Challenges in classifying the construction contract*

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OPSOMMING

Uitdagings ten opsigte van die klassifikasie van konstruksiekontrak

Suid Afrikaanse howe en skrywers aanvaar bloot dat die konstruksiekontrak onder die klassifikasie *locatio conductio operis* val. Daar word min gesê oor waar hierdie aanname vandaan kom en daarom onstaan die vraag of dit inderwaarheid korrek is. In hierdie artikel word hierdie vraag oorweeg, spesifiek met verwysing na die waarborg teen verborge gebreke.

1 INTRODUCTION

How should a construction contract be legally classified and does classification really matter? Under South African law, it is generally accepted that construction and engineering contracts fall to be classified as specific forms of letting and hiring of work (*locatio conductio*); namely, the *locatio conductio operis*.[1] In his book *The law of construction contracts*, Van Deventer[2] observes that the South African courts approach construction contracts from the assumption that they fall within the *locatio conductio operis*.[3] I cannot criticise this approach as it is also the approach of most modern commentators in the very little that has been written on the subject of the classification of construction contracts.[4] The question remains: Is this classification correct and why does it matter?

Various standard forms of construction contracts are published throughout the world.[5] The choices are vast and deciding which form to use can be challenging.

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* The article is based on sections of the author's LLD thesis (UP). Article submitted in partial fulfilment of the requirements for the LLD degree at the University of Pretoria.

1 Nagel *Commercial law* (2011) paras 39.03 39.32. See also Loots *Construction law and related issues* (1995) 4.

2 *The law of construction contracts* (1993) 59 61.

3 See, eg, *BK Tooling (Edms) Bpk v Scope Precision Engineering (Edms) Bpk* 1979 1 SA 391 (A) 393 419 420; *Nieuwoudt v Maswabi* 2002 6 SA 96 (O) 101; *Pellow v Club Refrigeration CC* 2006 1 SA 230 (SCA) 231.

4 See Zimmermann *The law of obligations: Roman foundations of the civilian tradition* (1990) 394 fn 58 (hereafter "Zimmermann").

5 See a list of general conditions in Lorenz "Contracts for work on goods and building contracts" *International Encyclopaedia of Comparative Law* Vol VIII: Specific contracts

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The consequences of the choice ultimately made in this regard may reach further than what may be anticipated at the time the choice is made. Unfortunately, the classification of a nominated contract is often merely accepted, and not properly considered by the draftsmen or by the parties to the contract.[6] To consider but a few options in respect of a construction contract's classification: Is it a contract of sale, a services contract, a contract of employment, a letting and hiring of work contract, or an amalgamation of two or more of these contracts?

To answer the question as to the necessity for a particular classification: Each specific contract attracts certain implied common law warranties.[7] These warranties may not have been considered or even known about at the outset when contracting, or the parties may expect, for example, certain common law warranties to be available to them, only to find when they wish to rely on them that they are not implied in that classification of contract. Similarly, and equally worrying, certain unexpected warranties may be implied when not expected.

As an example, and merely to demonstrate the importance of the relevance of classifying the construction contract, should it be argued that in some form (in part or in certain instances in whole)[8], the construction contract falls to be classified as a contract of sale,[9] then a warranty against latent defects may well be implied.[10]

Unfortunately, there is little clarity as to the classification of the construction contract when respected writers on this subject are consulted. Indeed, they acknowledge that this may not be a straightforward and simple task. Sharrock[11] comments that a construction and engineering contract may fall within the ambit of an *emptio venditio*,[12] especially if the employer is paying for the finished article as opposed to paying for the labour of the contractor. Nagel[13] acknowledges this possibility in respect of a contractor that uses his own materials to manufacture the plant, rather than having been provided with some or even all of the materials. Lorenz[14] comments that, theoretically, it may be easy to distinguish between the classification of these contracts, but that the lines quickly become blurred in practice.

Zimmermann[15] and Lorenz[16] go so far as to say that the engineering and construction industry may have developed a "self-made 'law'" in this regard. I must agree with this observation.

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ch 8 146 (hereafter Lorenz). See, eg, the suite of contracts published by the Fédération International des Ingénieurs-Conseils ("FIDIC"), or the NEC (New Engineering Contract) suite of standard form contracts developed by the Institution of Civil Engineers (ICE) in England.

