

# The Legal Regulation of Construction Procurement as a Relational Construct in South Africa

by

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## **Abstract**

Public procurement is generally considered to be the acquisition of goods or services by the government. It contributes a large deal to the country's economy and involves the expenditure of public funds. Due to its importance, public procurement is regulated by section 217 of the Constitution which provides that organs of state when contracting for goods or services must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

Public procurement in the construction industry forms part of the regulation of general public procurement under section 217. Construction procurement is also regulated by sector specific legal rules and constitutes a large part of the country's expenditure budget.

Public procurement is regulated by a hybrid legal system. This means that both public and private law apply to the procurement process. Based on the public nature of public procurement, private law is ill suited to the nuances of the complex, multi-party procurement process. Moreover, the doctrinal nature of private law is inadequate in addressing the needs of the various role-players involved in public procurement. This is exacerbated by the even more complex and highly specialised field of construction procurement which often lasts for long periods of time.

The question this dissertation aims to address is whether an alternative approach to public procurement law may assist in the manner in which it is regulated given the various inadequacies experienced. More specifically, the aim is to determine whether a relational perspective or understanding of construction procurement law in South Africa assists in formulating regulation in this area of law.

Chapter one sets out the research question to be answered, the hypothesis on which the dissertation is based and the methodology employed. Chapter two establishes the definition of construction procurement, its legal regulation, and recommends the separate categorisation of construction works and thus construction procurement in section 217 of the Constitution. Chapter three addresses the nature of the legal rules which regulate construction procurement and the manner in which these rules should be interpreted.

Following this, chapter four investigates relational contract theory created and developed in the American private law, its nature and whether it can be applied in South African public procurement law. This chapter recommends a relational procurement law to address the current inadequacies in public procurement law. Public-private partnerships form a large percentage of the country's infrastructure budget and are increasingly used as a means to deliver infrastructure in South Africa. As such, chapter five establishes whether relational procurement law can be implemented in the public-private partnership legal regime. In addition to the acquisition of goods or services, public procurement can be used for the promotion of collateral objectives such as socio-economic goals in the form of preferring certain groups of individuals when government contracts are awarded. This has been especially important in the South African context. Therefore, the working of relational procurement law within the preferential procurement regime is important. Chapter six thus discusses a relational preferential procurement law. The concluding chapter collectively refers to that discussed in preceding chapters including the conclusions reached and attempts to answer the research question as to whether a relational understanding of construction procurement law in South Africa assists the regulation of this area of law.

## Opsomming

Openbare verkryging word algemeen beskou as die verkryging van goedere of dienste deur die regering. Dit dra grootliks by tot die land se ekonomie en behels die besteding van openbare fondse. As gevolg van die belangrikheid daarvan, word openbare verkryging gereguleer deur artikel 217 van die Grondwet wat voorsiening maak dat staatsorgane wat kontrakte vir goedere of dienste sluit dit ooreenkomstig 'n billike, billike, deursigtige, mededingende en koste-effektiewe stelsel doen.

Openbare verkryging in die konstruksiebedryf maak deel uit van die regulering van algemene openbare verkrygings ingevolge artikel 217. Konstruksie verkryging word ook gereguleer deur sektor spesifieke regsreëls en vorm 'n groot deel van die land se bestedingsbegroting.

Openbare verkryging word gereguleer deur 'n hibriede regstelsel. Dit beteken dat beide die publiek en privaatreg op die verkrygingsproses van toepassing is. Op grond van die publieke aard van openbare kontrakte is die privaatreg sleg geskik vir die nuanses van die komplekse, veelparty-verkrygingsproses. Daarbenewens is die leerstellige aard van die privaatreg onvoldoende om die behoeftes van die verskillende rolspelers wat by openbare verkrygings betrokke is, aan te spreek. Dit word vererger deur die selfs meer komplekse en hoogs gespesialiseerde gebied van konstruksie verkryging wat dikwels vir lang tydperke duur.

Die vraag wat hierdie skripsie daarop gemik is, is of 'n alternatiewe benadering tot die reg op die verkryging en die wyse waarop dit gereguleer word gebruik kan word, gegewe die verskillende onvoldoende ervarings. Meer spesifiek is die doel om vas te stel of 'n

verhoudingsperspektief of begrip van die konstruksieverkrygingsreg in Suid-Afrika help om regulering in hierdie regsgebied te formuleer. Hoofstuk een stel die navorsingsvraag wat beantwoord moet word, die hipotese waarop die verhandeling gebaseer is en die metodologie wat gebruik word. Hoofstuk twee bepaal die definisie van konstruksieverkryging, die wetlike regulasie daarvan en beveel die afsonderlike kategorisering van konstruksiewerke en dus konstruksieverkryging in artikel 217 van die Grondwet aan. Hoofstuk drie handel oor die aard van die regsreëls wat konstruksieverkryging reguleer en die wyse waarop hierdie reëls vertolk moet word.

Hierna ondersoek hoofstuk vier die verbandhoudende kontraktheorie wat in die Amerikaanse privaatreëls geskep en ontwikkel is, die aard daarvan en of dit in die Suid-Afrikaanse reg op openbare verkrygings toegepas kan word. Hierdie hoofstuk beveel 'n verhoudingsverkrygingswet aan om die huidige tekortkominge in die wet op openbare verkrygings aan te spreek. Openbare-private vennootskappe vorm 'n groot persentasie van die land se infrastruktuurbegroting en word toenemend gebruik as 'n manier om infrastruktuur in Suid-Afrika te lewer. As sodanig bepaal hoofstuk vyf of die wet op die verhoudingsverkryging in die regsproses van openbare-private vennootskappe geïmplementeer kan word. Benewens die verkryging van goedere of dienste, kan openbare verkrygings gebruik word vir die bevordering van kollaterale doelwitte soos sosio-ekonomiese doelwitte in die vorm van voorkeur van sekere groepe individue wanneer regeringskontrakte toegeken word. Dit was veral belangrik in die Suid-Afrikaanse konteks. Daarom is die werking van verhoudingsverkrygingsreg binne die voorkeurverkrygingsregime belangrik. Hoofstuk ses bespreek dus 'n relasionele voorkeurverkrygingswet. In die afsluitende hoofstuk word gesamentlik verwys na wat in vorige hoofstukke bespreek is, insluitende die gevolgtrekkings wat bereik is en poog om

die navorsingsvraag te beantwoord of 'n verstandelike begrip van die konstruksieverkrygingswet in Suid-Afrika die regulering van hierdie regsgebied help.

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“It is important to recognize that our achievements not only speak well for us, they speak well for those persons and forces, seen, unseen, and unnoticed, that have been active in our lives”

Anne Wilson Schaefer

## LIST OF ABBREVIATIONS

|            |  |
|------------|--|
| BBBEEA     | Broad-Based Black Economic Empowerment Act 53 of 2003  |
| B-BBEE     | Broad-Based Black Economic Empowerment                 |
| BEE        | Black Economic Empowerment                             |
| CBE        | Council for the Built Environment                      |
| CESA       | Consulting Engineers South Africa                      |
| CIDB       | Construction Industry Development Board                |
| EME        | Exempted Micro Enterprise                              |
| FIDIC      | The International Federation of Consulting Engineers   |
| GDP        | Gross Domestic Product                                 |
| GG         | Government Gazette                                     |
| GN         | Government Notice                                      |
| HDI        | Historically Disadvantaged Individual                  |
| IDMS       | Infrastructure and Delivery Management System          |
| IMIESA     | Institute of Municipal Engineering of Southern Africa  |
| JBCC       | Joint Building Contracts Committee                     |
| LGB        | Local Government Bulletin                              |
| MFMA       | Municipal Finance Management Act 56 of 2004            |
| MSA        | Municipal Systems Act 32 of 2000                       |
| NEC        | New Engineering Contract                               |
| Nw.U.L.Rev | Northwestern University Law Review                     |
| OECD       | Organisation for Economic Co-Operation and Development |
| PAIA       | Promotion of Access to Information Act 2 of 2000       |
| PAJA       | Promotion of Administrative Justice Act 3 of 2000      |
| PFI        | Private Finance Initiative                             |
| PFMA       | Public Finance Management Act 1 of 1999                |

|            |   |
|------------|---|
| PPLR       | Public Procurement Law Review                                   |
| PPPFA      | Preferential Procurement Policy Framework Act 5 of 2000         |
| PPP        | Public-Private Partnership(s)                                   |
| QSE        | Qualifying small business enterprise                            |
| SADC       | Southern African Development Community                          |
| SAFCEC     | South African Forum of Civil Engineering Contractors            |
| SAICE      | South African Institution of Civil Engineering                  |
| SAIEE      | South African Institute of Electric Engineers                   |
| SALJ       | South African Law Journal                                       |
| SA Merc LJ | South African Mercantile Law Journal                            |
| SAPL       | South African Public Law  |
| SARS       | South African Revenue Service                                   |
| SCM        | Supply Chain Management   |
| SIPDM      | Standard for Infrastructure Procurement and Delivery Management |
| SMME       | Small, Medium and Micro Enterprises                             |
| THRHR      | Tydskrif vir Hedendaagse Romeins-Hollandse Reg                  |
| TSAR       | Tydskrif vir die Suid-Afrikaanse Reg                            |
| UNCITRAL   | United Nations Commission on International Trade Law            |

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## CHAPTER ONE

### INTRODUCTION

#### 1 Background

In 1994, with the constitutional transformation of South Africa, a need to transform the public procurement system of the time was identified. The construction industry was used as a model for procurement reform in South Africa and much of the rules and procedures incorporated into the new public procurement regime were adopted from English and international law.

Within the construction industry, public procurement is heavily regulated. The legislation applicable to general public procurement applies to construction procurement alongside the Construction Industry Development Board Act (CIDB Act)<sup>1</sup> and its Regulations.<sup>2</sup> The CIDB Act provides that prescripts must be published for further regulation of the industry.<sup>3</sup> The CIDB as a juristic entity is responsible for this and for the regulation of construction procurement as a whole.

This study investigates the possibility of using a relational theory as a basis for a legal framework on which construction procurement in South Africa can be regulated in order to ensure compliance with public procurement rules and the South African Constitution.

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<sup>1</sup> 32 of 2005.

<sup>2</sup> Construction Industry Development Regulations in Government Gazette (GG) 31603 of 14-11-2008 with certain amendments in GG 36629 of 02-07-2013.

<sup>3</sup> Section 5(2)(b) provides that the Construction Industry Development Board must promote best practice by publishing best practice guidelines and standards. The legal nature and status of these guidelines is discussed in chapter 3 of this dissertation.

## 2 Legal regulation of government procurement in South Africa

### 2.1 Legislative framework for general government procurement

Section 217(1) of the Constitution provides that when contracting for goods or services, organs of state in the national, provincial or local sphere of government or institutions identified in national legislation must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective. Section 217(2) in turn provides for the use of procurement as a policy tool. This provision states that organs of state or institutions in subsection (1) are not prevented from implementing procurement policies providing for categories of preference in the allocation of contracts and the protection or advancement of persons, or categories of persons disadvantaged by unfair discrimination. Section 217(3) prescribes that a national legislative framework must be enacted in terms of which preferential procurement policies as contemplated in subsection (2) must be implemented.

Legislation applicable to procurement in general includes the Preferential Procurement Policy Framework Act (PPPFA)<sup>4</sup> and its Regulations<sup>5</sup> which provides the framework which preferential procurement policies must be implemented as required by section 217(3) of the Constitution. At national and provincial government level, the Public Finance Management Act (PFMA)<sup>6</sup> and its Regulations<sup>7</sup> govern public finance in general and thus public sector procurement. The Local Government: Municipal Finance Management Act

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<sup>4</sup> 5 of 2000.

<sup>5</sup> GG 40553 of 20-01-2017.

<sup>6</sup> 1 of 1999.

<sup>7</sup> PFMA Public-private partnership Treasury Regulation 16 GG 25773 of 28-11-2003; PFMA Supply Chain Management Treasury Regulation 16A GG 27388 of 15-03-2005.

(MFMA)<sup>8</sup> with its Regulations<sup>9</sup> and the Local Government: Municipal Systems Act,<sup>10</sup> manage public finance and therefore public sector procurement at local government level.

The Supreme Court of Appeal (SCA) has held that the invitation, evaluation and award of tenders is of an administrative law nature,<sup>11</sup> therefore the Promotion of Administrative Justice Act (PAJA)<sup>12</sup> applies. Furthermore, the Promotion of Access to Information Act (PAIA)<sup>13</sup> is applicable as it regulates access to any information held by both the government and private parties. The Broad-Based Black Economic Empowerment Act (BBBEEA)<sup>14</sup> is applicable to preferential procurement in that it regulates black economic empowerment. Lastly, the Prevention and Combating of Corrupt Activities Act<sup>15</sup> is aimed at curbing corruption in procurement processes and is therefore relevant. Legislation which regulate procurement in general also prescribe that the specific prescripts of the CIDB apply to construction procurement alongside the general legislation.<sup>16</sup>

The law applicable throughout the procurement process is the private law of contract.<sup>17</sup> However, because the government is a party to the contract and is obligated to act in the

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<sup>8</sup> 56 of 2003.

<sup>9</sup> MFMA Municipal Supply Chain Management Regulations GG 27636 of 30-05-2005.

<sup>10</sup> 32 of 2000.

<sup>11</sup> See *Umfolozi Transport (Edms) Bpk v Minister van Vervoer* 1997 2 All SA 548 (A) paras 552-553; *Transnet Ltd v Goodman Brothers (Pty) Ltd* 2001 2 BCLR 176 (SCA) para 23; *Logbro Properties CC v Bedderson NO* 2003 2 SA 460 (SCA) para 5; *Metro Projects CC v Klerksdorp Municipality* 2004 1 SA 16 (SCA) para 12.

<sup>12</sup> 3 of 2000.

<sup>13</sup> 2 of 2000.

<sup>14</sup> 53 of 2003.

<sup>15</sup> 12 of 2004.

<sup>16</sup> See PFMA Supply Chain Management Treasury Regulation 16A6.3 (a)(ii) GG 27388 of 15-03-2005 and MFMA Municipal Supply Chain Management Regulation 1 GG 27636 of 30-05-2005 under "other applicable legislation".

<sup>17</sup> P Bolton *The Law of Government Procurement in South Africa* (2007) 16; G Quinot *State Commercial Activity* (2009) 258.

public interest, possesses public powers and is generally in a more powerful position, public law also applies.<sup>18</sup>

In 2013, the Office of the Chief Procurement Officer (OCPO) was established with the aim of constituting the central procurement body in South Africa through which all procurement matters would be filtered. The OCPO also manages any defaults in procurement contracts and insufficient or incomplete performance of contracts. The OCPO is further intended to be involved in procurement policy and legislative transformation.

## 2.2 Legislative framework for construction procurement in South Africa

Legislation applicable to public sector construction procurement are those applicable to procurement in general, the CIDB Act, the Regulations to the Act and the prescripts issued by the CIDB in terms of the CIDB Act. Section 2 of the Act establishes the CIDB as a juristic person and regulatory board for the construction industry and construction procurement in particular. The Act sets out the powers and functions of the board and it requires a register of contractors to be created for efficient procurement practices and to facilitate public sector construction procurement.

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<sup>18</sup> C Ferreira "The quest for clarity: an examination of the law governing public contracts" (2011) 128(1) *South African Law Journal* 172 173 sets out how the government as a party to the contract is different from a private contractant.

### 3 The meaning of construction procurement

In order to determine how construction procurement should be understood in terms of the law, what constitutes construction procurement and how it is classified under public procurement law must be established. The CIDB Act does not define construction procurement, however, Regulation 1 of the Regulations to the CIDB Act defines construction procurement as “procurement in the construction industry, including the invitation, award and management of contracts”.<sup>19</sup> Construction works, which appear to be the objects of the construction procurement contract are defined in section 1(j) of the Act as “the provision of a combination of goods and services arranged for the development, extension, installation, repair, maintenance, renewal, removal, renovation, alteration, dismantling or demolition of a fixed asset including building and engineering infrastructure”. This is also the definition referred to in CIDB guidelines.<sup>20</sup>

Public procurement in South Africa refers to goods and services as opposed to goods, services and works as appears in the 2011 United Nations Commission on International Trade Law (UNCITRAL) on the Procurement of goods, services and construction works (hereafter referred to as the Model Law). In the Model Law, provision is made for construction works as a separate category of procurement. In South Africa, however, construction forms part of services within the procurement context.<sup>21</sup> De la Harpe has noted that there is in fact no need for a separate category for construction or construction

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<sup>19</sup> According to Watermeyer in his paper “Public construction procurement in a global economy” presented at the Knowledge Construction Joint International Symposium of CIB Working Commissions in Singapore, October 2003, procurement constitutes the provision of supplies, services or engineering and construction works or any combination thereof, the disposal of moveable property, the hiring or letting of anything and the acquisition or granting of any rights. This definition is broader than that in the Regulations and the generally accepted definition of procurement which constitutes only acquisition, and not disposal.

<sup>20</sup> See best practice guidelines A – C.

<sup>21</sup> Bolton 66.

works within the South African public procurement context as “services” can be interpreted widely enough to make provision for construction works.<sup>22</sup>

Section 4(c)(iii) of the CIDB Act provides that one of the objects of the board is to establish and promote best practice that promotes procurement and delivery management reform. Best practice is defined in section 1(a) of the Act as “a desirable and appropriate standard, process, procedure, method or system in relation to the delivery process and the life cycle of fixed assets”. Section 5(2)(b) of the Act in turn provides that the board must, by notice in the Gazette, publish these best practice standards and guidelines. Furthermore, a Code of Conduct for the regulation of relationships amongst the various participants of the construction procurement process by prescribing a number of values to be complied with, has been published by the Board in accordance with section 5(4)(a) of the Act.<sup>23</sup> From the duty placed on the Board to regulate the construction procurement process, the Standard for Uniformity in Construction Procurement<sup>24</sup> has been published. It sets out the various stages of the procurement process, the rules applicable and further best practice guidelines as annexures are attached. These guidelines, the Code of Conduct and the Standard for Uniformity provide a detailed exposition of the construction procurement process and the parties involved. It is apparent from case law that our courts have readily applied these rules but have not yet adjudicated upon the nature of the rules.<sup>25</sup>

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<sup>22</sup> S De la Harpe *Procurement Law: A comparative analysis* PhD thesis University of South Africa (2009) 23.

<sup>23</sup> See Code of Conduct for all parties engaged in Construction Procurement GG 25656 of 31-10-2003.

<sup>24</sup> GG 33239 of 28-05-2010.

<sup>25</sup> See for example *Freeman NO & Another v Eskom Holdings Ltd* (43346/09) [2010] ZAGPJHC 29 (23 April 2010); *Haw & Inglis Civil Engineering (Pty) Ltd v MEC of Police, Roads & Transport: Free State Provincial Government and Others* (5972/2009) [2010] ZAFSHC 51 (28 May 2010); *The Industrial Corporation of South Africa Limited v Trencon Construction (Pty) Ltd & Basil Read (Pty) Ltd* (642/13) [2014] ZASCA 163 (1 October 2014); *Country Cloud Trading CC v MEC, Department of Infrastructure Development, Gauteng* (CCT 185/13) 2014 ZACC 28.

## 4 Relational construction procurement

Generally, public procurement including construction procurement entails a series of processes<sup>26</sup> with the aim of concluding a contract for the provision of goods and/or services at the best value for money. Watermeyer is of the view that construction procurement involves a process underpinned by various procedures and methods which follow a determined order.<sup>27</sup> Public procurement and more specifically, construction procurement thus appears to be understood as a process based on a series of transactions. According to Arrowsmith, Linarelli and Wallace,<sup>28</sup> there has over the years been an increasing practice in partnering between buyers and suppliers, referred to as “partnership sourcing”. This concept describes the relationship between a buyer and a supplier which is not limited to the scope of a specific contract but rather involves an expectation of continued future dealings. Such a relationship is characterised by co-operation between the parties and holds a number of advantages.<sup>29</sup>

In line with the idea of partnership sourcing, is a relational contract theory where a contract “means relations among people who have exchanged, are exchanging, or expect to be

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<sup>26</sup> This is evident from the various stages of the construction procurement process found in CIDB Best Practice Guideline A1 “The procurement cycle” December 2007 and the definition of construction procurement which involves invitation, award and management of contracts.

