' interests demand it. However, where a right to cancel accrues for reasons other than insolvency (for example, non-performance) before insolvency, but

insolvency occurs before the employer can cancel the contract, the employer can exercise its right to cancel the contract.

To mitigate risk, construction contracts typically provide that the employer acquires ownership of plant and materials intended for the works on the earlier of payment or delivery to site. If the right does not arise as a result of the contractor's insolvency, the employer's rights under these clauses are principally sustainable. However, set-off clauses and clauses providing for direct payments to subcontractors are invalid against the insolvent's trustee.

PPP/projects

29. Is the use of public private partnerships (PPPs) common in construction projects in your jurisdiction? If yes, please outline which sectors commonly use PPPs.

PPPs are becoming increasingly common. The government issued a policy confirming that PPPs are one of their instruments of choice for, among other things, developing infrastructure in the country. PPPs have been used in the following sectors:

- ❑ Government, for example, with administration buildings.
- ❑ Healthcare, including hospitals.
- ❑ Road infrastructure, such as toll roads.
- ❑ High speed rail links (such as the Gautrain project).
- ❑ Correctional services, consisting of buildings and prisons.
- ❑ Education, comprising schools and other facilities.

30. Please briefly outline the legislation applying to PPPs in your jurisdiction.

The Public Finance Management Act 1 of 1999 (PFMA) and the Municipal Finance Management Act 56 of 2003 are the two most noteworthy pieces of legislation that deal with PPPs in South Africa. Regulation 16 under the PFMA sets out the requirements and processes required by National Treasury for PPP arrangements.

31. Please briefly outline the typical procurement/tender process in a PPP transaction.

The government issues a request for qualification (RFQ) to potential tenderers who must respond to the RFQ to qualify for participation in the subsequent stages of the tender.

The government then issues a fully termed request for proposal (RFP), requesting all qualified tenderers to submit a bid for the proposed project. The base agreement for the RFP is the PPP agreement itself, which is gradually becoming more standardised.

Occasionally the government runs a best and final offer (BAFO) process after the RFP closes. This process stage is likely to become more infrequent as the process of concluding PPPs and standardised terms becomes more settled and common practice.

After the RFP and BAFO processes (if relevant), the government announces a preferred bidder and a reserve bidder, and then conducts the negotiations to financial close with the preferred bidder. If negotiations with the preferred bidder fail, the government can revert to the reserve bidder and negotiate with them.

Construction dispute resolution

32. Please briefly outline the most common dispute resolution methods used to resolve construction disputes in your jurisdiction.

Unless otherwise provided for in a construction contract or subsequently agreed to between litigants, the default position is that disputes are dealt with either in the high court or magistrates' court. Jurisdiction depends on the monetary value of the claim. The parties generally contractually agree for disputes to be referred to adjudication followed by private arbitration. The conduct of a private arbitration is regulated by terms of reference and rules agreed to by the parties, either in the contract or subsequently in terms of a separate arbitration agreement, subject to the provisions of the Arbitration Act 42 of 1965, which provides a statutory framework for arbitrations.

33. What are the most common alternative dispute resolution (ADR) methods used? Consider if relevant adjudication, dispute review boards and expert determination.

Adjudication (whether by a single adjudicator, through dispute review or adjudication boards) is commonly used as a first step dispute resolution mechanism for construction disputes. Mediation is also a common form of ADR. Both adjudication and mediation are non-legislated voluntary processes which are regulated by terms of reference and rules agreed to by the parties, either in the construction contract, or subsequently in terms of a separate agreement.

34. Which courts usually deal with construction disputes in your jurisdiction? Are there any specific construction courts or tribunals?

The relevant high court or magistrates' court with jurisdiction, depending on the monetary value of the claim, deals with construction related disputes. There are no specific construction courts or tribunals.

35. Which organisations are usually used to arbitrate construction disputes in your jurisdiction (please include their website address)?

The organisations usually used to arbitrate construction disputes are:

- ❑ The Association of Arbitrators (see www.arbitrators.co.za).
- ❑ The Arbitration Foundation of South Africa (see www.arbitrators.co.za).

Parties to private arbitration proceedings often select an arbitrator from the ranks of senior and junior counsel of the Society of Advocates of South Africa.

Construction tax

36. Please briefly outline the main tax issues that arise on construction projects in your jurisdiction. For example:

- Value added tax (VAT)?

- Stamp duty/transfer tax (or equivalent)?

Construction contracts are not subject to any stamp duty, withholding tax or other specific construction contract or construction activity based tax.

South Africa applies transfer pricing rules similar to the Organisation for Economic Co-operation and Development (OECD) transfer pricing rules.

VAT is payable on:

- The supply of goods and/or rendering of services by a registered VAT seller in the course or furtherance of any enterprise carried on by him.

- The importation of goods or on the supply of any imported services by any person.

VAT is generally levied at a rate of 14%, while certain supplies may be subject to a zero-rating and others, such as financial services, are exempt from VAT.

Any person who carries on an enterprise in South Africa (or partly in South Africa) on a continuous or regular basis, and whose taxable supplies exceed the annual threshold of ZAR300,000 (about US\$29,800) (due to be increased to ZAR1 million (about US\$99,300) from 1 March 2009) must register as a VAT seller.

South Africa applies a residence basis of taxation which basically means that residents are subject to income tax and capital gains tax (CGT) on their worldwide income and capital gains, while non-residents are subject to income tax only on their income from South African sources, and to CGT only in relation to capital gains arising from the disposal of immovable property in South Africa, or arising from the disposal of an asset which is attributable to a permanent establishment (PE) of that non-resident in South Africa.