6 Naudé "The preconditions for recognition of a specific type or sub-type of contract – The *essentialia-naturalia* approach and the typological method" 2003 *TSAR* 411.

7 *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 19743 SA 506 (A) 531.

8 With reference to "mixed contracts" see Lorenz 3.

9 *Emptio venditio.*

10 Zimmermann 305ff dedicates an entire chapter to the liability for latent defects under the *emptio venditio.*

11 Sharrock *Business transactions law* (2011) 360.

12 Contract of sale.

13 Nagel (2011) para 39.03.

14 Lorenz 5.

15 Zimmermann 394 fn 58.

16 Lorenz 11.

Although Lorenz's work has been met with some criticism[17] the queries he has raised and investigations he has conducted in this regard, especially comparing the laws of the different countries in this field, are extremely valuable. He, too,[18] acknowledges that this field of contracting is highly specialised and complex, and may well justify the necessity for it to be treated separately from the other legal classifications.[19] He comments that if one had to deal with the rapidly changing and voluminous published general conditions (like those of FIDIC and NEC), it would have to be a handbook in the form of a loose-leaf edition to take account of these ever-changing conditions. Of course, he is entirely correct.[20] It is submitted that the industry is in a continuous process of evolution.[21]

2 POSSIBILITY OF A "SELF-MADE 'LAW'"

Taking the above into consideration, it is necessary to consider the possibility of a "self-made 'law'" in more detail. Considering Lorenz's[22] and Zimmermann's[23] contention that it may be time to recognise that the construction and engineering industry may have developed a "self-made 'law'", Lorenz presents an especially interesting argument: He goes further than Zimmermann and comments that, in Roman law, although building contracts were accepted as falling within the *locatio conductio operis*, they ignored some of the special conditions under which construction works on lands were carried out, and accordingly "only very few specific rules dealing with this subject matter are to be found in the traditional civil codes".[24] This may be a further source of the current challenge. Wallace's[25] observation in this regard is sound:

> "Since most of the civilized systems of law . . . can be expected to give effect to the expressed agreement of freely contracting parties in a commercial matter, a comparative study of building contract law is likely, therefore, to be largely a study of the building contracts most commonly in use in the countries involved, whereas a comparative study of contracts for "work on goods" is likely to involve an in-depth study of often differing (and sometimes archaic) legal rules or principles."

It makes sense then that the construction industry, in many jurisdictions, saw the need to address this *lacuna* and attempted to do so by way of extensive express provisions in their contracts and laws. Unfortunately, not all contracts have achieved this successfully.[26]

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17 In a review of Wallace in Lorenz "Review work(s): International Encyclopaedia of Comparative Law Vol VIII *Specific contracts* Ch 8 Contracts for work on goods and building contracts *American Society of Comparative Law* (vol 32) 768 (www.jstor.org/stable/840379) (hereafter "Wallace").

18 As Zimmermann and Van Deventer do, too.

19 Lorenz 4.

20 See Murdoch and Hughes *Construction contracts law and management* (1996) 1–2.

21 Claassen "Development of general conditions of contract for construction works" 2009 *SA Merc LJ* 576.

22 Lorenz 11.

23 Zimmermann 394 fn 58.

24 Lorenz 11.

25 Wallace 769.

26 See Lorenz's extensive criticism of England's RIBA (Royal Institute of British Architects) standard forms of contract throughout his writings.

The English[27] and German[28] jurisdictions have acknowledged the nuances of the construction and engineering industry's contracting through legislation and they accordingly attract the necessity for special consideration: England has also done so, specifically by way of the introduction of specialised courts for this industry.[29] It is my contention that it is time for South Africa to do the same.

It remains my contention that this law has developed into what is referred to as this "self-made 'law'", which Lorenz regards as a "sociological fact of considerable importance".[30] However, it is important to consider that it is discernibly not a law such as one that would be regarded as a reference source of law: It remains subject to the sacred agreement between the parties. *Pacta sunt servanda*[31] reigns supreme.