<sup>27</sup> R Watermeyer “Regulating Public Procurement in Southern Africa through international and national standards”, a paper presented at the Public Procurement in Africa Conference in Stellenbosch, South Africa during October 2011.

<sup>28</sup> S Arrowsmith, J Linarelli & D Wallace *Regulating Public Procurement: National and International Perspectives* (2000) 21.

<sup>29</sup> According to the authors these include security for the buyer in contracting with a reliable provider, the expectation of future business with the buyer and a reduction of legal costs when disputes arise since both parties have an interest in resolving the matter amicably. Furthermore, costs involved in tender processes may also be reduced. On the other hand, partnership sourcing may have a number of disadvantages. The authors note that buyers need to be weary of complacency and inefficiency on the part of suppliers and should have an awareness of other suppliers who may be able to provide the goods or services at better value for money.

exchanging in the future – in other words, exchange relations”.<sup>30</sup> MacNeil is of the view that repeated human behaviour invariably creates norms.<sup>31</sup> Some of these include integrity, reciprocity, flexibility and contractual solidarity. He notes that a relational approach to exchange relations involves a good understanding of the relationship to which the exchange is central, an understanding and consideration of the essential elements of the relationship which would entail various norms and a contextual approach to the relationship and its transactions.

The CIDB Code of Conduct for parties engaged in construction procurement published in terms of section 5(4)(a) of the CIDB Act sets out the various parties involved in construction procurement. It entails six points of conduct according to which all parties involved must act and indicates what is regarded as acceptable conduct by all parties involved.<sup>32</sup> Section 29 of the CIDB Act impose a sanction for non-compliance with the Code of Conduct.<sup>33</sup> The fact that various parties and their roles in the construction procurement process are set out and are mandated to conduct themselves in a particular manner may indicate that construction procurement could be understood in terms of a relational theory rather than a transactional understanding of the process. Such a construction is similar to that developed by MacNeil. Relational contract theory relates specifically to the private law of contract and can therefore not directly be applied to the public procurement process. However, a relational understanding of construction

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<sup>30</sup> I MacNeil “Relational contract theory: challenges and queries” (2000) 94(3) *Northwestern University Law Review* 878.

<sup>31</sup> MacNeil (2000) *Nw.U.L.Rev.* 881.

<sup>32</sup> These include the duty to act equitably, honestly and transparently; discharge duties and obligations timeously and with integrity; satisfy all relevant requirements established in procurement documents; avoid conflicts of interest and lastly not maliciously or recklessly injure or attempt to injure the reputation of another person.

<sup>33</sup> This involves being subpoenaed to appear at a formal inquiry and produce requested documentation at the inquiry. In terms of the Code of Conduct, the CIDB may issue a warning or impose a fine, refer the matter to the South African Police Service or deregister contractors from the Register of Contractors on the CIDB database.

procurement may potentially affect the legal understanding and/or conceptualisation of construction procurement law.

## **5 Research question**

The primary question to be answered in this dissertation will be whether a relational understanding of construction procurement in South Africa assists in formulating regulation for this area of public procurement.

Essentially, the dissertation concerns an examination of relational contract theory as created in the American law of contract in order to determine whether it can be used in a South African construction procurement legal system. The purpose of this will be to establish whether the use of the theory improves the regulation of this area of law and to what extent the regulation as it currently stands will be affected.

## **6 Significance of this dissertation**

The construction industry plays an important role in the South African economy.<sup>34</sup> According to Statistics South Africa (Stats SA), the industry contributed 4% to the country's Gross Domestic Product (GDP) in the second quarter of 2017.<sup>35</sup> Despite being the industry

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<sup>34</sup> This has been acknowledged in instruments which were aimed at the transformation of the construction industry such as the Green Paper on Creating an Enabling Environment for Reconstruction, Growth and Development in the Construction Industry Government Gazette (GG) 18615 of 14-01-1998. The importance of the industry is also acknowledged in the preamble of the CIDB Act.

<sup>35</sup> Statistics South Africa "Gross Domestic Product, 2nd quarter 2017" (2017) <[http://www.statssa.gov.za/publications/P0441/GDP\\_Presentation\\_Q2\\_2017.pdf](http://www.statssa.gov.za/publications/P0441/GDP_Presentation_Q2_2017.pdf)> (accessed 02-10-2017).

with the largest turnover for the last quarter in 2014 according to Stats SA,<sup>36</sup> the industry's performance has steadily decreased and indicated a negative growth rate of 0,5% in 2017.<sup>37</sup>

Construction procurement in South Africa has received little academic attention. Currently, one legal study on the topic exists and a number of journal articles and theses written by economists and engineers which mostly entail empirical work. Furthermore, the rules regulating construction procurement were written by engineers and originated from foreign jurisdictions. It is therefore necessary that a South African study on the rules be conducted in order to determine the legal meaning and consequences of these rules. As noted, the construction industry currently contributes 4% to the country's GDP thereby making it an important economic contributor.

The field of public procurement law, although founded in legal rules, is not an isolated field. It regulates human behaviour by way of legal rules as well as buying and selling of goods, works and services to or from the government. Moreover, construction procurement further involves the construction and engineering profession. Therefore, the involvement of other fields of study such as commerce and social science is paramount to an efficient public procurement system.

The public procurement process, especially when involving a time-consuming tender process is more often than not a long-term contract and naturally involves a large number of role players. Relational contract theory is premised on the fact that general contract law

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<sup>36</sup> PJ Lehohla "Quaterly financial statistics" (2014) 1 2  
<<http://www.statssa.gov.za/publications/P0044/P0044December2014.pdf>> (accessed 09-06-2015).

<sup>37</sup> See <<http://www.statssa.gov.za/publications/P0441/P04412ndQuarter2017.pdf>> 9 (accessed 02-10-2017).

fails to adequately provide for the needs of long-term, relational contracts such as the public procurement process. It is explored in this dissertation in order to determine whether it may provide a solution to the consequences a restrictive general contract law system creates in a public procurement context. A study such as this will therefore address an area of the law not yet established, make valuable suggestions to improve legal compliance where necessary and contribute to the legal literature on the subject.

## **7 Methodology**

As a point of departure, the meaning of construction procurement will be explained. In order to do so, a literature-based analysis of the applicable legislation and government publications will be conducted. Following this, a legal analysis of the nature of construction procurement rules will be conducted and various legal interpretation theories are used in doing so. In this process, the pre-award and award stage of the construction procurement process are examined. Next, relational contract theory as created and developed in American contract law is discussed. Relational contract theory is compared to general or classical contract law in order to illustrate the differences in the two systems of law and in order to establish whether general contract law indeed inadequately provides for long-term contracts such as those arising from public procurement.

The approach used by that of the United States of America and international instruments are considered in order to aid an understanding of the rules that are suggested to be imported into the South African procurement system, namely a relational procurement law.

In order to illustrate the working of relational procurement law, an analysis of the legal rules in public-private partnerships (PPPs) and in the preferential procurement system is conducted. PPPs constitute billions of rands in the South African economy and form a large part of the country's infrastructure budget. They are thus an important form of construction procurement. PPPs are by nature long-term contracts involving a large number of role players, therefore, relational procurement law is best suited to being implemented in this area of construction procurement.

Public procurement is used not only for the achievement of value for money in obtaining goods, works and services but also for collateral objectives such as environmental goals, social advancement and innovation. Historically in South Africa the use of procurement as a policy tool has been particularly important. Therefore, implementing relational procurement law in preferencing is imperative. This is done by way of analysing the rules of preferential procurement as prescribed by legislation and government publications in order to determine whether a relational procurement law can function within the preferencing system.

## **8 Structure of the dissertation**

This dissertation examines the construction procurement process in a broad manner from the planning for a tender to be advertised, to the tender process, contract conclusion and contract management.

Chapter two examines the meaning of construction procurement. It explains the legislative framework for both general public procurement and construction procurement. It then looks at the manner in which construction procurement has been defined in legislation and

government publications to date and how such new publications influence its definition which may have far-reaching consequences for what is procured within the construction industry. An argument is then made that although construction procurement stems from and is regulated by general public procurement legislation, it is implemented in practice by way of sector-specific legislation and government publications based on the complex needs of the industry. This therefore warrants a call for section 217 of the Constitution to be amended so as to provide for goods, services *and* works. The legal implications of why the meaning of construction procurement is important to determine is then discussed.

Chapter three establishes the legal nature of the rules which regulate construction procurement. An explanation as to whether section 217 of the Constitution is applicable to construction procurement is provided. The legal nature of the pre-award and award stage of the construction procurement process is then discussed. It is argued in this chapter that the nature of the construction procurement process is akin to that of general public procurement, with sector-specific rules. Lastly, recommendations are made as to how the courts should approach the interpretation of construction procurement rules.

Chapter four discusses relational contract theory established and developed in the American private law of contract. The relationship between relational contract theory and the law is then explained. The theory is compared to general or classical contract law insofar as it is applicable to the public procurement process. The need to incorporate the theory into the South African public procurement law is examined. Based on a finding of inadequacy on the part of general contract law and a need for a more effective public procurement law, an argument is made that a relational procurement law may best provide

for a legal framework in which public procurement rules can function. This extends to the construction procurement context.

Chapters five and six of this dissertation are illustrations of how a relational procurement law would function in South Africa. Chapter five examines the regulation, nature, definition and working of PPPs in South Africa. The implementation of preferential procurement specifically in PPPs insofar as it differs from its implementation in general public procurement is then discussed. A discussion on PPPs and the general public procurement process is provided in order to determine whether PPPs are different from the latter. Following this, the benefits and challenges of PPPs are explored. Lastly, the working of relational procurement law in PPPs is examined.

Chapter six entails preferential procurement and the suggested relational procurement law. This chapter briefly discusses the various ways in which procurement has been used for collateral objectives. The use of procurement as a policy tool in South Africa specifically is then discussed based on the points system prescribed by the PPPFA. The various ways in which preference is awarded in construction procurement is explored and lastly the most important amendment in the 2017 PPPFA Regulations is then examined in light of a relational procurement law.

Chapter seven is the concluding chapter and establishes that relational contract theory is a basis on which relational procurement law can be built for a more efficient legal framework in which both general public procurement and construction procurement can function. It acknowledges that public procurement law concerns not only the law but also other fields

which should be incorporated into the manner in which public procurement is regulated  
which in turn will ensure better compliance with public procurement rules.

## CHAPTER 2

### CONSTRUCTION PROCUREMENT DEFINED

#### 1 Introduction

In general, public procurement refers to the acquisition of goods and services.<sup>38</sup> In other countries,<sup>39</sup> an additional category has been added, that of works. However, in South Africa section 217 of the Constitution<sup>40</sup> provides that organs of state contract for the provision of goods or services only. There is therefore no third category for works. In South Africa, construction is considered to be a service, therefore resorting under “services” in section 217. In this chapter, the law regulating general procurement and construction procurement will be looked at. Next, the current categorisation of construction procurement will be discussed. Following this, the meaning of construction procurement and whether it indeed constitutes a service or whether it is in fact a category of procurement on its own will be established. A definition of construction procurement will be proffered in an attempt to identify the product procured during the construction procurement process. An argument will be made that it indeed constitutes a separate category of procurement. How construction procurement differs from the procurement of general goods and services and current attempts at illustrating this in the practice of construction procurement will be discussed. Lastly, a workable definition of construction procurement will be proffered as well as the placing of construction procurement within the broader public procurement regime in South Africa.

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<sup>38</sup> P Bolton *The Law of Government Procurement in South Africa* (2007) 1 1.

<sup>39</sup> Such as the UK and the USA.

<sup>40</sup> Constitution of the Republic of South Africa, 1996.

## 2 Legal regulation of public procurement in South Africa

Section 217(1) of the Constitution provides that when contracting for goods or services, organs of state in the national, provincial or local sphere of government or institutions identified in national legislation must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective. Section 217(2) provides for the use of procurement as a policy tool. This provision states that subsection (1) does not prevent organs of state or institutions in subsection (1) from implementing procurement policies providing for categories of preference in the allocation of contracts and the protection or advancement of persons, or categories of persons disadvantaged by unfair discrimination. Section 217(3) prescribes a national legislative framework to be enacted in terms of which preferential procurement policies as contemplated in subsection (2) are to be implemented.

Legislation applicable to procurement in general includes the Preferential Procurement Policy Framework Act (PPPFA)<sup>41</sup> and its Regulations<sup>42</sup> which regulate preferential procurement by providing a framework in which preferential procurement policies are to be implemented. At national and provincial government level, the Public Finance Management Act (PFMA)<sup>43</sup> and its Regulations<sup>44</sup> govern public finance in general and public sector procurement. The Local Government: Municipal Finance Management Act (MFMA)<sup>45</sup> with its Regulations<sup>46</sup> and the Local Government: Municipal Systems Act,<sup>47</sup> manage public finance and thus public sector procurement at local government level.

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<sup>41</sup> 5 of 2000.

<sup>42</sup> Government Gazette (GG) 40553 of 20-01-2017.

<sup>43</sup> 1 of 1999.

<sup>44</sup> PFMA Public-private partnership Treasury Regulation 16 GG 25773 of 28-11-2003; PFMA Supply Chain Management Treasury Regulation 16A GG 27388 of 15-03-2005.

<sup>45</sup> 56 of 2003.

The Supreme Court of Appeal (SCA) has held that the invitation, evaluation and award of tenders is of an administrative law nature,<sup>48</sup> therefore the Promotion of Administrative Justice Act (PAJA)<sup>49</sup> applies. Furthermore, the Promotion of Access to Information Act (PAIA)<sup>50</sup> is applicable as it regulates access to any information held by both the government and private parties. The Broad-Based Black Economic Empowerment Act (BBBEEA)<sup>51</sup> is applicable to preferential procurement in that it regulates black economic empowerment. Lastly, the Prevention and Combating of Corrupt Activities Act<sup>52</sup> is aimed at curbing corruption in procurement processes and is therefore relevant. Legislation which regulate procurement in general also prescribe that the specific prescripts of the CIDB apply to construction procurement alongside the general legislation.<sup>53</sup>

The law applicable throughout the procurement process is the private law of contract.<sup>54</sup> However, because the government is a party to the contract and is obligated to act in the public interest, possesses public powers and is generally in a more powerful position, public law also applies.<sup>55</sup>

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<sup>46</sup> MFMA Municipal Supply Chain Management Regulations GG 27636 of 30-05-2005.

<sup>47</sup> 32 of 2000.

<sup>48</sup> See *Umfolozzi Transport (Edms) Bpk v Minister van Vervoer* 1997 2 All SA 548 (A) paras 552-553; *Transnet Ltd v Goodman Brothers (Pty) Ltd* 2001 2 BCLR 176 (SCA) para 23; *Logbro Properties CC v Bedderson NO* 2003 2 SA 460 (SCA) para 5; *Metro Projects CC v Klerksdorp Municipality* 2004 1 SA 16 (SCA) para 12.

<sup>49</sup> 3 of 2000.

<sup>50</sup> 2 of 2000.

<sup>51</sup> 53 of 2003.

<sup>52</sup> 12 of 2004.

<sup>53</sup> See PFMA Supply Chain Management Treasury Regulation 16A6.3 (a)(ii) GG 27388 of 15-03-2005 and MFMA Municipal Supply Chain Management Regulation 1 GG 27636 of 30-05-2005 under "other applicable legislation".

<sup>54</sup> Bolton *Government Procurement in South Africa* 16; G Quinot *State Commercial Activity* (2009) 258.

<sup>55</sup> Ferreira sets out how the government as a party to the contract is different from a private contractant. See C Ferreira "The quest for clarity: an examination of the law governing public contracts" (2011) 128 (1) *SALJ* 172 173.

### 3 Legal regulation of construction procurement in South Africa

Legislation applicable to public sector construction procurement are those applicable to procurement in general, the Construction Industry Development Board (CIDB) Act, the Regulations to the Act and the prescripts issued by the CIDB in terms of the CIDB Act. Section 2 of the Act establishes the CIDB as a juristic person and regulatory board for the construction industry and construction procurement in particular. The Act sets out the powers and functions of the board and it requires a register of contractors to be created for efficient procurement practices and to facilitate public sector construction procurement. In order to establish what construction procurement constitutes, a definition of construction procurement must be provided.

### 4 Construction procurement defined

The Construction Industry Development Board (CIDB) Act<sup>56</sup> does not provide a definition for construction procurement. However, Regulation 1 of the Construction Industry Development Regulations<sup>57</sup> defines it as “construction procurement in the construction industry, including the invitation, award and management of contracts.” This definition is wide and does not give any indication as to what the subject of construction procurement in South Africa is. It appears from the CIDB Act and its Regulations that the items that are procured, thereby forming the subject of construction procurement, are referred to as “construction works”. This is in turn defined in section 1(j) of the Act as:

“[T]he provision of a combination of goods and services arranged for the development, extension, installation, repair, maintenance, renewal, removal, renovation, alteration, dismantling or demolition of a fixed asset including building and engineering infrastructure.”

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<sup>56</sup> 38 of 2000.

<sup>57</sup> GG 31603 of 14-11-2008.

The regulations to the Act in turn refer to “classes of construction works” that are set out in Schedule 3 to the Regulations which provides a table of the various classes of construction works which may be procured. These include civil engineering works, electrical engineering works and general building works. In the case of electrical engineering works, a further distinction is made between electrical engineering works which constitute infrastructure and those which constitute buildings. Further classes of construction works include general building works, mechanical engineering and specialist works. The latter category consists of works identified by the CIDB which involve specialist capabilities.

In line with the duty of the CIDB to issue guidelines for best practice within the construction industry,<sup>58</sup> the CIDB Standard for Uniformity has been published which provides guidelines for the type of works and contracts used in the construction procurement process. The standard, unlike the CIDB Act and its Regulations refer to the various classes of construction as consisting of engineering and construction works, supplies and services other than professional services.<sup>59</sup> The definition of what constitutes construction works in the legislation and guidelines are therefore contradictory.

## **5 Categorising construction procurement in South Africa**

Section 217(1) of the Constitution provides that organs of state when contracting for goods and services should do so in accordance with a system which is fair, equitable,

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<sup>58</sup> Defined in s 1(h) of the CIDB Act as “the broad conglomeration of industries and sectors which add value in the creation and maintenance of fixed assets within the built environment”.

<sup>59</sup> See Table 3 at 9.

transparent, competitive and cost-effective. It appears therefore that procurement consists of two categories – goods and services. This begs the question whether construction procurement or more specifically, construction works resort under goods or services.

According to De la Harpe, “services” can include any kind of work, ranging from cleaning services to professional services, such as that of a banker for example. He further notes that it may at times be difficult to distinguish between “goods” and “services” and that a wide interpretation should be given to both terms, as, he argues, the purpose of section 217 is to provide for principles which would regulate all government procurement and not to limit these principles with a narrow interpretation of “goods” and “services”. De la Harpe is furthermore of the view that “goods or services” are wide enough to include “works” or “construction” and that no additional category is needed for this.<sup>60</sup>

International instruments, however, regard goods, works or construction and services as three separate categories. The 1994 United Nations Commission on International Trade Law (UNCITRAL) Model Law on Procurement of Goods, Construction and Services provides for three separate categories for goods, construction and services.<sup>61</sup> The 2011 UNCITRAL Model Law on Public Procurement was adopted on 1 July 2011 and replaces the 1994 version. It defines “public procurement” in Chapter 1 Article 2(j) as “the acquisition of goods, construction or services by a procuring entity”, therefore making a distinction between goods, construction and services.<sup>62</sup> Furthermore, the World Bank in

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<sup>60</sup> S De la Harpe *Procurement Law: A comparative analysis* PhD thesis University of South Africa (2009) 23-24 para 2.2.1.