Non-residents conducting business in South Africa are therefore subject to income tax only to the extent they derive income from a South African source, subject to any tax relief which may be available in terms of a double tax agreement (DTA), if applicable. In most DTAs, South Africa can only tax business profits of a non-resident enterprise to the extent these profits are attributable to a PE of the non-resident in South Africa.

Customs duties (at varying rates) and import VAT are payable for imported goods.

37. Are any methods commonly used to mitigate tax liability on construction projects? Are there any tax incentives to carry out construction regeneration projects?

A non-resident contractor who is tax resident in a country which has a DTA with South Africa can qualify for tax relief under the DTA (see *Question 36*).

There are no tax incentives available specifically for construction regeneration projects.

Cross-border issues

38. Please outline any special considerations for foreign contractors operating in your jurisdiction. For example:

- ❑ **Special licensing or other requirements for foreign contractors.**
- ❑ **Legal or practical considerations that may restrict foreign contractors.**

The CIDB Regulations require that any enterprise (including foreign contractors) that tenders or enters into a contract for construction works with the public sector, must be registered with the CIDB (see *Question 19*). A foreign contractor can apply for registration with the CIDB. The process can take several months and the cost depends on the specific grade of registration required. For example, the cost of a grade nine application (being for contracts with a value greater than ZAR10 million (about US\$993,000)) is approximately ZAR40,000 (about US\$4,000). For registration in the required grade to be granted, a contractor must prove its record of experience in contracts with a similar nature and value.

Further visa and permit requirements apply to foreign nationals working in South Africa (see *Question 21*).

The government has also implemented certain policies and legislation regarding economic transformation, local content, skills development and sustainable growth in South Africa, namely the:

- ❑ National Industrial Participation Programme (NIPP).
- ❑ South African government's Accelerated and Shared Growth Initiative (ASGISA).
- ❑ Broad Based Black Economic Empowerment Act (B-BBEE Act).

The NIPP and ASGISA are aimed at developing sustainable industry and growth in South Africa and apply only to state-owned entities and those parties contracting with state owned entities.

Black Economic Empowerment (BEE) is a central part of the South African government's economic transformation strategy. The BEE Act is the key legislation through which the BEE

process is managed. It does not set out offences or penalties relating to BEE performance but rather seeks, through economic measures, to facilitate a uniform approach to BEE in the South African economy.

Other than in state licensing, permitting and authorisation processes, there is no "hard law" requiring that any entity in South Africa must meet specific B-BBEE targets or must implement a B-BBEE policy within the entity. However, from a practical perspective any company (including a foreign contractor) wishing to do business in South Africa must consider and develop its B-BBEE position as, in addition to the pressures from government, an entity that does not have a good B-BBEE rating, or does not strive to improve its B-BBEE rating, is obstructed in the conduct of day-to-day business with the government, organs of state and private sector customers. For these reasons, a contracting party in South Africa may require a foreign contractor to have a certain B-BBEE rating.

In relation to exchange control restrictions, the following are relevant:

- ▣ Exchange controls have limited application to non-residents (although some rules do apply).
- ▣ A non-resident can operate a non-resident bank account with a South African bank, which allows it to freely receive foreign currency and convert Rand amounts received into foreign currency.
- ▣ Expatriate individuals are not subject to exchange control restrictions, provided they confirm their status as temporary workers with an authorised dealer, such as any of the commercial banks.

In practice, there are no legal obstacles to a foreign company opening bank accounts, renting office space or hiring local services or other local supports for its daily operations in South Africa.

Reform

39. Please summarise any proposals for reform and state whether they are likely to come into force and, if so, when.

Environmental

The National Environment Management Amendment Bill B36-2007 (Bill), among other things, increases the maximum fine for contravention of some environmental measures to ZAR10 million (about US\$993,000) and introduces the concept of anticipatory costs.

The National Environment Management: Waste Bill B39-2007 (Waste Bill) aims to reform the law relating to waste regulation.

Both bills are expected to be approved. The time scales for approval are uncertain at this stage.

Reforms relating to funding

National Treasury has produced a set of standardised terms to govern PPPs. However, recent experience has shown that actually concluded PPP agreements differ in a number of respects from these standardised terms (for example, there are differences in the debt calculations,

calculations of termination payments generally, insurance and indemnity arrangements, and step-in arrangements). Steps have been taken to revise and update the standardised terms which will probably come into effect during 2009.

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Main construction organisations

Construction Industry Development Board (CIDB)

Main activities. The CIDB is tasked, among other things, with:

- Establishing a national register of contractors and construction projects to regulate, monitor and promote the performance of the construction industry for sustainable growth, delivery and empowerment.
- Promoting improved delivery management capacity, and the uniform application of procurement policy throughout all spheres of government.
- Promoting improved performance and best practice of public and private sector clients.

W www.cidb.co.za

Council for the Built Environment (CBE)

Main activities. The CBE is a statutory body established under the CBE Act. Under the CBE Act, the CBE is, among other things, responsible for transforming the professions, acting as a conduit between the South African government and the built environment professions, fostering growth of the professions, and contributing to the creation of a dynamic built environment.

W www.cbe.org.za

The South Africa Federation of Civil Engineering Contractors (SAFCEC)

Main activities. SAFCEC was formed to advance the interests of civil engineering contractors in South Africa.

W www.safcec.org.za

Resource information

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Products: PLC Construction, PLC Law Department, PLC Cross-border Handbooks\2009
\Construction and Projects 2009/10, PLC Cross-border

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