3 BRIEF CONSIDERATION OF OTHER JURISDICTIONS AND THEIR STANDARD FORMS OF CONTRACT

In German law, building contracts attract different responsibilities and liabilities depending on whether the employer is state-owned or owned by a private person. The German VOB[32] has its origins in the private sector,[33] but is used where state-owned enterprises engage with contractors to have works executed.[34] A similar distinction can be made in South Africa.[35] The private sector mostly operates without the freedom to contract being limited by the restrictions imposed on state-owned enterprises. The VOB takes account of legislation applicable to building contracts and makes specific reference thereto.[36] These contracts are drafted and intended for specific use in Germany, whereas FIDIC and NEC[37] are intended to be broad enough to cater for international contracts over a wide array of different jurisdictions and applicable laws.

In English law, the position is somewhat different. The RIBA[38] standard form contracts are similarly intended for exclusive use in England. These publications, however, have been met with stern criticism to the effect that "the stage has now been reached where architects and others recommending the RIBA standard forms to their clients in unmodified form should be held liable for professional

27 See particularly "Constructing the team, joint review of procurement and contractual arrangements in the United Kingdom construction industry", Final Report, July 1994, published by HMSO.

28 Lorenz 7.

29 The Technology and Construction Court, a sub-division of the Queen's Bench Division, part of the High Court of Justice, which is one of the Senior Courts of England and Wales.

30 Lorenz 11.

31 Agreements must be kept.

32 *Verdingungsordnung für Bauleistungen.*

33 Drafted by the *Deutscher NormenausschuB* (*DNA*).

34 Lorenz 11.

35 The Construction Industry Development Board (CIDB) is a national body established by an Act of Parliament (Act 38 of 2000): See specifically https://bit.ly/2HxC3Nu.

36 See Lorenz 12 where examples are given: "VOB(b) S 2 no. (I) concerning deviations from the contract: Reference to rules relating to *negotiourm gestio* (CC S 677-678); VOB (B) S 8 no. I (2) concerning cancellation of the contract by the employer (CC S 649); VOB (B) S 9 cancellation of the contract by the contractor (CC S 293-304 and 642); VOB (B) S 11 no. I concerning liability of the contracting parties or liquidated damages (CC S 339-345)."

37 Widely used in South Africa.

38 Published by the Royal Institute of British Architects and issued by the Joint Contracts Tribunal.

negligence if damage or loss to the employer ensues".[39] The criticism is levied on a number of scores, but essentially comprises a lack of consideration for providing protection for the employer therein. The English ICE Conditions of Contract[40] are far better balanced and have a more reasonable allocation of risk. Unfortunately they, too, lack clarity.[41] These contracts are also drafted for specific use in England, whereas FIDIC and NEC are intended to be broad enough to cater for international contracts over a wide array of different jurisdictions and applicable laws. NEC, however, finding its roots in England,[42] caters for specific English laws,[43] but leaves it to the parties to choose a different option when contracting outside of this jurisdiction.

4 RELEVANCE OF THE CLASSIFICATION OF THE CONSTRUCTION CONTRACT

> "The modern construction contract contains a most impressive and comprehensive set of regulations to govern the contractual relationship between the parties. If such a complete express set of regulations does not oust the *naturalia* of the construction contract, it is difficult to see that they can ever be ousted. If this is correct, then the *naturalia* have become irrebuttable presumptions of law, which is completely unacceptable."[44]

Keating[45] comments that where there are comprehensive written terms, as are found in standard forms of building, construction and engineering contracts, there may be little room to imply any terms. If subject matter is expressly dealt with there will not be room to imply any terms. This may be so, but these contracts are certainly not able to provide for every eventuality in an ever-changing industry. Thus, without a clear understanding as to how the construction contract is to be classified, it will remain uncertain what terms are to be implied. A relevant example in this regard is the warranty against latent defects, which is discussed in more detail below.

Some compassion is found, albeit without proposing answers, for the existence of this quandary as Wallace[46] comments that when considering the common law in this field "practitioners and judges [are] faced with a bailment or related implied term problem where common law authority, as is so often the case, is sketchy or lacking, or its rationale unclear".