<sup>61</sup> See UNCITRAL Model Law Procurement of Goods, Construction and Services with Guide to Enactment <<http://www.uncitral.org/pdf/english/texts/procurem/ml-procurement/ml-procure.pdf>> (accessed 14-10-2017).

<sup>62</sup> See UNCITRAL Model Law on Public Procurement (2014) <<https://www.uncitral.org/pdf/english/texts/procurem/ml-procurement-2011/2011-Model-Law-on-Public-Procurement-e.pdf>> (accessed 14-10-2017).

the January 2011 Procurement Guidelines also distinguishes between goods, works and non-consulting services.<sup>63</sup>

Regulations 5 and 6 of the 2011 Preferential Procurement Regulations provide for a point system in terms of which preference should be awarded to contractors. In terms of the Regulations, a procuring body may award points for the acquisition of goods, services and/or works. This differs from the 2001 Regulations which referred to a point system for tenders or procurement and not for goods, works or services.<sup>64</sup> The current Regulations seem to therefore follow the approach adopted by international legal instruments with regard to the classification of procurement into goods, works and services as opposed to goods and services as generally used in South Africa. It may be advantageous to re-categorise construction procurement as works under section 217 in order to provide for its own category. The significance and potential advantage of this will be discussed next.

## **6 A case for categorising construction procurement separately**

Arrowsmith<sup>65</sup> notes that for purposes of control and regulation, procurement is generally classified into three categories – “supplies”, “services”, and “works”. She writes that supplies normally refer to the acquisition of “off the shelf” items such as stationery and office furniture.<sup>66</sup> Works refer to construction and engineering activities such as the building of a road and services is generally used to refer to non-construction services.<sup>67</sup> At

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<sup>63</sup> See Guidelines for Procurement of Goods, Works and Non-Consulting Services (2011) <[http://siteresources.worldbank.org/INTPROCUREMENT/Resources/278019-1308067833011/Procurement\\_GLs\\_English\\_Final\\_Jan2011.pdf](http://siteresources.worldbank.org/INTPROCUREMENT/Resources/278019-1308067833011/Procurement_GLs_English_Final_Jan2011.pdf)> (accessed 14-10-2017).

<sup>64</sup> See Regulations 3 and 4 of the 2001 Regulations.

<sup>65</sup> S Arrowsmith *The law of public and utilities procurement* (2005) 1.1.

<sup>66</sup> 1.2.

<sup>67</sup> 1.2.

the same time, she notes that construction is a type of service and is often used in a broader sense in providing for both construction and non-construction services.<sup>68</sup>

As noted, internationally public procurement has been categorised as consisting of goods, services and works. One may ask what the significance of this is and what impact it would have on South African public procurement law if the same classification were to be used. The division of public procurement into three categories creates the impression that each category is regulated either individually or somewhat differently from one another. In countries where procurement is classified as such, this is indeed the case. In other words, where public procurement is divided into goods, services and works, each of the categories are regulated individually, each with its distinct rules. Classifying construction works as a service creates the impression that when procuring works, a service is procured. However, the categorisation of works in the CIDB Regulations indicate that both goods and services are procured.

For regulation purposes, section 217 of the Constitution should refer to the procurement of goods, works and services. Construction procurement should therefore consist of four sub-categories. Firstly, construction works which will consist of those classes set out in the CIDB Regulations namely civil engineering, electrical engineering, general building works, mechanical engineering and specialist work. Secondly, supplies which are “goods” in general procurement. In other words tangible items used in the construction industry such as cement, wood, steel etc. Thirdly, non-professional services such as cleaning services and in the fourth instance professional services which should entail the services of those persons registered with a professional body to perform a professional service such as

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<sup>68</sup> 1.2. Non-construction services Arrowsmith writes include manual services such as gardening and advertising.

engineers or architects who fulfil consulting services. It is further submitted that it may at times be difficult to determine whether supplies, services or a combination of the two is procured at any one time. However, the aim in providing this separation of works from services in section 217 is not to create a strict divide between the three categories at all times but rather to indicate that construction procurement is a category on its own, with nuanced and complex rules causing its procurement to be different from the general procurement of goods or services as understood in section 217.

If construction procurement was to be given a separate category of procurement in section 217, it may attract foreign contractors to engage in procurement contractors with South Africa. It will further bring South African public procurement law in line with international trends, thereby attracting foreign contractors who may identify similarities between their own and the South African procurement system. It may further indicate the South African government's willingness to align its legislation and policies with international norms and standards with the result that construction procurement and its regulation may be given increased attention if it is seen to be regulated separately.<sup>69</sup>

At present, public procurement regulation in South Africa is undergoing amendments which will have an impact on the regulation of construction procurement. A new standard, the Standard for infrastructure and delivery management has been published in terms of s 76(4)(c) of the PFMA and came into operation on 1 July 2016.

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<sup>69</sup> Watermeyer records a number of changes which should be brought about in what he terms "a culture change" to bring about better outcomes in the delivery of construction works. One of these changes is progressing from poorly structured procurement documents based on local standards which in turn are based on local knowledge, to structured procurement documents based on international standards which are standardised and need minimal customisation. This illustrates the need for the procurement process to become aligned with international standards which will in turn attract international construction works opportunities for South Africa. See R Watermeyer "Changing the construction procurement culture to improve project outcomes" presented at the Joint CIDB W070, W092 and TG72 International Conference on Facilities Management, Procurement Systems and Public Private Partnerships in Cape Town 23 – 25 January 2012 <<http://www.ioptions.co.za/Files/Doc/RBWnew/P7-5.pdf>> (accessed 22-04-2016).

## 7 New Standard for Infrastructure Procurement and Delivery Management

On 1 July 2016, a new Standard for Infrastructure Procurement and Delivery Management (SIPDM)<sup>70</sup> came into operation. The standard has been issued as National Treasury Instruction Note 4 of 2015/2016 in terms of section 76(4)(c) of the PFMA<sup>71</sup> and Regulation 3(2) of the MFMA SCM Regulations. It applies to all departments, constitutional institutions and public entities listed in Schedules 2 and 3 to the PFMA including the CIDB and organs of state in terms of section 239 of the Constitution.<sup>72</sup> The instruction note introduces a new term into South African public procurement, that of “infrastructure procurement” which is defined as “the procurement of goods or services including any combination thereof with the acquisition, refurbishment, rehabilitation, alteration, maintenance, operation or disposal of infrastructure”.<sup>73</sup> No reference is made in the instruction note to construction procurement or construction work or even the construction industry. It appears therefore that the intention is to re-name procurement in the construction industry, infrastructure procurement. It is unclear what the purpose of the change in terminology is, however, it appears that the term “infrastructure” is intended to be an umbrella term for all activities in the construction industry which lead to the creation of infrastructure. This is evident from the definition of “infrastructure delivery” which is:

<sup>70</sup> National Treasury’s Instruction Note 4 of 2015/2016 <<http://www.treasury.gov.za/legislation/pfma/TreasuryInstruction/Treasury%20Instruction%20No.%204%20of%202015%202016%20on%20Std%20for%20Infr%20Proc%20and%20Delivery%20Mngmt.pdf>> (accessed 14-10-2017). The legal nature of this standard and other construction procurement guidelines will be analysed in chapter 3 of this dissertation.

<sup>71</sup> S 76(4)(c) provides that National Treasury may make regulations or issue instructions applicable to all institutions to which the PFMA applies concerning the determination of a framework for an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective. Regulation 3(2), in turn, provides that an accounting officer may make use of any Treasury guidelines which determine standards for municipal supply chain management policies.

<sup>72</sup> National Treasury Instruction Note 4 of 2015/2016 3. It is clearly stated at 1 that the instruction note does not apply to a) the storage of goods and equipment, following their delivery to an organ of state, which are stored and issued to contractors or to employees of that organ of state b) the disposal or letting of land c) the conclusion of any form of land availability agreement and d) the leasing or rental of moveable assets.

<sup>73</sup> 4. “Infrastructure” in turn is defined at 3 as “a) immovable assets which are acquired, constructed or which result from construction operations; or b) movable assets which cannot function independently from purpose-built immovable assets”. Neither “constructed” nor “construction operations” is defined, however, “construction” according to the instruction note at 3 means “everything that is constructed or results from construction operations”.

“[t]he combination of all planning, technical, administrative and managerial actions associated with the construction, supply, renovation, rehabilitation, alteration, maintenance, operation or disposal of infrastructure.”<sup>74</sup>

Based on this definition, construction procurement, or rather, infrastructure procurement therefore forms part of infrastructure delivery as a whole.

It appears as though the main purpose of the standard is to create a more efficient and streamlined framework within which infrastructure procurement will function. It is therefore a process rather than a law. This is evident from the various stages of the process, from a needs analysis to the final delivery of the works. The Infrastructure and Delivery Management System (IDMS) was developed by National Treasury, the CIDB, the Departments of Public Works, Education and Health and the Development Bank of Southern Africa.<sup>75</sup> After the Instruction Note was published, various role players in construction procurement were asked to comment on the new standard.<sup>76</sup> It appears to be the unanimous opinion of all role players that firstly, the current general public procurement regime is not well suited to the complexities of the construction industry.<sup>77</sup>

Secondly, it is believed that this standard creates a

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<sup>74</sup> See Instruction note 4 at 3 under “terms and definitions”.

<sup>75</sup> Watermeyer, Nevin and Langenhoven note that the SIPDM consists of a number of stages. Firstly, an infrastructure planning system, an infrastructure gateway system which will serve as control points in the process where a decision is required as to whether the procurement is still in accordance with the plans and specifications. The last two stages of the process consist of the construction procurement system, the programme and project management system and lastly an operation and maintenance system. The SIPDM therefore provides for a process in which construction works are planned, specified, procured and the entire project management until conclusion. According to the authors therefore, construction procurement forms one stage in the entire process. See R Watermeyer, G Nevin & K Langenhoven “The supply chain management system for the delivery and maintenance of infrastructure by organs of state” (2012) *Civil Engineering* 51 51-52.

<sup>76</sup> Such as the South African Institute of Electrical Engineers (SAIEE), Institute of Municipal Engineering of Southern Africa (IMIESA), South African Forum of Civil Engineering Contractors (SAFCEC), Consulting Engineers South Africa (CESA), South African Institution of Civil Engineering (SAICE), CIDB, and Council for the Built Environment (CBE) according to the *Civilution* magazine of February 2016 which is a special issue published by National Treasury to explain the working of the new standard.

<sup>77</sup> Watermeyer illustrates the complex operations in the procurement of construction works in describing the process as one where professional services are required to plan, budget and conduct assessments of existing works, scope requirements in response to the owner’s brief, propose solutions, evaluate alternative solutions, develop the design for the selected solution, produce production information which enables

“[s]eparate industry-based procurement process for obtaining contracting services. Making a distinction between the procurement of general goods and services, and construction activities, the SIPDM will be better placed to accommodate the requirements of the construction industry.”<sup>78</sup>

It is noted by National Treasury that:

“The delivery and maintenance of infrastructure differ considerably from those for general goods and services required for consumption or operational needs, in that there cannot be the direct acquisition of infrastructure. Each contract has a supply chain which needs to be managed and programmed to ensure that the project is completed within budget, to the required quality, and in the time available. Many risks relate to the ‘unforeseen’ which may occur during the performance of the contract. This could, for example, include unusual weather conditions, changes in owner or end user requirements, ground conditions being different to what were expected, market failure to provide materials, or accidental damage to existing infrastructure. Unlike general goods and services, there can be significant changes in the contract price from the time that a contract is awarded to the time that a contract is completed.”<sup>79</sup>

Watermeyer, Wall and Pirie<sup>80</sup> are of the opinion that some general procurement practices are not suited to construction procurement. These include awarding a tender to a tenderer with the lowest price, generic conditions of contracts which provide only for the rights and obligations of parties and not for the management of the contract, negotiation of terms after the evaluation of tenders, lack of standardised procurement documents, reliance on a “check-list” of procedures that are applied indiscriminately and inflexible allocation of risk

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construction and confirm that design intent is met during construction. On the other hand, contractors are required to construct or refurbish works in accordance with requirements or perform maintenance services. See R Watermeyer “Changing the construction procurement culture to improve project outcomes” presented at the Joint CIDB W070, W092 and TG72 International Conference on Facilities Management, Procurement Systems and Public Private Partnerships in Cape Town 23 – 25 January 2012.

<sup>78</sup> This was highlighted by the SAFCEC at *Civilution* (2016) 7.

<sup>79</sup> *Civilution* (2016) 15. See also R Watermeyer, K Wall & G Pirie “The case for a separate supply chain for the delivery and maintenance of infrastructure” (2013) 1 4 <<http://www.ioptions.co.za/Files/Doc/RBWnew/P7-6.pdf>> (accessed 12-04-2016). According to the authors, the procurement of general goods and services entail merely sourcing, purchasing, receipt, storage and issuing of the goods or payment of the services provided. In contrast, the procurement of works involves a wide range of goods (or supplies as referred to in the construction industry) and services which are required to develop or maintain a fixed asset on site. Construction works are therefore not readily available or attainable. They note that “non-construction procurement deals with direct acquisitions which involve standard, well defined and scoped services, off-the-shelf items and readily available commodities. The business need is commonly achieved through the production of a specification, which then forms a requisition for the procurement of goods or services. An immediate choice can generally be made in terms of the cost of goods or services satisfying specified requirements.”

<sup>80</sup> R Watermeyer, K Wall & G Pirie “How infrastructure delivery can find its way again” (2013) *IMIESA* 17 21.

to parties.<sup>81</sup> They rightly indicate that the risks to be managed and skills required by the role players are different to those for the procurement of general goods and services.<sup>82</sup> It has further been noted by the Consulting Engineers South Africa (CESA), that due to the fact that the procurement of works is done in terms of the rules for procurement of general goods and services, an emphasis is placed on price.<sup>83</sup> However, functionality as referred to in the PPPFA<sup>84</sup> is treated as an obstacle. All products procured in terms of the PPPFA are subjected to minimum functionality requirements which according to CESA is not feasible for the procurement of works since every project is unique<sup>85</sup> – there may be instances where price forms a much smaller role than functionality and vice versa. It therefore appears that construction procurement role players are of the opinion that a more flexible approach than that in the PPPFA to the evaluation of functionality should be adopted.

Furthermore, a concern raised by Watermeyer, Wall & Pirie<sup>86</sup> is the lack of use by municipal entities of budgets allocated for infrastructure. This is an indication that planned infrastructure projects are not met, alternatively that low-quality construction works are being constructed to the personal financial benefit of state officials. There are therefore various indications that there is a need to transform the process followed to deliver high quality and cost-effective infrastructure which can be addressed through public procurement law.

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<sup>81</sup> Watermeyer, Wall & Pirie (2013) *IMIESA* 21.

<sup>82</sup> Watermeyer, Wall & Pirie (2013) *IMIESA* 21.

<sup>83</sup> It has been noted that the primary goal of public procurement is the attainment of goods or services at the best possible price. See Bolton *Government Procurement in South Africa* 99.

<sup>84</sup> See Regulation 4 of the PPPFA Regulations.

<sup>85</sup> *Civilution* (2016) 6.

<sup>86</sup> Watermeyer, Wall & Pirie (2013) <<http://www.ioptions.co.za/Files/Doc/RBWnew/P7-6.pdf>> 1 1.

## 8 Legal implications of the meaning of construction procurement

Although, as indicated above, the SIPDM highlights a number of important factors to be considered in amending the law, it naturally has a number of legal consequences for construction procurement law as it is currently (14 November 2017) implemented. The new Standard effectively creates a parallel system in terms of which construction procurement is implemented. On 1 July 2016 when the standard came into operation, and at present (14 November 2017), the CIDB Act and its Regulations, together with guidelines issued by the CIDB for construction procurement are still in operation. The new standard creates definitions different from those in the Act which makes determining whether supplies or services in fact constitute construction works as per the definition in the Act and its Regulations, problematic.

To illustrate this, “construction procurement” is defined in the CIDB Regulations<sup>87</sup> as “procurement in the construction industry including the invitation, award and management of contracts”.<sup>88</sup> “Construction works” in turn, are defined in section 1(j) of the CIDB Act as “the provision of a combination of goods and services arranged for the development, extension, installation, repair, maintenance, renewal, removal, renovation, alteration, dismantling or demolition of a fixed asset including building and engineering infrastructure”. “Infrastructure procurement” appears to exclude the development, extension, installation, repair, renewal, removal, dismantling and demolition, yet adds

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<sup>87</sup> See Regulation 1.

<sup>88</sup> According to Watermeyer, procurement is a process which creates, manages and fulfils contracts. He notes that procurement commences once the need for goods, services and works or disposals have been identified and ends when the goods are received and the services or works are completed or the relevant asset is disposed of. He writes that construction procurement consists of six phases, namely the establishment of what should be procured, a decision on a procurement strategy, solicitation of tender offers, evaluation of those tender offers, award of a contract and administration of the contract and confirmation that requirements for the procurement were indeed met. See R Watermeyer “A systems approach to the effective delivery of infrastructure” (2012) *Civil Engineering* 46 47, 51.

refurbishment,<sup>89</sup> rehabilitation,<sup>90</sup> operation and disposal of infrastructure. Moreover, “infrastructure” refers to immovable assets which result from “construction operations” which are not defined. The result is that a number of works are not subject to the new standard but may arguably resort under “construction operations” which has been left open for interpretation.

Further to this, the new standard may influence the registration of construction contractors on the CIDB Register of Contractors<sup>91</sup> if the Act and its Regulations were to be repealed or amended to be brought in line with the standard. The effect would be that the class of construction works in Schedule 3 to the CIDB Regulations would fall away and a new way of placing contractors on the Register of Contractors would have to be determined since contractors are currently registered based on the class of works they are able to perform.

The definition of “construction works” indicates that these are a combination of goods and services and the subject of a construction contract. There is therefore no strict divide between goods and services when procuring construction works as there is in general procurement. In addition to this, professional services may also be procured. Neither the Act nor its Regulations define services, however, the Standard for Uniformity for Construction Procurement issued by the CIDB defines a services contract as a “contract for the provision of labour or work, including knowledge-based expertise, carried out by hand, or with the assistance of equipment and plant”.<sup>92</sup> To this end, Regulation 1 refers to a “qualified person” which is defined as “a person who is recognised by virtue of his or her training and experience as having the necessary qualifications to undertake construction

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<sup>89</sup> Defined in *Civilution* (2016) 5 as “modification and improvements to existing infrastructure in order to bring it up to an acceptable condition”.

<sup>90</sup> Defined in *Civilution* (2016) 5 as “extensive work to bring infrastructure back to acceptable functional conditions, often involving improvements”.

<sup>91</sup> This is provided for in Chapter 3 of the CIDB Act.

<sup>92</sup> See 3.12 at 5 of the Standard for Uniformity in Construction Procurement May 2010.

works in a specific category as contemplated in regulation 12(8)". Regulation 12(8) in turn, refers to professionals registered as such.<sup>93</sup> These are the professional services of engineers, architects, construction managers and quantity surveyors.

Watermeyer notes that construction procurement involves construction works, supply contracts which entail the purchase of construction materials and equipment, service contracts relating to construction, professional service contracts and the disposal of surplus materials, equipment and demolition.<sup>94</sup>

It is suggested that procurement be referred to in section 217 of the Constitution as goods, works and services which organs of state contract for. A proposed definition for construction procurement is the procurement of works, supplies and services, including professional services in the construction industry. Works in turn, can refer to the various classes of works as described by the CIDB Regulations which will keep the Register of Contractors in place which in turn will promote fairness and transparency found in section 217. The word procurement in the context of construction can have a determined meaning in order to make clear what is being procured. In other words, "procurement" as referred to in "the procurement of works, supplies and services" in the proposed definition of "construction procurement" can refer to the list of services performed in the industry. For example acquisition, sale, refurbishment, alteration, development, extension, installation, repair, maintenance, renewal, removal, renovation, alteration, dismantling or demolition, rehabilitation and disposal of construction works in the invitation, award and management

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<sup>93</sup> These are professionals registered in terms of the Engineering Profession Act 46 of 2000, Project and Construction Management Professions Act 48 of 2000, Architectural Profession Act 44 of 2000, Quantity Surveying Profession Act 49 of 2000 and the Landscape Architectural Profession Act 45 of 2000.

<sup>94</sup> Watermeyer (2012) *Civil Engineering* 49.

of contracts.<sup>95</sup> Any service which is not covered in one of these, can resort under “specialist works”, one of the classes of construction works provided for in the Regulations.

It is further submitted that there is no benefit in changing the terminology to infrastructure procurement. All terms relating to procurement in the construction industry refer to “construction”. Therefore, to maintain uniformity and clarity of what is actually procured, the reference to “construction” should remain. The Oxford Dictionary defines “infrastructure” as “the basic physical and organisational structures (e.g. buildings, roads, power supplies) needed for the operation of a society or enterprise”. The word “infrastructure” is therefore a word to describe all forms of construction, a “catch-all” term and is not an industry on its own. It further defines “construction” as “the action or process of constructing – the industry of erecting buildings”. “Works”, on the other hand, are defined as an “activity involving construction or repair” and “the materials for this”. As noted, procurement in the construction industry more often than not, refers to a combination of goods or supplies and services. Therefore, it is apt that the subject of construction procurement is referred to as “construction works” by definition.

The aim of this dissertation is to establish whether a relational understanding of construction procurement aids in the legal regulation of this area of law or whether it affects the legal understanding of construction procurement law. The concept of relational theory is discussed in chapter four. However, for purposes of this chapter, a relational contract theory is where a contract “means relations among people who have exchanged, are exchanging, or expect to be exchanging in the future – in other words, exchange

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<sup>95</sup> Arrowsmith, Linarelli and Wallace write that in a broad sense, the term “procurement” refers to the entire process of acquisition. From the planning decision to make a purchase to choosing a provider and finally contract administration. The proposed definition of construction procurement therefore refers to procurement in the broad sense. See S Arrowsmith, J Linarelli, & D Wallace *Regulating public procurement: national and international perspectives* (2000).

relations”.<sup>96</sup> MacNeil is of the view that repeated human behaviour invariably creates norms. Some of these include integrity, reciprocity, flexibility and contractual solidarity. He notes that a relational approach to exchange relations involves a good understanding of the relationship to which the exchange is central, an understanding and consideration of the essential elements of the relationship which would entail various norms and a contextual approach to the relationship and its transactions.<sup>97</sup> When applied to construction procurement law, it is important that this relational theory begins at the definition of construction procurement. Uniformity in definitions and wording will ensure that all role players in the construction procurement process are in agreement with regard to the subject of procurement, the process to be followed and the aims of the procurement process which is *inter alia* to achieve fairness, equity, transparency, competition and cost-effectiveness. All terminology should therefore be linked and clearly defined for the purpose of legal certainty and establishing contractual relations where all parties involved in each construction procurement process are sure of their rights and obligations. Repetitive construction procurement processes where this occurs will go a long way in ensuring value for money in the delivery of infrastructure.<sup>98</sup>

## 9 Conclusion

A contradictory definition of construction procurement and what construction works constitute is found in the CIDB Regulations and the guidelines issued by the CIDB. These

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<sup>96</sup> I MacNeil “Relational contract theory: challenges and queries” (2000) 94 (3) *Northwestern University Law Review* 877 878.

<sup>97</sup> MacNeil (2000) *Northwestern University Law Review* 881.

<sup>98</sup> Watermeyer describes value for money in infrastructure projects as “the optimal use of resources to achieve the intended outcomes.” See R Watermeyer “Realising value for money through procurement strategy in the delivery of public infrastructure” (2014) presented at the 8<sup>th</sup> CIDB Post Graduate Conference, University of the Witwatersrand, Johannesburg 1 <<http://www.ioptions.co.za/sites/default/files/rbwpapers/P7%2B%20P8%20papers/P7-9.pdf>> (accessed 14-10-2017).

guidelines are, however, not law and therefore the definitions in the Act and its Regulations prevail. In practice, however, construction contractors make use of the guidelines rather than the law to assist them in construction procurement rules. Therefore, it is important that all CIDB guidelines be brought in line with the CIDB Act and its Regulations.

Currently in South Africa, public procurement refers to contracting for goods and services. Some authors<sup>99</sup> are of the view that construction constitutes a service and can resort under “services” in section 217 of the Constitution. There is therefore no need for an additional category. However, it is submitted that this is not the case. Procurement in the construction industry is in fact a combination of goods and services and therefore a unique form of procurement. Furthermore, construction procurement is regulated by specific legislation. The CIDB is a juristic body appointed to regulate the activities of the construction industry, including construction procurement. It is also empowered by the CIDB Act to publish guidelines for construction procurement. It is therefore clear that construction procurement is legally regulated separately from general goods and services.

There are a number of benefits in categorising construction procurement on its own. It may attract foreign investment, improve international perception of South Africa’s compliance with international trends and place more attention both legally and economically on the performance of the construction industry and therefore construction procurement as a big contributor to the country’s Gross Domestic Product (GDP).

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<sup>99</sup> See S De la Harpe *Procurement Law: A comparative analysis* PhD thesis University of South Africa (2009) 23 and P Bolton *The Law of Government Procurement in South Africa* (2007) 66.

The new Standard published by the National Treasury which attempts to change construction procurement has both positive and negative aspects. It affirms that construction procurement is different from the procurement of general goods and services and legally cannot be treated the same. It also highlights the fact that infrastructure in general can improve the South African economy if managed better to attain better value for money. However, where the Standard does not assist the development of construction procurement is in changing a number of terms. The new terms, “infrastructure procurement” and “infrastructure”, add no value to the legal regulation of construction procurement. Instead, it creates a parallel system for construction contractors to comply with. In order to attain value for money in construction procurement, it is recommended that uniformity be maintained in terminology. Therefore, references to the construction industry, construction procurement and construction works should be maintained.

It is recommended that section 217 of the Constitution reads “when organs of state contract for goods, works or services they should do so in accordance with a system that is fair, equitable, transparent, competitive and cost-effective”. Construction procurement could be defined as “the procurement of construction works, supplies and services, including professional services in the construction industry”. “Procurement” in this definition would therefore refer to acquisition, sale, refurbishment, alteration, development, extension, installation, repair, maintenance, renewal, removal, renovation, alteration, dismantling or demolition, rehabilitation and disposal in the invitation, award and management of contracts. “Construction works” in turn will refer to the various classes of construction works namely civil engineering works, electrical engineering works, mechanical engineering works, general building works and specialist works identified by the CIDB. This will ensure legal certainty and that contractors are at all times aware of the subject of procurement and what the objectives of the projects are. In ensuring that

consistency is maintained, it is the aim that each procurement of construction works, supplies or services including professional services will reflect the same principles such as clarity, integrity, certainty, transparency, fairness and competition which in turn will reveal a relationship between the various phases in the construction procurement process. This consequently indicates that construction procurement is indeed underscored by a relational theory which should have an impact on the legal understanding of what construction procurement is

In the following chapter, the legal nature of the rules which regulate construction procurement will be examined.

## **CHAPTER 3**

### **THE LEGAL NATURE OF CONSTRUCTION PROCUREMENT RULES**

#### **1 Introduction**

The aim of this chapter is to determine the legal nature of the rules which govern the construction procurement process. In doing so, the pre-award and award stage of the process will be examined. First, the organs of state bound by section 217 of the Constitution will be established in order to determine whether the CIDB is indeed bound by the section and its applicable legislation. Next, the legal regulation of construction procurement will be discussed. Following this, the legal nature of the construction procurement process and its rules will be examined, including a discussion on how the courts should approach the interpretation of these rules. The discussion of the process will start from the invitation of tenders, registration of contractors, the procurement procedures used to award construction tenders, how these tenders are evaluated and end with the cancellation of construction tenders.

#### **2 Organs of state bound by section 217 of the Constitution and construction procurement**

As noted in chapter two, section 217(1) provides for the contracting of goods or services by organs of state in the national, provincial or local sphere of government or any other institution identified in national legislation. Section 239 of the Constitution defines an organ of state as:

- (a) any department of state or administration in the national, provincial or local sphere of government; or
- (b) any other functionary or institution-
  - (i) exercising a power or performing a function in terms of the Constitution or a provincial constitution; or
  - (ii) exercising a public power or performing a public function in terms of any legislation, but does not include a court or a judicial officer

It has been established that organs of state for purposes of section 217 are departments of state or administration in the national, provincial or local sphere of government and those institutions identified in national legislation to which section 217 applies. The Construction Industry Development Board (CIDB) is a public entity listed in Schedule 3 of the Public Finance Management Act (PFMA)<sup>100</sup> and is therefore also bound by section 217 of the Constitution. All procurement in the construction industry must therefore be done in accordance with the principles of section 217 and the legislation applicable to public procurement. Legislation which regulate procurement in general also prescribe that the specific prescripts of the CIDB apply to construction procurement alongside the general legislation.<sup>101</sup>

### 3 The legal regulation of construction procurement

As noted in chapter two, in addition to general public procurement legislation, the Construction Industry Development Board (CIDB) Act<sup>102</sup> and its Regulations<sup>103</sup> have specifically been enacted for the regulation of the construction industry, including construction procurement. The Act establishes the Construction Industry Development Board which is responsible for *inter alia* the promotion of procurement reform and creating

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<sup>100</sup> 1 of 1999.

<sup>101</sup> See PFMA Supply Chain Management (SCM) Treasury Regulation 16A6.3 (a)(ii) and MFMA Municipal Supply Chain Management Regulation 1 which include the CIDB Act under the definition of “other applicable legislation”.

<sup>102</sup> 38 of 2000.

<sup>103</sup> Construction Industry Development Regulations Government Notice (GN) R8986 in Government Gazette (GG) 31603 of 14-11-2008.

uniformity in procurement procedures.<sup>104</sup> The CIDB is empowered in terms of sections 4(c) and 5(4) of the CIDB Act to create a Code of Conduct in terms of which all parties involved in construction procurement must act as well as best practice<sup>105</sup> for the regulation of construction procurement. The CIDB has published a Standard for Uniformity in Construction Procurement<sup>106</sup> in which these best practice guidelines are included. The Standard for Uniformity is aimed at standard and uniform construction procurement practice as provided for in section 4(c) of the CIDB Act.

The objects of the CIDB are *inter alia* to improve public sector delivery management, promote best practice and performance of public sector clients and promote uniform application of policies in the construction industry throughout all spheres of the government.<sup>107</sup> The CIDB thus performs a public function in terms of legislation. Therefore, all actions taken by the CIDB, including decisions taken in terms of the best practice guidelines may be taken on judicial review.<sup>108</sup>

The Standard for Infrastructure Procurement and Delivery Management (SIPDM) was published in 2016 for the regulation of construction procurement. The above depiction of the law applicable to construction procurement therefore indicates that it is regulated by classical public procurement law with sector specific rules to enhance the process of procurement in the construction industry.

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<sup>104</sup> See s 5(1)(a)(vii)-(viii) of the Act.

<sup>105</sup> Defined in s 1(a) of the Act as “a desirable or appropriate standard, process, procedure, method or system in relation to the delivery process and the life cycle of fixed assets.”

<sup>106</sup> Published in GG 33239 of 28-05-2010.

<sup>107</sup> See s 4(c)(iv), s 4(d) and s 4(e) of the CIDB Act.

<sup>108</sup> For a detailed discussion on judicial review of state commercial activity see G Quinot *State Commercial Activity* (2009); “Towards effective judicial review of state commercial activity” (2009) 3 *TSAR* 436-449.

## 4 The legal nature of the construction procurement process

In this section, the legal nature of the pre-award and award stage of the construction procurement process will be examined.

### 4 1 Pre-award stage

The construction procurement process is regulated by CIDB prescripts<sup>109</sup> and the new Standard for Infrastructure Procurement and Delivery Management. The Standard states that the “control framework” for the procurement process indicates how it should be managed and consists of various gates<sup>110</sup> and stages.<sup>111</sup> In other words, it indicates what the process for the construction procurement process is. The process is divided into nine stages. After project initiation,<sup>112</sup> infrastructure planning,<sup>113</sup> strategic resourcing,<sup>114</sup>

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<sup>109</sup> CIDB Standard for Uniformity, Code of Conduct, various best practice guidelines and practice notes.

<sup>110</sup> This is defined as “a control point at the end of a process where a decision is required before proceeding to the next process or activity.” See SIPDM para 2.1 at 3.

<sup>111</sup> A stage is defined as “a collection of logically related activities in the infrastructure delivery cycle that culminates in the completion of a major deliverable.” SIPDM para 2.1 at 5. A major deliverable is not defined.

<sup>112</sup> This is said to entail “an initial report which outlines the high-level business case (not defined in the Standard) together with the estimated project cost and proposed schedule for a single project or a group of projects having a similar high-level scope.” SIPDM Table 1 at 9. This process is complete when the initiation report has been accepted. SIPDM para 4.1.2.5 at 10.

<sup>113</sup> This entails “an infrastructure plan which identifies and prioritises projects and packages against a forecasted budget over a period of at least five years.” SIPDM Table 1 at 9. A package is defined as “work which is grouped together for delivery under a single contract or an order.” SIPDM para 2.1 at 4

<sup>114</sup> Meaning “a delivery and/or procurement strategy which, for a portfolio of projects, identifies the delivery strategy in respect of each project or package and, where needs are met through own procurement system, a procurement strategy.” SIPDM Table 1 at 9. A portfolio is defined as a “collection of projects or programmes and other work that are grouped together to facilitate effective management of that work to meet a strategic objective.” SIPDM para 2.1 at 4. A programme is in turn defined as “the grouping of a set of related projects in order to deliver outcomes and benefits related to strategic objectives which would not have been achieved had the projects been managed independently.” An order is “an instruction to provide goods, services or any combination thereof under a framework agreement.” A framework agreement is defined as “an agreement between an organ of state and one or more contractors, the purpose of which is to establish the terms governing orders to be awarded during a given period, in particular with regard to price and, where appropriate, the quantity envisaged.” SIPDM para 2.1 at 3. A procurement strategy is then defined as “selected packaging, contracting, pricing and targeting strategy and procurement procedure for a particular procurement.” SIPDM para 2.1 at 4.

prefeasibility,<sup>115</sup> preparation and briefing<sup>116</sup> take place, feasibility,<sup>117</sup> concept and viability<sup>118</sup> occurs, and is followed by design development,<sup>119</sup> design documentation which entails determining production information,<sup>120</sup> manufacture, fabrication and construction information,<sup>121</sup> followed by the works which are those that are capable of being occupied or used.<sup>122</sup> After this, handover takes place which means that it has been taken over by the user or owner and a complete record of information has been given. The package is then complete which means that any defects have been corrected, the final account has been settled and the “close out report” has been issued.<sup>123</sup> A procuring organ of state may add additional stages to the process as it deems necessary.<sup>124</sup>

From the process described above, it can be seen that the construction procurement process set out in the SIPDM is rather convoluted and complex. Reference is made to words and definitions not used or found in general public procurement law. A “gate” for example, is generally a point in the process at which a decision must be made to continue with the following step in the process or not. The use of this term therefore seems

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<sup>115</sup> This refers to a report “which determines whether or not it is worthwhile to proceed to the feasibility stage.” SIPDM Table 1 at 9.

<sup>116</sup> This is “a strategic brief which defines project objectives, needs, acceptance criteria and client priorities and aspirations, and which sets out the basis for the development of the concept report for one or more packages.” SIPDM Table 1 at 9.

<sup>117</sup> This is “a report which presents sufficient information to determine whether or not the project should be implemented.” SIPDM Table 1 at 9.

<sup>118</sup> This entails “a concept report which establishes the detailed brief, scope, scale, form and control budget, and sets out the integrated concept for one or more packages.” SIPDM Table 1 at 9.

<sup>119</sup> This involves a report “which develops in detail the approved concept to finalise the design and definition criteria, sets out the integrated developed design, and contains the cost plan and schedule for one or more packages.” SIPDM Table 1 at 9.

<sup>120</sup> This consists of production information “which provides the detailing, performance definition, specification, sizing and positioning of all systems and components enabling either construction (where the constructor is able to build directly from the information prepared) or the production of manufacturing and installation information for construction.” SIPDM Table 1 at 9.

<sup>121</sup> Manufacture, fabrication and construction information together entail manufacture, fabrication and construction information “produced by or on behalf of the constructor, based on the production information provided for a package which enables manufacture, fabrication or construction to take place.” SIPDM Table 1 at 9.

<sup>122</sup> Works refers to “completed works which are capable of being occupied or used.” SIPDM Table 1 at 9.

<sup>123</sup> See SIPDM Table 1 at 9. A defect is defined as “non-conformity of a part or component of the works to a requirement specified in terms of a contract.” SIPDM para 2.1 at 3.

<sup>124</sup> SIPDM para 4.1.1.7 at 9.

somewhat superfluous. By the same token, the word “stage” is unnecessarily complex for what appears to be merely a stage in the procurement process where a number of activities are performed in order to continue with the next phase and is very simply described by the Oxford Dictionary as “a point, period, or step in a process or development; a section of a journey or race”.

When it comes to interpreting words that are not as simple or straight forward as the words “stage” or “gate”, the courts may need to turn to the law of interpretation to assist. The Interpretation Act<sup>125</sup> provides that it is applicable to the interpretation of every law as defined by the Act. Section 2 of the Act in turn defines “law” as “any law, proclamation, ordinance, Act of Parliament *or other enactment having the force of law*” (own emphasis). The SIPDM was published in the form of an Instruction Note by National Treasury, therefore, it has the force of law.<sup>126</sup> The Standard thus constitutes a “law” for purposes of the Interpretation Act.<sup>127</sup> The significance of this is that courts may be confronted with having to interpret the various stages and as a result, the technical terminology of the construction procurement process as described in the SIPDM in order to determine

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<sup>125</sup> 33 of 1957.

<sup>126</sup> Devenish writes that words in any legal document or statute must be given a legal meaning and in order to do so, those words must always be read in their context. They can never have an acontextual meaning. He notes further that “[l]egal interpretation involves an evaluation of both linguistic and non-linguistic considerations to ascertain the meaning of words through a process of understanding.” See G E Devenish *Interpretation of Statutes* (1992) 288 – 289. Patterson in turn writes that interpretation makes understanding possible although there is often disagreement about the meaning of legal texts. See D Patterson “Interpretation in Law” (2005) 42(2) *San Diego Law Review* 685 689. He goes further in saying that understanding is a matter of being a master of a technique – the technique of argument, which lawyers use to make claims about what is true as a matter of law. In some cases, the relevant forms of argument will point to a single conclusion. However, in other instances, forms of argument conflict and when they do a tension arises which must be resolved. The process of resolving this tension is legal interpretation. Patterson (2005) *San Diego Law Review* 692, 696 – 697. De Ville writes that no understanding is possible without interpretation and that a text cannot be understood and meaning attached to it without interpretation. He notes that “[t]exts and text-analogues...do not have a meaning in and of themselves. They only have a meaning in and through the act of interpretation.” See JR De Ville *Constitutional and Statutory Interpretation* (2000) 3 – 4.