I support the comments of Zimmermann[47] and Lorenz[48] that the construction and engineering industry's continued efforts to deal with its innate intricacies

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39 Wallace *Hudson's Building and engineering contracts: Including the duties and liabilities of architects, engineers and surveyors* (1979) preface. The aforementioned was the 10th edition. We of course now have Hudsons in its 13th edition (by Dennys *et al*), no longer at the hand of Sir Duncan Wallace, but still by the prominent members of Atkin Chambers in full-time practice.

40 Published by the Institution of Civil Engineers.

41 Lorenz 15.

42 NEC Engineering and Construction Contract, June 2005, guidance notes, foreword.

43 Taking cognisance of the Housing Grants, Construction and Regeneration Act, 1996, in its Dispute Resolution Options, as well as the Local Democracy, Economic Development and Construction Act, 2009.

44 Van Deventer 89.

45 Fürst *et al A Keating on construction contracts* (2000) 52.

46 Wallace 770.

47 Zimmermann 394 fn 58.

and challenges have developed a "self-made 'law'", and that this law needs to be treated as a specialist field (as is done in England),[49] so that it may be developed further to cater for its specific nuances and particular needs.

5 WARRANTY AGAINST LATENT DEFECTS

In an *emptio venditio*[50] one of the obligations of the seller comprises a warranty against latent defects in the object or thing sold.[51] This warranty is part of the *naturalia* of this specific type of contract and accordingly will only be excluded through explicit agreement by the parties thereto (such as through a *voetstoots* clause).[52]

Repeating well known law, where a seller in an *emptio venditio* breaches the warranty given in respect of latent defects (whether it was given expressly or by way of a tacit term), the buyer may turn to the *actio empti* for relief.[53] Under the *actio empti* the buyer may either cancel the contract of sale (where the defect is material) and claim damages, or elect only to claim damages from the seller.[54] Where there is no contractual warranty against latent defects, but a latent defect appears in the object sold, the buyer may turn to the *aedilitian* actions, namely, the *actio redhibitoria* and *actio quanti minoris*.[55] Under the *actio redhibitoria* the buyer will look for restitution. He may only look to this specific aedilitian action where he is not able to use the object sold for the intended purpose and where restitution is accordingly justified.[56] The intent is to place both parties in the position they were in before the breach of the warranty. Under the *actio quanti minoris* the buyer may ask for a reduction in the purchase price where a latent defect appears in the object sold.[57] The reduction of the purchase price will be calculated by determining the difference between the price paid and the true value of the object, taking into consideration the latent defect.[58] As such, it is in essence a form of specific performance: Money is made available to remedy the defect that exists.

Following the intent of these remedies, what would the remedy for breach be should a warranty against latent defects exist in construction contracts? Surely the consequences as under an *emptio venditio* go too far for a breach of such a warranty that may exist in a construction contract?

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48 Lorenz 11.
49 The Technology and Construction Court, a sub-division of the Queen's Bench Division, part of the High Court of Justice, which is one of the Senior Courts of England and Wales.
50 Contract of sale.
51 Nagel *Commercial law* (2015) 226.
52 *Minister van Landbou-Tegniese Dienste v Scholtz* 1971 3 SA 188 (A); *Consol Ltd t/a Consol Glass v Twee Jonge Gezellen (Pty) Ltd* 2002 6 SA 256 (C).
53 Nagel (2015) 229.
54 *Minister van Landbou-Tegniese Dienste v Scholtz* 1971 3 SA 188 (A); *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A).
55 Nagel (2015) 230.
56 *De Vries v Wholesale Cars* 1986 2 SA 22 (O); *Janse van Rensburg v Grieve Trust CC* 2000 1 SA 315 (C).
57 Nagel (2015) 232.
58 *Phame (Pty) Ltd v Paizes* 1973 3 SA 397 (A).

6 CONCLUSION

It is possible that a warranty against latent defects may be implied into construction and engineering contracts through custom, or perhaps even trade usage:[59] There appears to be a presumption in the industry that such a warranty exists and should indeed exist. This proposition, however, will need to be tested properly against the circumstances and requirements laid down by the courts. Should it be found that the warranty against latent defects is indeed to be implied into these contracts, I doubt that it will be to the extent as in the case of a contract of sale, with no requirement of fault on the part of the contractor.[60] It is improbable that a contractor would be held liable for latent defects to the extent that a seller would be.