<sup>127</sup> As noted above in para 2 of this chapter, the PFMA binds the CIDB as an entity subject to its provisions. S 76 of the Act provides that National Treasury may publish regulations and instructions which concern *inter alia* the alienation, letting or disposal of state assets, the treatment of any specific expenditure, any matter that facilitates the application of the Act and any matter that may be prescribed for all institution in terms of the Act. Since the Act regulates public procurement and binds the CIDB, the Standard published as an Instruction Note by National Treasury therefore has the force of law in terms of s 76.

whether the procurement process was followed correctly. Since these words are sector-specific and not “legal terminology”, the court may have to employ the use of canons of interpretation to assist them in this task. These canons allow a court to permit expert testimony for the interpretation of technical terms with which the court may not be familiar. Interpretation of these words may also be necessary for purposes of legal certainty, clarity and precedent.

In a Constitutional Court judgment,<sup>128</sup> the court held that whatever the nature of the document to be interpreted is, consideration must be given to the ordinary rules of grammar, the context in which the words appear, the purpose at which it is directed and the material known to those who produced it.<sup>129</sup> It held further that:

“Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation.”<sup>130</sup>

This therefore serves as an indication that courts, when faced with interpretation of provisions or words not familiar to them, should make use of expert evidence.

The court in *Dexgroup (Pty) Ltd v Trustco Group International (Pty) Ltd*<sup>131</sup> confirmed this in holding that:

“[I]n interpreting any document the starting point is inevitably the language of the document but it falls to be construed in the light of its context, the apparent purpose to which it is directed *and the material known to those responsible for its production* (own emphasis). Context, the purpose of the provision under consideration and the background to the preparation and production of the document in question are not secondary matters introduced to resolve linguistic uncertainty but are fundamental to the process of interpretation from the outset.”<sup>132</sup>

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<sup>128</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA).

<sup>129</sup> Para 18.

<sup>130</sup> Para 18.

<sup>131</sup> (687/2012) [2013] ZASCA 120 (20 September 2013).

<sup>132</sup> Para 16.

Following this, the court in *Bothma-Batho Transport (Edms) Bpk v S Bothma & Seun Transport (Edms) Bpk*<sup>133</sup> held that:

“Whilst the starting point remains the words of the document, which are the only relevant medium through which the parties have expressed their contractual intentions, the process of interpretation does not stop at a perceived literal meaning of those words, but considers them in the light of all relevant and admissible context, including the circumstances in which the document came into being.”<sup>134</sup>

Therefore, when interpreting the construction procurement process, the courts should read the language of the prescripts and the SIPDM in a construction context, having regard to the purpose of the provisions and the background to the preparation and production of the documents.<sup>135</sup> This may be especially important when courts are faced with interpreting provisions of the CIDB prescripts alongside the SIPDM unless a court finds it appropriate to interpret either the CIDB prescripts or the SIPDM if contractors performed in terms of either of the two systems.<sup>136</sup> In order to ensure that the construction procurement process remains in line with section 217 of the Constitution, a court will have to not only employ the services of a technical expert but also apply the principles of teleological interpretation.<sup>137</sup>

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<sup>133</sup> (802/2012) [2013] ZASCA 176 (28 November 2013).

<sup>134</sup> Para 12.

<sup>135</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) para 18.

<sup>136</sup> See chapter 2 which highlights the contradictory nature of the CIDB prescripts and the SIPDM. De Ville notes that a provision should not be construed on its own but in the context of the entire Act. Where there is a conflict between different provisions, it must be resolved by means of harmonization. See De Ville *Constitutional and Statutory Interpretation* 142 – 143. The same approach can be used in the case of a conflict between provisions of CIDB prescripts and provisions of the SIPDM.

<sup>137</sup> du Plessis writes that “Teleological interpretation endeavours to realise the ‘scheme of values’ that informs the legal order.” See L du Plessis *Re-Interpretation of Statutes* (2002) 247. De Ville in writing about the effect of constitutional interpretation on statutory interpretation notes that the context within which a law is interpreted should include constitutional values (such as those enumerated in section 217 of the Constitution), the history of the statute, its purpose viewed in light of the aims of the Constitution (delivery of construction works through a procurement system in line with section 217), other statutes (perhaps the CIDB Act, its Regulations and other public procurement legislation), the social, political and economic context and where relevant, comparative and international law. See De Ville *Constitutional and Statutory Interpretation* 62. With regard to interpretation of a provision in light of other statutes, he notes that contextualization within a broader statutory context is of great importance. To this end, a hierarchy of norms can be identified, of which the highest is the Constitution. “In principle a norm of a higher rank can influence the interpretation of a norm of a lower rank”. De Ville *Constitutional and Statutory Interpretation* 159. The courts will therefore, in its interpretation of the norms to be complied with in the construction procurement process, take into consideration firstly, those norms in section 217 of the Constitution, those in the general public procurement legislation and those contained in the CIDB Act and its Regulations which will inform the meaning of the norms of the processes in the CIDB prescripts and the SIPDM.

Despite the complex nature of the construction procurement process, some of the descriptions attributed to the stages may be useful to those participating in the process. For example, “handover”, indicates when the construction works have been taken over by the user or owner complete with record information. This clearly indicates that the end product has been completed and that the owner has taken possession of it. The same applies to the description of “package completion” which indicates that defects have been corrected, the final account settled and the close out report has been issued. This description therefore describes the tasks which have to be complete at the end of the procurement process.

#### 4 1 1 The construction procurement process *vis-à-vis* the general public procurement process

It appears that the construction procurement tender process is similar to the general public procurement tender process. The process described above reconciles with that referred to in the Treasury Regulations which regulate Supply Chain Management (SCM) under the PFMA and Municipal Finance Management Act (MFMA).<sup>138</sup> These Regulations,<sup>139</sup> like the SIPDM provide for demand, acquisition, logistical, disposal and risk management processes to be done. The MFMA SCM Regulation 20 specifically also refers to site meetings or briefing sessions to be held where applicable as in the case of construction tenders. It would therefore appear that the construction tender process as set out in the new SIPDM is merely that required by the PFMA and MFMA, with sector specific details such as design documentation and construction information that are to be provided.<sup>140</sup>

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<sup>138</sup> 56 of 2003.

<sup>139</sup> PFMA SCM Regulation 16A6.2 and MFMA SCM Regulation 20.

<sup>140</sup> See SIPDM Table 1 at 9.

Further to this, it appears that stages two to four of the construction procurement process constitutes the feasibility stage in general public procurement. Stages five and six together form the planning stage, stage seven consists of provision of the service or product and stages eight and nine constitute the handover and contract management. Therefore, as noted above, the process is essentially the same as that used in general public procurement with additional sector specific requirements, the purpose of which may be to avoid confusion as to which activities are to be performed in a specific stage and perhaps to report in detail on the steps taken to complete the construction contract since large numbers of people and amounts of money are involved in delivering construction works, making construction procurement an important and high risk process.

Since it has been established that construction procurement law is general public procurement law with sector specific rules, a call for a construction tender is treated in the same manner as a tender under general public procurement law. This means that a call for a construction tender, is merely an offer to treat and the submission of a tender does not amount to the conclusion of a contract. Only upon acceptance of a tender and communication of such acceptance, does a contract come into being.<sup>141</sup> Due to the fact that tenders are of an administrative law nature, administrative law rules will be applicable prior to the conclusion of a contract between the procuring organ of state and the winning tenderer. After the conclusion of the contract, the normal private law of contract applies. It will be argued in this dissertation that a nuanced form of contract law, namely relational procurement law should apply throughout the procurement process and after the conclusion of the contract. However, for purposes of this chapter, the law as it applies (at 14 November 2017) will be discussed.

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<sup>141</sup> P Bolton *The Law of Government Procurement in South Africa* (2006) 14 – 16.

In order for construction contractors to contract with government, they must register their financial and works capability and their past experience on the Register of Contractors found on the CIDB website.<sup>142</sup> This serves as an indication to the CIDB as the procuring organ of state, which contractors are capable of performing efficiently. The court in *Intsimbi Industrial Manufacturing CC v The Municipal Manager of the Nelson Mandela Metropolitan Municipality*<sup>143</sup> held that the object which the registration requirement seeks to achieve is to verify the details of any tenderer and is therefore fundamental to the proper regulation of the municipality's procurement process.<sup>144</sup> The court held further that:

“Clearly the need for registration...satisfies an important requirement. That of making sure that work or projects that are to be undertaken for the benefit of the citizens...are undertaken by suitable entities. For example not by service providers who are not tax compliant or have been prohibited from doing business within the public sector. This, in my view is in keeping with section 217(1) of the Constitution.”<sup>145</sup>

In *MEC for Public Works and Infrastructure, Free State Provincial Government v Mofomo Construction CC*<sup>146</sup> the court acknowledged the working of the prescripts of the CIDB in construction procurement. The court held that advertisements for construction tenders should be placed on the CIDB website as required by CIDB prescripts and that an advertisement in the Government Tender Bulletin was not mandatory. It held that the mere fact that a public tender was not invited by way of advertisement in the Government Tender Bulletin does not mean that a competitive process was not followed. The court is correct in noting that calls for construction tenders must be advertised on the CIDB website as stipulated in Regulation 24 to the CIDB Act. However, this Regulation also states that such advertisement must be done in accordance with the PFMA Regulations, MFMA SCM Regulations<sup>147</sup> and the Standard for Uniformity in Construction Procurement.

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<sup>142</sup> [www.cidb.org.za](http://www.cidb.org.za).

<sup>143</sup> (1961/2012) [2015] ZAECPEHC 64 (13 November 2015).

<sup>144</sup> Para 43.

<sup>145</sup> Para 43.

<sup>146</sup> (A138/2016) [2016] ZAFSHC 196 (24 November 2016).

<sup>147</sup> Regulation 22(1)(a) indicates that a public advertisement must be included in a newspaper circulating locally, the website of the municipality or in another appropriate way. It states further that the procuring entity

Regulation 16A6.3(c) of the PFMA SCM Regulations provides that invitations for tenders should at least be advertised in the Government Tender Bulletin for a minimum of twenty-one days before the date of closure.<sup>148</sup> An advertisement in the Bulletin is as a result mandatory and not correctly interpreted by the court.

Regulations 21(a)(iii) of the MFMA SCM Regulations stipulates that a supply chain management policy must determine the criteria according to which tender documentation for a competitive tender process must comply. The documentation must take into consideration the requirements of the CIDB in the case of a construction contract. Similarly, Regulation 16A6.3(a)(ii) of the PFMA Regulations for SCM provides that an accounting officer must ensure that tender documentation and the general conditions of contract are in accordance with the prescripts of the CIDB in the case of a construction tender. Therefore, the requirements of the PFMA, MFMA and the CIDB prescripts must align in order to comply with requirements for advertising a call for a construction tender.

After contractors register on the relevant database and receive an invitation to tender, they may submit tenders for contracts advertised by organs of state. In submitting a tender, compliance with certain criteria is required. These criteria are referred to as qualification criteria. In relation to this the court in *Afriline Civils (Pty) Ltd v Minister of Rural Development and Land Reform and Another; In re: Asla Construction (Pty) Ltd v Head of the Department of Rural Development and Reform and Another*,<sup>149</sup> noted that:

“An established legal principle is that non-compliance with specifications, prescripts, requirements or conditions included in a tender document would render a tender unacceptable or non-responsive and liable to disqualification from the further tender

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may include an advertisement in the Government Tender Bulletin. It is therefore not mandatory to do so in terms of these Regulations.

<sup>148</sup> The only exception permitted is in urgent cases where tenders may be advertised for a shorter period as the accounting officer deems appropriate.

<sup>149</sup> 2016 3 All SA 686 (WCC).

process. If unacceptable or non-responsive tender or tenders were to be further considered despite failing to comply with and/or conform to mandatory requirements, then certainly the consequences would be that the tender process as a whole is not transparent as required by the provisions of the PPPFA and [s]ection 217(1) of the Constitution...The common cause is that the requirements relating to the Tax Clearance Certificates and the CIDB registration remain mandatory requirements and therefore non-compliance therewith would translate to the invalidity of the tender or tenders.”<sup>150</sup>

In *Umso Construction (Pty) Ltd v Member of the Executive Council for Roads and Public Works Eastern Cape Province and Others*,<sup>151</sup> the tender submitted by the Appellant Umso Construction (Pty) Ltd was found to be non-responsive based on non-compliance with tender conditions. It was alleged that the Appellant did not have the required prior experience required to perform the work advertised.

Once tenders are received, they are opened and each offer is recorded. The procuring organ of state and its various committees<sup>152</sup> determine the completeness of the tenders and whether they are responsive.<sup>153</sup> The responsive tenders are then evaluated by means of using various procurement procedures which will be discussed next.

#### 4.2 Award stage

The procedures used to award tenders in the public procurement process are largely the same the world over. In the South African construction industry, the same procedures are used along with additional procedures to provide for additional factors or requirements for

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<sup>150</sup> Paras 16 – 17 and 21.

<sup>151</sup> (20800/2014) [2016] ZASCA 61 (14 April 2016).

<sup>152</sup> These are the bid specification committee, bid evaluation committee and the bid adjudication committee.

<sup>153</sup> A responsive or acceptable tender is defined in s 1 of the Preferential Procurement Policy Framework Act 5 of 2000 as “any tender, which in all respects, complies with the specifications and conditions of tender as set out in the tender document.”

construction projects. What follows is a discussion of how construction procurement procedures differ from general procurement procedures and what their legal nature is.

#### 4 2 1 Procurement procedures in construction procurement *vis-à-vis* general procurement

In general public procurement, mainly five different procedures are used. These are open tendering, restricted tendering, request for proposals, request for quotations and competitive negotiation.<sup>154</sup> These procedures are also used in construction procurement and are merely referred to differently or have certain nuances. Construction procurement procedures resort under three main procedures. These are the negotiation procedure, competitive selection which branches into various sub-procedures<sup>155</sup> and lastly the competitive negotiation procedure which may take various forms. The only procedures which appear to be unique to the construction procurement process as opposed to general procurement are the proposal procedure with a two-envelope or two-stage system. These two procedures are used where functionality is an important factor in the project to be undertaken. In the two-envelope procedure, tenderers are requested to submit a technical proposal (first envelope) which demonstrates their technical ability to perform the work required. Those tenderers which achieve a minimum score (stated in the call for proposals) for their technical proposals will be considered further based on their financial proposal (second envelope). This procedure is of course used for high value contracts.

Similarly, in the two-stage procedure, tenderers are requested to submit technical proposals only. Those who comply with the threshold for technical ability will be requested

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<sup>154</sup> For a detailed description on each of these procedures see A Anthony *The Legal Regulation of Construction Procurement in South Africa* LLM thesis University of Stellenbosch (2013) 65-106.

<sup>155</sup> These are the nominated procedure, open procedure, qualified procedure, quotation procedure, proposal procedure with two-envelope system, proposal procedure with two-stage system and the shopping procedure. See Anthony *The Legal Regulation of Construction Procurement* 73 – 79.

to submit financial proposals or the procuring organ of state will continue to negotiate a contract with the highest scoring tenderer for technical ability.<sup>156</sup> This procedure is also used for high value, complex projects in which functionality and other technical aspects are of great importance.<sup>157</sup> The same procedures are used when procuring professional services in the construction industry.

The unique procedures used in construction procurement are indeed justified. Based on the complex and technical nature of construction projects, the construction procurement process should provide for adequate award procedures of tenders in order to ensure that capable tenderers perform work in order to achieve cost-effectiveness.

#### 4 2 2 Evaluation of construction tenders

Various methods are used to evaluate construction tenders. The first entails evaluating tenders based on price only. The second evaluates tenders on price and preference, the third on price and functionality and lastly tenders are evaluated based on price, preference and functionality. The correct manner of evaluation is the fourth method where price, preference and functionality are evaluated. This is prescribed by the PPPFA and cannot be amended by the CIDB.<sup>158</sup>

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<sup>156</sup> Regulation 24 of the MFMA SCM Regulations provides for negotiation to take place with preferred tenderers. The provision allows for negotiation of final terms of a contract provided that it does not allow the preferred tenderer a second or unfair opportunity, the negotiations must not be to the detriment of any other tenderer and lastly it must not lead to a higher tender than that which was submitted.

<sup>157</sup> Regulation 25 of the MFMA SCM Regulations provides for a two-stage bidding process similar to that used in the construction industry. The Regulation indicates that two-stage bidding is permitted in the case of large, complex projects, instances where it may be undesirable or impossible to complete technical proposals for a tender or in the case of long-term projects such as construction contracts. Technical proposals are invited first, after which financial proposals can be submitted. This is in line with the procedures used in the construction industry.

<sup>158</sup> The specific role of functionality in the valuation of tenders will be discussed in detail in chapter 6.

After tenders are evaluated, they are ranked from highest to lowest scoring, after which a risk analysis on the possible winning tenderer is performed. After this is completed, the procuring entity must compile an evaluation report of the procurement process which was followed. The procedures and all criteria used must be stated and how tender offers were evaluated. The evaluation of construction tenders as required by the PPPFA will be discussed in detail in chapter six.

#### 4 2 3 Cancellation of construction tenders

The CIDB Standard for Uniformity provides that a procuring entity

“may accept or reject any variation, deviation, tender offer or alternative tender offer, and may cancel the tender process and reject all tender offers at any time before the formation of a contract. The employer shall not accept or incur any liability to a tenderer for such cancellation and rejection, but will give written reasons for such action upon written request to do so”.<sup>159</sup>

A procuring entity is further not permitted to re-advertise a tender call which substantially covers the scope of work of the initial tender advertisement within six months after it has cancelled or abandoned a tender process or has rejected all responsive tenders. However, this would be possible if only one tender was received and was returned unopened.<sup>160</sup> A possible reason for the cancellation of construction tenders has been that the work involved must be refined in order to finalise the scope of work. In such circumstances, the cause of the cancellation is normally that it was the intention of the procuring entity to test market prices in order to create suitable design and cost models.<sup>161</sup> Furthermore, funding may not be available in order to proceed with procurement and may have been caused by insufficient planning. The goods, services or works to be procured may no longer be

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<sup>159</sup> CIDB Standard for Uniformity 35 para F.1.5.1.

<sup>160</sup> CIDB Standard for Uniformity 35 para F.1.5.2.

<sup>161</sup> CIDB Practice note 18 “Cancellation of tenders” June 2009 2 para 1.

needed or the tender prices may exceed that which the procuring entity budgeted for. A further reason may be that the preferred tenderer did not submit a responsive tender, or did not tender at all or that there was insufficient competition or the belief that the tender would be re-advertised or set at a lower price due to poor advertising. A tender may also be cancelled where no responsive tenders were received.<sup>162</sup>

Some of the reasons provided by the CIDB for cancellation of construction tenders are legally sound and in line with the 2017 PPPFA Regulations.<sup>163</sup> These Regulations provide that a tender process may be cancelled only where there is no longer a need for the goods or services, there are no funds for the process, no acceptable or responsive tenders have been received and lastly where there is a material irregularity in the process. These reasons are also provided by the CIDB and are therefore in line with legislation. However, a number of the reasons provided by the CIDB for cancellation of a tender process justify further attention. The first is the provision that a procuring entity may accept or reject a tender offer, alternative tender offer or any deviation or variation of a tender offer and may cancel the tender process at any time before the formation of the contract. This appears to allow a procuring entity to firstly accept any tender offer, whether it is in keeping with tender specifications and conditions or not and also the freedom to cancel the tender process at any stage before a contract is concluded. This naturally cannot be the case as it would be procedurally unfair and not transparent. The fact that the procuring entity will not accept or incur liability for the cancellation is also not legally sound. Only where legitimate reasons (such as those in the 2017 PPPFA Regulations) for the cancellation exist, can liability be avoided. A case of cancellation based on a need for refinement of the scope of work is unjustified.

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<sup>162</sup> CIDB Practice note 18 2 para 1.

<sup>163</sup> Published in GG 40553 of 20-01-2017.

The competitive selection procurement procedure provides for an advertisement for expressions of interest or proposals which give tenderers an opportunity to create tender specifications themselves, thereby refining the scope of work to be stated in the call for tenders. Therefore a way to avoid cancellation in this instance is provided. Where a tender process is cancelled because the preferred tenderer did not submit a tender or did not submit a responsive tender, it is clear that the procuring entity already earmarked a winning tenderer which is procedurally unfair and therefore unlawful. By the same token, cancellation based on the belief that the tender will be re-advertised due to poor advertising is indicative of the intention to draw specific tenderers, thereby earmarking the possible winning tenderer. These reasons for cancellation of the construction tender process should therefore be excluded entirely.

## **5 Conclusion**

Section 217(1) of the Constitution provides that the section is applicable to all organs of state as defined in section 239. Section 239 in turn states that organs of state are *inter alia* those identified in national legislation to which section 217 applies. This legislation is the PFMA. The CIDB is a public entity listed in Schedule 3 to the PFMA and as such is an organ of state for purposes of section 217 of the Constitution. All procurement in the construction industry, in other words, construction procurement must comply with the principles in section 217 and all legislation applicable to the section.

In addition to this, the PFMA and MFMA make reference to requirements of the CIDB which must be complied with in a public procurement process. The CIDB Act empowers the CIDB to publish best practice guidelines to steer the construction procurement

process. National Treasury has also published a new Standard for Infrastructure Procurement and Delivery Management which sets out the construction procurement process to be followed. Construction procurement is therefore regulated by section 217 of the Constitution, the PFMA and its Regulations, the MFMA and its Regulations, all other legislation applicable to public procurement, the CIDB Act and its Regulations and any prescripts issued by the CIDB as well as the SIPDM. The construction procurement process is therefore quite fragmented and complex in its regulation. The words and definitions used to describe the process are both simple and complex at the same time. In some instances, simple words are given unnecessarily complex definitions. In order to determine the legal nature of the process, the normative framework of construction procurement must be examined. Interpretation of the provisions is thus called for.

The Interpretation Act defines a law as *inter alia* an enactment having the force of law. The CIDB prescripts and the SIPDM therefore constitute law for purposes of the Interpretation Act. This means that the courts when faced with interpretation of the construction procurement process may make use of the various canons of interpretation available to them. Since the construction procurement process is a technical and complex one, the courts may be confronted with terminology not familiar to them in their quest to determine whether the process was followed correctly or whether provisions of construction procurement laws were complied with. As noted by legal interpretation scholars, words in a legal document must be given legal meaning and must be given such meaning within context.

The Constitutional Court has further held that when a document must be interpreted, consideration must be given to the ordinary rules of grammar, the context in which the

words appear, the purpose of the words and the material known to those who produced it. However, in giving legal meaning to words, regard must be had to the temptation to substitute what the courts regard as reasonable or businesslike for the words actually used. Therefore, based on the technical nature of the construction procurement process, use must be made of technical expert evidence to assist the court in its endeavour. The Supreme Court of Appeal has emphasized that importance of contextual interpretation and the purpose of a provision in attributing meaning to words.

It is also important when interpreting construction procurement provisions to consider not only a contextual, but also a teleological interpretation. This means that a value-based interpretation must be given to the provisions. It has been noted that the context within which provisions are interpreted must include constitutional values, such as those of fairness, equity, transparency, competition and cost-effectiveness in section 217 of the Constitution. In addition to this, the provisions should be interpreted in light of a broader statutory context. In other words, the PFMA, MFMA, CIDB and all other public procurement legislation must be considered in giving meaning to construction procurement provisions. The norms found in these statutes will inform the meaning of those in the CIDB prescripts and the SIPDM which the courts may have to interpret.

It has been established that although the construction procurement process is a technical and complex one, it is essentially the same as the general public procurement process. This means that it follows the same chronological order with sector-specific details included perhaps to ensure clarity of what is expected of those participating in the process. The rules which regulate a call for construction tenders, opening of tenders, consideration,

evaluation and award of tenders are the same as those used in general public procurement.

The procurement procedures used in the construction industry are also similar to those used in general public procurement. There appears to be only one unique procedure which allows for negotiation with a preferred tenderer, after technical proposals have been received and the tenderer has achieved a minimum threshold. This procedure is justified in that construction tenders require a high degree of technical ability which at times may be more important than the price component of a tender. Therefore, much emphasis is placed on technical proposals. In the same vein, negotiation with tenderers although generally not permitted based on procedural fairness requirements, may be justified in some instances where finer technical and complex details of a tender must be determined which ultimately may influence the price at which the work is performed, thereby impacting on cost-effectiveness.

The evaluation of construction tenders is done in a similar manner to that in general public procurement. However, it differs in a choice granted to procuring entities to evaluate price alone, price and functionality without preference, or price, functionality and preference. This is not in line with the PPPFA and will be discussed in further detail in chapter six of this dissertation.

With regard to the cancellation of construction tenders, a number of reasons provided for the justification of cancellation are not legally sound. The provision that acceptance, rejection or cancellation of a tender may take place at any time before a contract is concluded is problematic. This naturally impedes procedural fairness in permitting a

procuring entity to cancel a contract without sound reasons. The fact that the entity will not incur any liability for such cancellation is also problematic. Furthermore, cancellation based on the belief that the tender will be re-advertised or because the preferred tenderer did not submit a tender or did not submit a responsive tender amounts to procedural unfairness. It indicates a clear intention to avoid a proper public procurement process and earmarking a winning tenderer. These reasons for cancellation are thus unlawful and should be excluded.

In the following chapter, an analysis of relational contract theory as a possible legal framework in which public procurement in South Africa can operate is provided.

## CHAPTER 4

### RELATIONAL THEORY AND CONSTRUCTION PROCUREMENT LAW

#### 1 Introduction

Relational contract theory was created by American legal scholars Stewart Macaulay<sup>164</sup> and Ian MacNeil who developed the theory and noted that relational contracts are a specific form of contracting, deserving of recognition as a separate form of contract.<sup>165</sup> Relational contract theory is said to be an alternative to classical or general contract law, based on social values and customs in terms of which long-term contracts should be conducted. Those who advocate MacNeil's theory are of the opinion that it better provides for the complexities of long-term contracts.<sup>166</sup> Although relational contract theory was not formally accepted into American contract law, it had a great influence on economic theory and a number of researchers support MacNeil's synthesis of relational contracts. There are also researchers who criticise MacNeil's theory. However, it will be explained in this chapter that the criticism does not render relational contract theory invalid or less convincing.

Although MacNeil and Macaulay are together regarded as the stalwarts of relational contract theory, MacNeil developed relational contract theory into the manner in which it is

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<sup>164</sup> He first published an article on relational contract theory in 1963. See S Macaulay "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28(1) *American Sociological Review* 55.

<sup>165</sup> I MacNeil *Cases and Materials on Contracts: Exchange Transactions and Relationships* (1971).

<sup>166</sup> See PJ Gudel "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763-797; J Feinman "Relational contract theory in context" (2000) 94(3) *Nw.U.L.Rev* 737-748; R Speidel "The Characteristics and Challenges of Relational Contracts" (2000) 94(3) *Nw.U.L.Rev* 823-846; D Campbell, H Collins & J Wightman *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003); C Mitchell "Contracts and Contract Law: Challenging the Distinction Between the 'Real' and 'Paper' Deal" (2009) 29(4) *Oxford Journal of Legal Studies* 675-704 and L Hawthorne "Justice Albie Sachs's contribution to the law of contract: Recognition of Relational Contract Theory" (2010) 25(1) *SAPL* 80-93.

understood and discussed in this chapter.<sup>167</sup> Diathesopoulos writes that relational contract theory is one mainly developed by MacNeil's legal theory and by Macaulay's empirical work.<sup>168</sup> Commentators after MacNeil have either supported or rejected his theory. Therefore, MacNeil remains the author who most traversed the field of relational contract theory.

In this chapter, what relational contract theory is will be discussed. Next, the influence of relational contract theory will be explained. Following this, the relationship between the law and relational contract theory will be explored, including the possible advantage relational theory may hold for construction procurement law. A comparison between classical contract law and relational contract theory will be made and following this will be an exposition of the significance and need for relational contract theory in South African law. Finally, the working of a possible relational procurement law will be analysed.

## **2 Relational contract theory<sup>169</sup>**

### **2 1 Defining relational contract theory**

Relational contract theory begins with the concept of exchange. MacNeil defines exchange as the act of giving someone a commodity with the expectation that something of value will

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<sup>167</sup> MacNeil writes that "[m]y students...all know that I invented relational contract, and I daresay Stewart Macaulay's students know that he invented relational contract." See I MacNeil "Relational Contract: What we do and do not know" (1985) *Wis.L.Rev* 483 483.

<sup>168</sup> M Diathesopoulos (2010) "Relational Contract Theory and Management Contracts: A Paradigm for the Application of the Theory of Norms" *Munich Personal RePEc Archive Paper* 1 10.

<sup>169</sup> MacNeil later referred to his theory as essential contract theory in order to distinguish it from any other relational theories. However, in this dissertation, reference will be made to relational contract theory. See I MacNeil "Contracting Worlds and Essential Contract Theory" (2000) 9(3) *Social & Legal Studies* 431-438.

be received in return.<sup>170</sup> He notes that due to the fact that our economy is based on economic exchange motivations, many of our social values are expressed in the ways in which we respond to these exchange transactions.<sup>171</sup> These exchange transactions, are often done by way of concluding contracts. MacNeil writes that a contract has four roots – society,<sup>172</sup> specialisation of labour and exchange,<sup>173</sup> choice<sup>174</sup> and an awareness of the future.<sup>175</sup> At first, Macaulay<sup>176</sup> defined “contract” in 1963 as the (a) rational planning of a transaction with careful provision for as many future possibilities or contingencies as possible and (b) existence or use of actual or potential legal sanctions to ensure performance or to compensate for non-performance. MacNeil later defined a contract as:

“[T]he relations among parties to the process of projecting exchange into the future. A sense of choice and an awareness of future regularly cause people to do things and to make plans for the future. When these actions and plans relate to exchange, it is projected forward in time. That is, some of the elements of exchange, instead of occurring immediately, will occur in the future. This, or rather the relations between people when this occurs, is what I mean by contract.”<sup>177</sup>

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<sup>170</sup> MacNeil *Cases and Materials on Contracts* 1.

<sup>171</sup> MacNeil *Cases and Materials on Contracts* 1.

<sup>172</sup> MacNeil writes that the basis of contract is society. From society arises common needs, languages and norms needed to form the basis of a contract. He notes that exchange in any meaningful economic sense is impossible without society since society is the provider of a means of communication, a system of order which allows parties to exchange, a system of money and lastly an effective enforcement mechanism. See I MacNeil *The New Social Contract: An Inquiry into Modern Contractual Relations* (1980) 1 and 11.

<sup>173</sup> MacNeil notes that specialisation entails having a specific skill and using this for the purpose of exchange. Therefore, without exchange, specialisation cannot exist. MacNeil *The New Social Contract* 2. Subsequently, MacNeil made a distinction between non-specialised and specialised exchange. The latter refers to an exchange of goods made with a specific and specialised skill. For example where a certain tribe makes wooden bowls, the other makes pottery and they exchange with one another. Non-specialised exchange occurs where there is vice-versa movement between people not resulting from a specialisation of labour. For example, if a cow is given to someone as a gift with the understanding that a cow will be given in return or a different commodity with roughly the same value. See I MacNeil “Exchange Revisited: Individual Utility and Social Solidarity” (1986) 96(3) *The University of Chicago Press* 567 570-571.

<sup>174</sup> This relates to freedom of contract – a sense of freedom of will in choosing to conclude a contract and which behaviour or norms of behaviour to consider binding within the contract. MacNeil *The New Social Contract* 3.

<sup>175</sup> As a fourth root of contract, MacNeil notes that once humans have this awareness, the potential of a contract, which involves an exchange in future, arises. See MacNeil *The New Social Contract* 3 - 4.

<sup>176</sup> See Macaulay (1963) *American Sociological Review* 56.

<sup>177</sup> MacNeil *The New Social Contract* 4. He further notes that “contract” is what denotes these relations and *the contract*, meaning the physical document, refers to an example of such relations. See I MacNeil “Relational contract theory: challenges and queries” (2000) 94(3) *Nw.U.L.Rev* 877 878 footnote 6.

## 2.2 Discrete and relational contracts

In explaining relational theory, MacNeil initially makes a distinction between discrete and relational contracts. In effect, he places general contract law or classical contract law as he refers to it and what has been named relational contract law at opposite ends of the contract law pole.<sup>178</sup> He writes that classical contract law on the one hand, prescribes a contract based on defined rules and obligations. These he describes as discrete contracts.

On the other hand, relational contracts are characterised by long-term relationships between the parties to a contract. MacNeil is of the view that human behaviour creates norms which over time become the norms on which contracts are based.<sup>179</sup> He writes that the existence of contractual relations creates an expectation that exchange will occur in future and that it will occur in predictable patterns.<sup>180</sup> He notes that just as discrete behaviour creates discrete norms, so does relational behaviour create relational norms.<sup>181</sup> Often, a large number of people are party to a relational contract.<sup>182</sup> It involves a great deal of planning, with the hope that an exchange will occur in future. There is a division of risks, benefits and obligations and encompasses an awareness of a possible conflict of interest. Due to the extended duration of the contract, not all details to the contract can be clearly defined at the time of conclusion.<sup>183</sup> It therefore requires open terms and discretion<sup>184</sup> in

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<sup>178</sup> I MacNeil "Relational Contract Theory as Sociology: A Reply to Professors Lindenberg and de Vos" (1987) 143(2) *Journal of Institutional and Theoretical Economics* 272 276. See also M Eisenberg "Why there is no law of relational contracts" (2000) 94(3) *Nw.U.L.Rev* 805 805.

<sup>179</sup> MacNeil (2000) *Nw.U.L.Rev* 879.

<sup>180</sup> MacNeil *The New Social Contract* 8.

<sup>181</sup> MacNeil (1987) *JITE* 276.

<sup>182</sup> MacNeil (1987) *JITE* 276.

<sup>183</sup> Speidel notes that an extended relationship could mean that the parties concluded a series of "spot" contracts over an indefinite period of time or it could consist of a twenty-year contract between the parties. It could also involve third parties. Therefore, "patterns of interaction and expectation develop that involve more than two people and transcend the boundaries of the traditional discrete bargain." See R Speidel "The Characteristics and Challenges of Relational Contracts" (2000) 94(3) *Nw.U.L.Rev* 823 828.

<sup>184</sup> According to Speidel, the parties to a relational contract may view their exchange as an ongoing integration of behaviour which will grow and vary as time progresses. Therefore, they may at conclusion

performance on the part of all parties. This type of contract is in MacNeil's opinion "the dominant form of exchange behaviour in society".<sup>185</sup>

In discrete contracts, limited to no relations exist. This means that there is a mere exchange of goods between two parties with no expectation of a long-term relationship. The contract is therefore of a short duration and is quickly terminated.<sup>186</sup> Furthermore, minimum co-operation is expected, no sharing of any benefits takes place and no altruism is expected.<sup>187</sup>

Walker & Davis conducted a study on contractual relationships in local authorities in the UK and discovered that the same norms in discrete or transactional contracting and relational contracting exist in the public sector as those in the private sector.<sup>188</sup> They found that aspects of the relational contracting most appreciated amongst contractors were co-operation, communication, the fact that the relationship should be seen as a joint effort and lastly that difficulties are solved by mutual co-operation.<sup>189</sup>

MacNeil notes that the term "relational" has two meanings. In the first instance, it describes the global relations in which any exchange occurs since all exchange involves some kind

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leave certain terms open or reserve a discretion to be exercised when the need arises. At the same time he warns that opportunism may occur when a party exceeds its discretion or departs from the internal norms of the contract. In such a case, where the contract does not provide for this, a court would have to intervene. The question the court is faced with will then be whether the conduct is permitted or whether breach of the contract has occurred. Speidel (2000) *Nw.U.L.Rev* 828, 838 – 839 and 823.

<sup>185</sup> I MacNeil "Reflections on Relational Contract" (1985) *Journal of Institutional and Theoretical Economics* 37 37.

<sup>186</sup> MacNeil (1987) *JITE* 275. See also I MacNeil (1981) 75(6) *Nw.U.L.Rev* 1018 1025 where he lists the differences between discrete and relational contracts. These he notes as commencement, duration and termination, measurement and specificity, planning, sharing versus dividing benefits and burdens, interdependence, future cooperation and solidarity, personal relations among and number of participants and last power between the contracting parties.

<sup>187</sup> MacNeil (1987) *JITE* 275.

<sup>188</sup> See B Walker & H Davis "Perspectives on contractual relationships and the move to best value in local authorities" (1999) 25(2) *Local Government Studies* 16 25.

<sup>189</sup> Walker & Davis (1999) *Local Government Studies* 28.

of relations.<sup>190</sup> In the second instance the term is used to indicate the opposite of discrete. In other words those exchanges which involve a large number of parties, or rather, contracts which are more relational than others. To this end, MacNeil has received criticism for placing discrete and relational contracts at opposite ends of the spectrum.

Eisenberg notes that it is important to create a workable distinction between discrete and relational contracts and not simply the number of parties involved.<sup>191</sup> He suggests that a distinguishing characteristic could be the duration of the contract and the fact that a relational contract involves a relationship and discrete contracts merely an exchange. It is submitted that neither Eisenberg nor MacNeil is incorrect when referring to these factors in defining a relational contract. A discrete contract, as defined by MacNeil is a “once-off” transaction for the purpose of exchange. There exists no expectation on the side of either party to form a relationship. An example of such a transaction could be buying an item at a shop at a local garage while traveling long distance. The parties involved are the buyer and the seller and the transaction lasts a very short period of time. An obvious defining factor in a relational contract could be the creation of a relationship and the intention of both or all parties to do so, rather than relying merely on the number of parties or the duration of the exchange.

Contrary to the above, Vincent-Jones in relying on MacNeil’s explanation of discrete contracts writes that what defines these contractual relations at the time of the conclusion of the contract is reference to the “rule book” applied by the parties themselves or by an adjudicating third party.<sup>192</sup> The “rule book” he refers to, is the set of rules prescribed by the

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<sup>190</sup> See I MacNeil “Values in contract: internal and external” (1983) 78(3) *Nw.U.L.Rev* 340 341-342.

<sup>191</sup> Eisenberg (2000) *Nw.U.L.Rev* 816.