I suggest that the parties to construction contracts in general have already shown this common intent through their dealings on other aspects. For instance, and as an example, should be their approach to a *force majeure* event. A *force majeure* event is an event that is outside of the control of both parties and does not occur as a result of an action or inaction of either party.[61] Nevertheless, the parties accept that the contractor should not bear the entire risk and allow him, at the very least, to claim for additional time to complete his contract (albeit not always money).[62]

Accordingly, and following this intent, I suggest that such a warranty against latent defects should be implied into construction contracts, but that this warranty be a limited one, unique to this industry. This warranty should attract the question of causation. In other words, the defect that has now become apparent (latent defect) should have been caused by something the contractor did or did not do before the employer took over the executed contract works. Where the defect is a result of events beyond that of an act or inaction of the contractor, the contractor should not be held liable[63] as, in my opinion, this would be unjustifiable.

Accordingly, with reference to the arguments regarding the warranty against latent defects, it must be clear that the *essentialia* and *naturalia* of this arguable "self-made 'law'" of construction contracts should be addressed and developed with a warranty against latent defects that is limited and unique to this industry.

Unfortunately, the South African courts have not had the full opportunity to investigate and consider the modern construction contract. This may be as a result of the participants in the construction and engineering industry finding benefit in dealing with and resolving disputes privately and confidentially. Most of the standard forms of contract provide for private dispute resolution mechanisms, usually through adjudication and arbitration.[64] Although I accept

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59 See specifically *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 19743 SA 506 (A) 531.

60 As discussed in Zimmerman 337.

61 See in this regard sub-clause 19.1 of the FIDIC Silver Book, Yellow Book and Red Book where this term is defined.

62 See in this regard *idem* sub-clause 19.4 where the consequences of an event of *force majeure* are dealt with.

63 Where, under a contract of sale, the seller would have been liable.

64 See, eg, sub-clauses 20.2–20.8 of the FIDIC Yellow Book, Red Book and Silver Book conditions of contract, and Clause W of the NEC conditions of contract.

that these dispute resolution mechanisms have their advantages,[65] the consequence is that fewer cases are brought to the courts and, as a corollary, fewer decisions are published.[66] This has proven to be a particular challenge in researching this subject matter.

Moreover, it is my opinion that as awards and findings in adjudications and arbitrations are not published, and because they are not binding on or even persuasive to the South African courts,[67] this has led and will continue to lead to uncertainty in the industry. Just because a particular argument was successful in one arbitration matter does not mean it will succeed in another. A previous arbitration award needs not be considered by any other arbitrator. Similarly, it would not be considered by a court, as the case would be in court where a court of similar standing (or higher standing) has considered a particular point of law.

Finally, what may assist the building, construction and engineering industry in South Africa is to offer the industry a specialised venue to which they may refer disputes that arise. This will also assist in the legal fraternity recognising this field as a specialised field of law. I accept that in doing so the privacy and confidentiality that are so attractive in alternative dispute resolution procedures will be jeopardised. Nevertheless, it is my view that the law applicable to this industry is in dire need of development and that sacrificing privacy and confidentiality for development of the law applicable to the industry will be to the benefit of legal certainty. There is accordingly justification to consider specialised courts in South Africa for this industry, as have already been recognised and provided for in England.[68] Published decisions on important and relevant points of law, which are then required to be considered and followed in subsequent disputes, allow for greater certainty in the industry.

It is crucial for the construction and engineering industry to consider and develop the true and relevant *essentialia* and *naturalia* applicable to these contracts carefully. I am of the view that it is time for the legislator to intervene and establish this. Only then will there be certainly as to what may be implied into these contracts, and what will not so be implied.

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65 Such as privacy and confidentiality.

66 The decisions are not for public record in South Africa, and, as aforesaid, in many instances subject to stringent confidentiality provisions.

67 Should there be an opportunity to present such an award in court where it is not subject to confidentiality clauses.

68 As England does: Technology and Construction Court, a sub-division of the Queen's Bench Division, part of the High Court of Justice, which is one of the Senior Courts of England and Wales.