<sup>192</sup> See P Vincent-Jones “The limits of contractual order in public sector transacting” (1994) 14 *Legal Studies* 364 366-367.

classical contract law. However, different from Macneil he notes that these contracts involve planning, the use of legal sanctions in the case of non-performance or in the event of a dispute. It is interesting to note that the author refers to discrete contracts as “relations” as opposed to MacNeil’s description. MacNeil’s relational contracts, Vincent-Jones describes as transactions that have not been contractually planned or adjusted and which therefore cannot be said to involve contractual relations. They can, however, be supported and regulated by “extra-legal normative constraints” such as customary or conventional propositions. Customary norms, he notes, are different from their conventional counterparts in that they are created internally by conscience and self-discipline, rather than externally by formal or informal social disapproval. These he names non-contractual relations. The author notes a third category, namely that of near-contractual relations which he notes are those, which at the time of creation or adjustment of the exchange, involve formal but not strictly legal processes, practices and procedures or to the “rule book”. What distinguishes near-contractual relations from non-contractual relations is that it involves obligations which derive from a planned exchange between two parties.<sup>193</sup>

It appears that Vincent-Jones’ description above categorises contracts according to firstly, discrete contracts which he regards as relational and planned. Secondly, the description of non-contractual relations is akin to a “gentleman’s agreement” and lastly he refers to near-contractual relations as relational contracts described by MacNeil. Based on the “transactional” nature of discrete contracts, Vincent-Jones’ description of discrete contracts cannot be accepted. Although these transactions are done according to the “rule book”,

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<sup>193</sup> Vincent-Jones (1994) *Legal Studies* 367. It should be noted that Vincent-Jones’ reference to contracts and contract relations is based on the public sector in Britain and not the private sector as MacNeil’s descriptions. His aim is to develop a theoretical model of the role of contract in the public transaction process. This section aims to provide an exposition of the private law of relational contract theory. The link between this theory and the public sector, specifically public procurement, will be discussed below.

they do not involve planning in the manner that relational contracts do. “Planning” in the case of discrete exchanges, as defined by MacNeil, refers to the focus on the substance of the exchange, quantity, price and payment terms and not the planning of processes for an exchange in the future.<sup>194</sup> MacNeil notes that planning is embedded in relations and post-commencement planning of relations is an obligation. This is in strong contrast with the planning of discrete contracts where the parties are free to continue the agreement or not with no ties to one another before or after the prospective agreement.<sup>195</sup> Relational contracts, are like Vincent-Jones notes, informed by customary norms and regulated by conscience and self-discipline. They are, however, planned whether in an express contract or not since both or all parties intend to create a relationship to the benefit of all involved. They can therefore not be referred to as non-contractual relations. If the definition of contract as created by MacNeil is relied on, it means that a relational contract is a process in which the exchange is projected into the future. In other words, the parties plan to exchange in future, based on their relationship which is informed by their cultural or customary norms.

It is submitted that the distinction between non- and near-contractual relations is superfluous due to the fact that relational by definition does not refer to *the* contract. In other words, a physical document is not needed to establish a relational contract. In Vincent-Jones’ description, the distinction lies in the planning aspect of the relational contract. The planning relies on the intention of the parties to the contract to exchange in the future. Relational contracts are based on this intention. Therefore, a gentleman’s agreement and a near-contractual relation essentially falls within the same category – that of relational contracts. Vincent-Jones’ contention that a gentleman’s agreement does not

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<sup>194</sup> See MacNeil (1981) *Nw.U.L.Rev* 1029. See also MacNeil (1983) *Nw.U.L.Rev* 356 where he notes that in discrete exchanges, *pacta sunt servanda* is akin to *planning est servanda*.

<sup>195</sup> See MacNeil *The New Social Contract* 26-27.

involve any planning and therefore an intention to be bound, is thus not justified. Even though his analysis is based on public sector contracts and relational contract theory originates from the private law of contract, the same norms in transactional and relational contracting are found in the public sector as in the private sector as found by Walker and Davis.<sup>196</sup>

### 2.3 Development of relational contracts

Barnett<sup>197</sup> and later, Campbell<sup>198</sup> noted that MacNeil's dual meaning of "relational" is erroneous. They note that MacNeil did not completely appreciate the complication caused by this definition. MacNeil later referred to these contracts as being intertwined so as to indicate complex and highly relational contracts on the one hand and the relational nature of all contracts on the other hand.<sup>199</sup> In other words, he later acknowledged that all contracts are, to some extent, relational but that some are more or less relational than others. He notes that even the most discrete exchange "necessarily postulates a social matrix" in which at least the following is found – a means of communication understandable to both parties, a system of order so that the parties exchange instead of kill or steal, a system of money and an effective mechanism to enforce promises where they have been made.<sup>200</sup> In illustrating this, he uses the example of filling a car with petrol at a petrol station. Except for the expectation of the driver that the garage will have petrol, and the expectation of the agent of the petrol station that the driver has some means to

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<sup>196</sup> See Walker & Davis (1999) *Local Government Studies* 16.

<sup>197</sup> RE Barnett "Conflicting Visions: A Critique of Ian MacNeil's Relational Theory of Contract" (1992) 78 *Virginia Law Review* 1175 1178.

<sup>198</sup> See D Campbell "Good Faith and the Ubiquity of the 'Relational' Contract" (2014) 77(3) *The Modern Law Review* 475 484. See also D Campbell "Ian MacNeil and the Relational Theory of Contract" (2004) 41 <[http://www.lib.kobe-u.ac.jp/handle\\_kernel/80100023](http://www.lib.kobe-u.ac.jp/handle_kernel/80100023)> (accessed 14-10-2017).

<sup>199</sup> See MacNeil (1983) *Nw.U.L.Rev.* 344. See also MacNeil *The New Social Contract* 10.

<sup>200</sup> MacNeil (1983) *Nw.U.L.Rev.* 344.

pay for the petrol, there exists no relationship between them. The transaction is short and limited in scope.

Despite this, he notes that relational elements may underlie the transaction making it a relational exchange. For example, customs may dictate that the driver does not smoke at the petrol station, that the petrol assistant cleans the windscreen of the vehicle and check the oil and water consumption of the vehicle. MacNeil notes that these are relational elements omitted from the example including brand loyalty and the use of credit cards.<sup>201</sup>

Campbell writes that MacNeil should have, from the start, distinguished between “complex” contracts and relational contracts.<sup>202</sup> The latter would describe the relational quality of all contracts. The definition of relational as suggested by Campbell and later referred to by MacNeil causes more confusion. The example used by MacNeil is in fact one of discrete exchanges as he initially described. The examples of relational elements he uses are ones which, at least in South Africa, are mandated by rules of safety or included in the work description of the petrol assistant, therefore it is in line with the “rule book”. Such an exchange therefore squarely falls within the realm of discrete exchanges as referred to by MacNeil. Another example of a discrete exchange could be the purchase of goods from a grocery store where the expectation is to buy goods in exchange for monetary payment. This can possibly be distinguished from a customer who buys goods from the same grocery store due to his/her preference of products, good service or an established relationship with the shop assistant who acts on behalf of the store.

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<sup>201</sup> MacNeil (1983) *Nw.U.L.Rev* 345.

<sup>202</sup> Campbell (2004) <[http://www.lib.kobe-u.ac.jp/handle\\_kernel/80100023](http://www.lib.kobe-u.ac.jp/handle_kernel/80100023)> 41.

The manner in which MacNeil developed relational contract theory is from making a strict distinction between discrete and relational contracts by attempting to identify a distinguishing factor, to discovering that all contracts are in fact relational to some extent. In other words, he now places discrete and relational exchanges or contracts on the common norm continuum. In other words, all contracts, whether discrete or relational ascribe to common contract norms. Depending on the context of the exchange, one will move to one side or the other of the continuum in order to determine which contract norms are applicable. Therefore, he no longer makes a strict distinction between discrete and relational. The variation lies in the intensity of relational norms which are applicable. To this end, MacNeil writes that:

“[T]hey do not necessarily blossom fully in all contractual relations at all times. Contractual relations fall along a ‘success spectrum’. Those contractual relations operating effectively will reveal the common contract norms in robust condition, while those in varying degrees of trouble will reveal the common contract norms in varying degrees of disarray, both as they affect contract behaviour and as they affect the internal rules and principles of that behaviour.”<sup>203</sup>

This is a clearer analysis of relational contracts rather than placing relational and complex contracts at opposite ends of the relational pole.

## 2.4 Discrete and relational contract norms

MacNeil’s view that human behaviour gives rise to contractual norms has led to his identification of nine common contract norms. He notes that contract behaviour cannot exist without these common contract norms. In the event that the common contract norms

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<sup>203</sup> MacNeil (1983) *Nw.U.L.Rev* 351-352. In referring to trouble, MacNeil writes that contractual relations create an awareness that trouble *may* arise. In large, long-term relations it is accepted that trouble *will* arise. This awareness leads to planning to deal with trouble when it arises. This is distinguishable from discrete contracts which are supposedly trouble free. See MacNeil *The New Social Contract* 31. However, where trouble does occur in discrete transactions, it should be entirely planned ahead with no open-ended remedies. MacNeil *The New Social Contract* 62.

which underlie discrete or relational norms disappear, contract behaviour will disappear.<sup>204</sup> These common norms include role integrity,<sup>205</sup> mutuality,<sup>206</sup> implementation of planning, effectuation of consent,<sup>207</sup> flexibility,<sup>208</sup> contractual solidarity, linked norms: restitution, reliance and expectation interests,<sup>209</sup> creation and restraint of power,<sup>210</sup> harmonisation with the social matrix<sup>211</sup> and later propriety of means was added.<sup>212</sup>

In the case of discrete exchanges, implementation of planning and effectuation of consent are most prevalent. This is due to the fact that discrete exchanges are consent-oriented and efficiency driven.<sup>213</sup> MacNeil notes that whenever discrete transactions occur, the discrete norms describe how people behave and how they should behave. Discrete transactions are “the product of great magnification” of implementation of planning and consent.<sup>214</sup> As these norms are a result of intensified discrete transactions, so too is presentation a result thereof. Discreteness, as MacNeil describes it, “is the separating of a

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<sup>204</sup> MacNeil (1983) *Nw.U.L.Rev* 355. He writes that “[r]elative dearth of the discrete or the relational norms does not destroy contractual relations. Rather, dearth of the discrete or relational norms causes, respectively, the relation to become less discrete (more relational) or less relational (more discrete).”

<sup>205</sup> This norm has three further aspects namely, consistency required by each party who plays a role in a contract, conflict which arises because of the desire to maximise immediate selfish gains and maintaining social solidarity with other participants to the contract. Lastly, complexity which exists because of the conflict aspect of contracts. MacNeil *The New Social Contract* 40 - 44.

<sup>206</sup> Later referred to as “reciprocity”. See MacNeil (1983) *Nw.U.L.Rev* 347 footnote 19. Mutuality or reciprocity occurs only when all parties will benefit from the future exchange. It calls for what MacNeil terms “evenness” between parties based on contractual solidarity. MacNeil *The New Social Contract* 44 – 47.

<sup>207</sup> This relates to the exercise of choice which may include sacrificing other opportunities by agreeing to conclude a contract. MacNeil *The New Social Contract* 47 – 50.

<sup>208</sup> Meaning flexibility between parties to the contract. MacNeil *The New Social Contract* 50 – 52.

<sup>209</sup> These three norms operate together in order to perform obligations and bring contract goals to fruition. MacNeil *The New Social Contract* 52 – 56.

<sup>210</sup> This concerns the power that is transferred between parties when they enter into a contract and the restraint of that power. MacNeil *The New Social Contract* 56 – 57.

<sup>211</sup> MacNeil *The New Social Contract* 40. In explaining this norm, MacNeil writes that “[w]hatever the norms of that society must become at least partially the norms of the contracts occurring within it. These norms are particularistic to the extent the societies differ.” MacNeil *The New Social Contract* 58.

<sup>212</sup> MacNeil (2000) *Nw.U.L.Rev* 879-880. Vincent-Jones describes this norm as “placing constraints on the ways in which ends may legitimately be achieved.” See P Vincent-Jones *The New Public Contracting* (2006) 5. MacNeil notes that these common contract norms or “categories of behaviour” conflict in many ways and also overlap in many ways but some basic level of compliance is required in the case of each norm, otherwise the relations will cease to exist. See I MacNeil “Contract Remedies: A Need for Better Efficiency Analysis” (1988) 144(1) *Journal of Institutional and Theoretical Economics* 6 7-8 and Vincent-Jones *The New Public Contracting* 5.

<sup>213</sup> MacNeil (1983) *Nw.U.L.Rev* 359.

<sup>214</sup> MacNeil *The New Social Contract* 59-60.

transaction from all else between the participants at the same time and before and after.”<sup>215</sup> Presentation, is bringing the future into the present.<sup>216</sup> Discreteness and presentation are not the same concepts despite the fact that they merge in discrete contracts.<sup>217</sup> However, underlying both is 100% planning of the future. Only if the future is 100% planned, can a transaction be regarded as discrete. If this is the case, we know that the future (presentation) will occur. Both discreteness and presentation depend on 100% consent and planning which should occur only through formal and specific communication.<sup>218</sup>

Discrete exchanges require the exclusion of relational values because it focusses on money and “easy-to-quantify” subjects of exchange, it does not recognise the identity of the parties involved and it uses precise promise as its cornerstone.<sup>219</sup> These values may conflict with those of relational exchanges. However, the two primary values of discrete exchanges – planning and consent – must be measured against all other contract values, but will be vitally affected by the presence of the discrete norms. MacNeil notes that other contract norms are in fact maintained in discrete transactions.<sup>220</sup> This is in line with his assertion that all contracts have at least some relational aspects. These are role integrity evidenced by the parties acting within the rules of the law, reciprocity in the mutual consent process and flexibility not within the discrete transaction but outside it in the repeated use of a number of discrete transactions. Contractual solidarity is maintained through the external force of the law of contract and propriety of means is maintained where the discrete norm prevails by whatever the parties consent to in the agreement

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<sup>215</sup> 60. MacNeil writes that contract relates to the process of projecting exchange into the future. It is this projection of exchange which is brought into the present and referred to a presentation. It is in line with MacNeil’s common contract norm of planning in discrete contracts which refers to the substance or entity to be exchanged and the price thereof. See MacNeil *The New Social Contract* 4 and 60.

<sup>216</sup> 60.

<sup>217</sup> 60.

<sup>218</sup> 60-61.

<sup>219</sup> MacNeil (1983) *Nw.U.L.Rev* 360.

<sup>220</sup> MacNeil (1983) *Nw.U.L.Rev* 360.

process.<sup>221</sup> Lastly, the discrete norms must be harmonised with the social matrix since it can be implemented only if the larger society in which it takes place is willing to allow implementation.

MacNeil notes that all contract norms are important for exchange to occur successfully. However, some may become exaggerated relative to others.<sup>222</sup> Such exaggeration may greatly alter the nature of other contract norms. As a whole, the common contract norms are equivocal and the only conflicting norm is the absence of some relational norms in the case of discrete exchanges.<sup>223</sup>

Along with this “normative structure”<sup>224</sup> MacNeil uses, he makes a distinction between internal and external norms. Internal norms are those which parties to a contract decide they will be bound by and are included in the contract. External norms are those considered important by the surrounding environment in which the parties to the contract operate. For example those of the specific industry involved.<sup>225</sup> Often, internal and external norms may merge. MacNeil uses the example where parties, who consider legal remedies for breach of a sales contract to be important (external norms), incorporate these into their contract. These norms therefore become internal.<sup>226</sup> Further examples of external norms are those imposed by the government legal system and socially reinforced habit and institutional behavioural patterns.<sup>227</sup> Therefore, three classes of contract norms exist: common contract norms, discrete norms (resulting from discrete behaviour patterns) and

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<sup>221</sup> MacNeil (1983) *Nw.U.L.Rev* 361.

<sup>222</sup> MacNeil (1983) *Nw.U.L.Rev* 365-366.

<sup>223</sup> MacNeil (1983) *Nw.U.L.Rev* 366.

<sup>224</sup> As referred to by J Feinman “Relational contract theory in context” (2000) 94 (3) *Nw.U.L.Rev* 737 742.

<sup>225</sup> Feinman (2000) *Nw.U.L.Rev* 742. He defines external norms as those which “include values of the society defined by law that may or may not be reflected in the particular relation...relevant external norms include customs of an industry or other relevant group, rules of a trade association or professional organization, and norms generated by any group intersecting with the relation at issue.”

<sup>226</sup> MacNeil *The New Social Contract* 36.

<sup>227</sup> MacNeil *The New Social Contract* 37.

relational norms (resulting from relational behaviour).<sup>228</sup> A further classification of norms exists – internal and external. MacNeil writes that common contract norms are essential to any contractual behaviour and become rules which “are” and rules which “ought to” be applicable. They are therefore principles of “right action”.<sup>229</sup> He then notes that:

“Given the intertwining of these norms in behaviour, principle, and rule, they encompass the two merged value-arenas of contract behaviour and internal principles and rules. The common contract norms are then, in my view, *the* values in the internal (as opposed to external) arenas of contracts whether the contracts are discrete or relational.”<sup>230</sup>

Feinman notes that the use of a normative structure in contracts leads to a rejection of doctrinal method as traditionally used in favour of a more policy-like analysis of contracts.<sup>231</sup> He succinctly says that:

“In analyzing a relation, we find facts that, when seen through the structure of norms internal and external to the relation, suggest that the law ought to reach a certain result. This analysis is aimed at determining the benefits of acting in a certain way, however, not at formulating rules or principles that dictate results independent of the norms.”<sup>232</sup>

He suggests that the substantive core of relational contract theory is based on the proposition that contract essentially concerns co-operative social behaviour and that relational contracts are the dominant forms of contract. This suggests that there is a minimum obligation required from parties to a contract that arises from contract norms. This is not the case in general or classical contract law. Therefore, relational contract theory should be considered an alternative to general contract law.<sup>233</sup>

In addition to the above norms, MacNeil writes that relational contract theory is based on four core propositions. First, every transaction is embedded in complex relations. Second,

<sup>228</sup> MacNeil (1983) *Nw.U.L.Rev* 346.

<sup>229</sup> MacNeil (1983) *Nw.U.L.Rev* 346.

<sup>230</sup> MacNeil (1983) *Nw.U.L.Rev* 347 (original emphasis).

<sup>231</sup> In this sense, he refers to doctrine as rules and standards of contract law and policy as a more discretionary form of analysis. Feinman (2000) *Nw.U.L.Rev* 743.

<sup>232</sup> Feinman (2000) *Nw.U.L.Rev* 743.

<sup>233</sup> See Feinman (2000) *Nw.U.L.Rev* 743 – 744.

understanding any transaction requires an understanding of all the essential elements of the enveloping relations in the contract. Third, in order to effectively analyse any transaction, a recognition and consideration of all the essential elements of the relations that might affect the transaction significantly is required. Fourth, a combined contextual analysis of relations and transactions is more efficient and produces a more complete and final product than a non-contextual analysis of transactions.<sup>234</sup>

## 2.5 Critique on relational contract theory

Barnett critiques MacNeil's relational theory on the basis that MacNeil asserts that what underlies relational exchange is a socially-enforced system of property.<sup>235</sup> Barnett notes that although he agrees that this is true, MacNeil does not properly integrate this into his social analysis. Therefore, his social theory of contract is virtually, if not entirely, uninfluenced by any comparable social theory of property. In addition to this, he alleges that MacNeil insists that the principle of freedom of contract can best be understood by referring to the power of contract or what Barnett refers to as freedom *to* contract. In doing this, Barnett notes, MacNeil dismisses the important function of freedom *from* contract and its importance for contract theory. Moreover, he notes that MacNeil does not fully recognise the vital social function of freedom to contract. Due to this, MacNeil's relational theory is too encompassing and not encompassing enough at the same time. It is too encompassing in that it does not distinguish between legally enforceable and legally unenforceable exchanges and focusses instead on the common characteristics and functions of all exchanges. At the same time it is not encompassing enough in that it fails sufficiently to integrate his conception of contract into the set of social norms that it

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<sup>234</sup> MacNeil (2000) *Nw.U.L.Rev* 881.

<sup>235</sup> See Barnett (1992) *Virginia Law Review* 1180-1182.

presupposes. Barnett suggests that these observations were probably not random oversights. Instead, they are likely to be a product of MacNeil's attempt to "embrace conflicting visions of society".<sup>236</sup>

Although MacNeil makes reference to the transfer of ownership of property in the case of a discrete exchange, he does so in an attempt to explain relational contract behaviour and not as a basis on which his relational theory is built.<sup>237</sup> He notes that in order to understand contract behaviour, one must understand what exchange entails and that exchange is an inevitable consequence of specialisation of labour – as long as specialisation occurs, there will be exchange.<sup>238</sup> He writes further that discrete exchange is the product of particular kinds of social relations such as markets permitting and encouraging it. Discrete exchange, can only perform a limited function in the economy and that function is the transfer of control of capital or goods and services.<sup>239</sup> However, it cannot be the only function essential to the production, distribution and consumption of goods and services.<sup>240</sup> This he does also in order to distinguish discrete from relational exchanges in emphasising that the sole purpose of discrete exchanges is to transfer control of capital, labour, goods and services.<sup>241</sup> MacNeil does refer to property as a prerequisite for discrete exchange,<sup>242</sup> which may be what caused Barnett's confusion with the role the law of property plays in relational contract theory. He writes this in reference to influence of the "positive law and the sovereign" on relational exchanges between the years 1865-1933.<sup>243</sup>

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<sup>236</sup> Barnett (1992) *Virginia Law Review* 1180-1182.

<sup>237</sup> See MacNeil (1985) *Wis.L.Rev.* 488.

<sup>238</sup> MacNeil (1985) *Wis.L.Rev* 485.

<sup>239</sup> MacNeil (1985) *Wis.L.Rev* 485.

<sup>240</sup> To this end he writes that "[d]iscrete exchange will always be a comparatively rare phenomenon because it performs only the transfer of control function and is only minimally related to physical production of goods and services." See MacNeil (1985) *Wis.L.Rev* 488.

<sup>241</sup> MacNeil (1985) *Wis.L.Rev* 490.

<sup>242</sup> See MacNeil (1985) *Wis.L.Rev* 491.

<sup>243</sup> MacNeil (1985) *Wis.L.Rev* 491.

MacNeil's relational contract theory is one steeped in socio-legal behaviour based on the fact that the law does not, as will be argued in this chapter, take cognisance of the social impact of contracts. If MacNeil, as Barnett proposes, integrated the law of property into relational contract theory, it would inadvertently couch the theory in purely legal terms once again. In other words, the rules of the law of property would become applicable to relational contract theory which defeats the purpose of the theory which is to remove the strict legal framework attached to contracts in terms of classical contract law. The same argument is applicable to the law of property. Moreover, Barnett does not explain or suggest what a "social theory of property" would entail, therefore it is difficult to imagine how such a theory would enhance or influence relational contract theory.

It is submitted that Barnett may be correct in his observation that MacNeil purposely did not recognise or emphasise the important social function of freedom to contract. He alleges that MacNeil's relational contract theory is too encompassing in that it does not distinguish between legally enforceable and unenforceable exchanges, but rather focusses on the characteristics of all exchanges. This is in line with the very nature of relational contract theory – the freedom to exchange in the way parties choose to, based on the norms of their exchange. In other words, a non-enforceable contract would depend on the nature of the exchange or contract and the enforceability of the norms which the parties agreed to, based on their intention to do so. In not strictly distinguishing between enforceable and unenforceable exchanges, MacNeil stays true to the nature of relational contract theory which is to contract at will by parties who intend to do so. MacNeil has in fact incorporated his conception of contract which is different from that understood by Barnett. As noted, contract denotes the relationship of exchange between parties. The physical contract document, is an example of a relationship formed. Therefore, Barnett's insistence that MacNeil has not incorporated his conception of contract into relational

contract theory is inaccurate.<sup>244</sup> Furthermore, MacNeil also notes that any useful, complete and logical system where human behaviour or societies are involved can never be fully developed.<sup>245</sup> This would result in an immense distrust of any closed system of social analysis.

## 2.6 The influence of relational contract theory

In evaluating the effect of relational contract theory, a commentator on MacNeil's work, Jay Feinman, notes that the theory has had both a general and fragmented effect on contract law.<sup>246</sup> Feinman writes that based on MacNeil's idea that contracts encompass all human activities of which exchange is an important element, exchange:

"is not limited to defined monetizable exchange, but also includes other interactions in which reciprocity is a dominant element. Accordingly, the scope of relational contract is very general, in some respects even more general than was classical contract law."<sup>247</sup>

At the same time, relational theory also fragments the classification of contracts. Feinman notes that for a long period of time, the doctrinal structure of private law has declined.<sup>248</sup> One of the reasons for this has been the shift away from classical or general contract law in favour of a more relational perspective on contracts. This has resulted in the separation of certain "subfields" that have become independent of the "parent law".<sup>249</sup> Examples Feinman uses are insurance law which has separated from contract law and the law of

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<sup>244</sup> See MacNeil (1983) *Nw.U.L.Rev* 343 footnote 5.

<sup>245</sup> MacNeil (1983) *Nw.U.L.Rev* 366.

<sup>246</sup> Feinman (2000) *Nw.U.L.Rev* 741.

<sup>247</sup> Feinman (2000) *Nw.U.L.Rev* 741.

<sup>248</sup> Arrowsmith, Linarelli & Wallace write that "whilst there may be special provisions to govern the procedure for formation of contracts between a public body and its suppliers, the law which governs the contract once the contractual relationship has come into existence is the same, or substantially the same, as the law applying to contracts between private citizens." Feinman's observation is therefore relevant to public procurement law. See S Arrowsmith, J Linarelli & D Wallace *Regulating Public Procurement: National and International Perspectives* (2000) 13-14. The link between relational contract theory and public procurement is analysed in more detail in para 8 below.

<sup>249</sup> Feinman (2000) *Nw.U.L.Rev* 744.

sale and lease from general property law. This new “division of law” has been referred to as neoclassical contract law. Hawthorne notes that the substantive core of neoclassical contract law is still to act out of self-maximising individual interest, but within a trade custom context based on reasonableness and fairness which has been introduced by consumer legislation.<sup>250</sup> Freedom and sanctity of contract, however, still remain its cornerstones as in the case of classical contract law.

In Feinman’s opinion, the most important contribution that relational contract theory has made, has been MacNeil’s creation of the discrete-relational continuum which has highlighted the importance of long term relationships in contracts as a distinctive form of contracting.<sup>251</sup> As a result of this, he notes that “relational contracts can be governed by the core principles of contracts, as long as the courts applying the principles are sensitive to the factual differences in context.”<sup>252</sup>

### **3 Relational contract theory and the law**

MacNeil writes that exchange relations give rise to legal rights which makes the law an integral part of relational contracts.<sup>253</sup> However, the law is only one of many fields applicable to contracts. He notes that more than the law, contracts are about achieving practical goals such as constructing buildings, buying and selling things etc. Furthermore, ascribing a purely legal definition to relational contracts would be too narrow as it creates the impression that relational contracts concern only the law. Therefore, to understand

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<sup>250</sup> L Hawthorne “Relational Contract Theory: Is the Antagonism Directed at Discrete Exchanges and Presentation Justified?” in G Glover (ed) *Essays in Honour of AJ Kerr* (2006) 137.

<sup>251</sup> Feinman (2000) *Nw.U.L.Rev* 739. See also D Campbell *The Relational Theory of Contract: Selected Works of Ian MacNeil* (2001) 181

<sup>252</sup> Feinman (2000) *Nw.U.L.Rev* 740.

<sup>253</sup> MacNeil *The New Social Contract* 5.

contracts and how contracts operate, one should consider exchange first and the law second.

According to MacNeil, the law provides stability in society. It facilitates co-operation between parties and its enforcement mechanisms allow for continuation of interdependence where it otherwise may not have existed.<sup>254</sup> In alignment with his notion of common contractual norms, he writes that the law is or perhaps should be an indication of our customs and social practices in terms of which human affairs are conducted.<sup>255</sup> Therefore, the function the law fulfils in this instance is to tell society what its most important norms are and based on relational contract theory, become the norms in terms of which exchanges are conducted.

Gottlieb noted in 1983, and it is submitted that this is still relevant today, that any theory of law which emphasises the law, the courts and enforceable remedies, focusses on the individual, the state, regulation and discrete transactions is “woefully incomplete”.<sup>256</sup> It fails to recognise the broad spectrum of interaction between institutions and organisations that dominate modern societies and neglects the way the law functions in these societies. This emphasises the fact that the law does not recognise vital social imperatives in its daily functioning. Moreover, numerous constitutional norms indicate the need for the law to recognise social rules and behaviour.

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<sup>254</sup> MacNeil *The New Social Contract* 93. According to Bell, a long-term relationship may exist between parties based on a deliberate creation of the relationship or as a result of an interaction between the parties over a period of time. In the case of the former, the law acts to enable and supplement rational planning by the parties. In the latter instance, the function of the law is to secure the expectations which have grown out of the *de facto* long-term relationship and to substitute the planning by the parties, rather than to supplement it. See J Bell “The Effect of Changes in Circumstances on Long-term Contracts” in D Harris & D Tallon (eds) *Contract Law Today* (1991) 195.

<sup>255</sup> MacNeil *The New Social Contract* 94.

<sup>256</sup> See G Gottlieb “Relationism: Legal Theory for a Relational Society” (1983) 50 *University of Chicago Law Review* 567 567.

Section 41 of the South African Constitution<sup>257</sup> regulates principles of co-operative government and intergovernmental relations. It provides that all spheres of government and all organs of state must provide effective, transparent, accountable and a coherent government. It further states that these institutions must co-operate with one another in mutual trust and good faith by fostering friendly relations, assisting and supporting one another, consulting one another on matters of common interest, co-ordinate their actions and legislation with one another, adhere to agreed procedures and avoid legal proceedings against one another.<sup>258</sup> Therefore, the Constitution requires that the government must act in accordance with these principles which are akin to those of relational contract theory.

Arrowsmith, Linarelli and Wallace write that procurement refers to the situation where a government entity requires goods or services and contracts with a private body for such goods or services.<sup>259</sup> There is therefore an exchange which takes place between the government entity and the private body. Trepte notes that this exchange involves the economic activities of the government “and of its relationship with other economic entities”.<sup>260</sup> The public procurement process is, like relational contract theory, based on principles, norms or values such as fairness, accountability, equity, competition, reciprocity, consent and co-operation. It is also a long-term relationship formed between the procuring body and contractors based on the time involved in a competitive tendering procedure. The process and the resultant contract are therefore examples of relational contracts. When applied to this context, the norms MacNeil refers to are or should

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<sup>257</sup> Constitution of the Republic of South Africa, 1996.

<sup>258</sup> Section 41(1)(a)-(h).

<sup>259</sup> Arrowsmith, Linarelli & Wallace *Regulating Public Procurement* (2000) 6. Both Vincent-Jones and Davies refer to this as “government by contract” when referring to contracts involving public bodies. This includes *inter alia* contracting out, public-private partnerships and agreements between the government and private parties. See P Vincent-Jones *The New Public Contracting – Regulation, Responsiveness, Relationality* (2006) 14 and ACL Davies *Accountability – A Public Law Analysis of Government by Contract* (2001) 1.

<sup>260</sup> P Trepte *Regulating Procurement: Understanding the Ends and Means of Public Procurement Regulation* (2004) 9.

therefore be the norms on which the procurement process should be based. The aim of the following paragraphs is to determine what these norms are or should be and whether perceiving the public procurement process and the subsequent contract through a relational lens has or will have an effect on the way in which public procurement is regulated.

#### 4 Classical and relational contract law compared<sup>261</sup>

What follows will be an exposition of the working of classical contract law compared to relational contract law. The question to be answered is whether classical contract law inadequately provides for the complexities of long-term, relational contracts and whether relational contract theory is a better alternative to addressing these inadequacies.

##### 4 1 Classical contract law

Classical contract law can be said to be based on doctrine. The law which regulates classical contracts is presented as a settled body of rules with few exceptions. No baseline or minimum obligation is expected.<sup>262</sup> A contract is formed based on an intention to contract, *animus contrahendi*, on the part of all parties to the contract.<sup>263</sup> It consists of an

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<sup>261</sup> In this section, it is not the focus of this dissertation to discuss the private law of contract at length, but is included for purposes of comparison with relational contract theory in order to illustrate that it is insufficient for the law of public procurement. Therefore, merely a brief exposition of the salient points in the private law of contract are discussed.

<sup>262</sup> Feinman (2000) *Nw.U.L.Rev* 743. Gordon notes that in classical contract law, parties to a contract have no obligations to one another except those created by the coercive rules of the state or those made by themselves. Therefore, any contract analysis must rest on the grounds of consent rather than public policy. See R Gordon "MacNeil, Macaulay, and the Discovery of Power and Solidarity in Contract Law" (1985) *Wisconsin Law Review* 569.

<sup>263</sup> GB Bradfield *Christie's Law of Contract in South Africa* 7 ed (2016) 37. See also LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract - General Principles* 5 ed (2016) and AJ Kerr *The Principles of the Law of Contract* 6 ed (2002).

unequivocal offer and an unequivocal acceptance.<sup>264</sup> It is further required that the acceptance must correspond exactly or at least materially to the offer.<sup>265</sup> In addition to this, classical contracts are bound by the agreement evidenced by the rule of *pacta sunt servanda* and evidence of that which the parties agreed to is contained only in the four corners of the contract. In other words, no external evidence may be used as proof of the parties' obligations or terms of agreement. This is referred to as the parol evidence rule.<sup>266</sup> When a dispute as to the terms of the contract arises, proof of the facts are determined solely by that which is contained in the written document. Bradfield notes that when a term of the contract is alleged by one party and not by the other, this must be treated as a denial of the terms by the latter party.<sup>267</sup> It has also been said that classical contracts arise from the idea of individual freedom of contract – contracting for one's own interests.<sup>268</sup> Other parties to the contract are thus viewed as threats or simply as a means to achieving individual interests.<sup>269</sup> There exists the notion that consent to a contract is evidenced by the signature of the party who consents – the *caveat subscriptor* principle.<sup>270</sup>

Despite the notion that contracts consist of a collection of express terms stated in a written agreement, the classical law of contract does recognise implied and tacit terms. Bradfield refers to these as terms implied from trade usage or terms implied from the facts.<sup>271</sup> When analysing the terms of a contract, he notes that the most convenient method to use is to identify the express terms, determine whether there are any terms implied by law<sup>272</sup> or

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<sup>264</sup> Bradfield *Christie's Law of Contract* 40 and 74.

<sup>265</sup> 75.

<sup>266</sup> 226.

<sup>267</sup> 181.

<sup>268</sup> Feinman (2000) *Nw.U.L.Rev* 739.

<sup>269</sup> Gordon (1985) *Wisconsin Law Review* 568.

<sup>270</sup> Bradfield *Christie's Law of Contract* 205 – 206. However, an exception may be applied. The question in such a case is whether the other party to the contract is reasonably entitled to assume that the first signatory was signifying his intention to be bound by the contract.

<sup>271</sup> Bradfield *Christie's Law of Contract* 187.

<sup>272</sup> Explained by Bradfield in his reference to *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration* 1974 3 SA 206 (A) 531 where the learned judge held that "...it is used to describe an unexpressed provision of the contract which the law imports therein, generally as a matter of course, without

from trade usage<sup>273</sup> and lastly whether there are any tacit terms.<sup>274</sup> Despite recognition of implied and tacit terms in classical contract law, these are limited to those imputed by the law or those derived from the express terms of the contract. Therefore, no outside behaviour of the parties or norms decided on by the parties themselves are considered. The limits of these terms are thus stricter than those in relational contract theory discussed in this chapter.<sup>275</sup>

Campbell and Collins argue not that classical contract law cannot recognise implicit dimensions of contracts, but rather that the techniques or mechanisms used often prove to be inadequate.<sup>276</sup> Wightman<sup>277</sup> notes that in relational contract theory, there exists three kinds of implicit dimensions. Firstly, those which stem from a shared language, knowledge of the social institution of money, currency and a shared “market mentality” which includes many tacit understandings about buying and selling. It also involves understandings about modes of payment, the banking system, expectations of interest and the like. These, he

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reference of the actual intention of the parties. The intention of the parties is not totally ignored. Such a term is not normally implied if it is in conflict with the express provisions of the contract. On the other hand, it does not originate in the contractual *consensus*: it is imposed by the law from without.”

<sup>273</sup> These Bradfield notes are those terms between terms implied by the law and tacit terms. He writes that “[i]f the trade usage is known to both parties their knowledge will be a contextual consideration informing a decision as to whether the trade usage ought to be incorporated in their contract as a tacit term. The implication will not be made by law but the term will be incorporated into the contract because of the presumed common intention of the parties to include a term customarily included to the knowledge of both of them...If, however, one party cannot prove that the other knew of the trade usage, it will nonetheless be incorporated as an implied term in the contract, if in addition to other requirements, it is so universal and notorious that the party’s knowledge and intention to be bound by it can be presumed.” Bradfield *Christie’s Law of Contract* 190.

<sup>274</sup> 187. Alternatively referred to as terms implied from the facts by Bradfield. These are unexpressed terms of the contract, derived from the common intention of the parties to the contract. It is inferred by the court from the surrounding circumstances and express terms of the contract. Bradfield *Christie’s Law of Contract* 196.

<sup>275</sup> Scott notes that the formalistic nature of classical contract law is not as radical as it seems. He is of the view that parties to a contract have learned to behave in terms of two sets of rules. Firstly, a strict set of rules for purposes of legal enforcement and a second more flexible set of rules for social enforcement. He notes that any attempt to “judicialise” these social rules will destroy the very formality that makes them so effective in the first place. See R Scott “The Case for Formalism in Relational Contract” (2000) 94(3) *Nw.U.L.Rev* 847 852.

<sup>276</sup> Campbell & Collins “Discovering the Implicit Dimensions of Contracts” in *Implicit Dimensions of Contract* 26-27.

<sup>277</sup> J Wightman “Beyond Custom: Contract, Contexts, and the Recognition of Implicit Understandings” in D Campbell, H Collins & J Wightman (eds) *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 147-148.

notes, are general implicit dimensions in that they are not specific to any type of contract or transaction. In the second instance, there are those implicit dimensions which emerge over time between parties to a contract and which stem from specific behaviour of the parties. These are different from general understandings, dimensions or terms because they relate to behaviour rather than background knowledge. The third type of implicit understandings concerns those about how commercial relations in a particular sector are carried out – the practices or norms with which parties must become familiar in order to participate in the sector. Although these three types of implicit terms are distinguishable, they are also related since general terms form the basis for sector-specific norms and inter-party understandings.

Campbell and Collins write that even when implicit dimensions are considered by a court of law, the analysis is based on the assumption that the legal reasoning will not refer to these implicit dimensions. When these implicit dimensions are in fact considered, they are marginalised or minimised by classical legal doctrine as they amount to “dangerous supplements” to classical reasoning. This means that the acknowledgement of implicit dimensions in a contract “threatens the collapse of an analysis that holds itself out as being an instrument of explicit, rational choices.”<sup>278</sup> Relying on express terms only and the literal meaning thereof is in fact to misunderstand the communication system used in

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<sup>278</sup> Campbell & Collins “Discovering the Implicit Dimensions of Contracts” in *Implicit Dimensions of Contract* 27. Bhana writes that the “hands-off” approach by the state and thereafter the law, facilitated a strict divide between the public and private law spheres. This divide came to be regarded as a wall through which public law norms could not infiltrate into private law matters such as contracts. Therefore, the judiciary was able to maintain “the veil of judicial neutrality” in the law of contract and insist on a conservative approach to contract interpretation. What was contemplated was a formal or strict application of the law premised on a rules-based analysis with minimal judicial discretion. The idea was that judges would “simply feed the ‘hard facts’ of problems into the ‘common law of contract machine and the machine in turn would spit out the ‘logically correct’ (and therefore *formally just*) legal solution (original emphasis).” See D Bhana “The Role of Judicial Method in Contract Law Revisited” (2015) 132 *SALJ* 122 126. Deputy Chief Justice Dikgang Moseneke to this end writes that the law of contract is meant to facilitate the market needs. It is meant to be a value-neutral set of rules that ensure certainty whilst inspiring confidence in the market place. For this reason, the law of contract allows for limited or no judicial discretion. See D Moseneke “Transformative Constitutionalism: Its Implications for the Law of Contract” (2009) *Stellenbosch Law Review* 3 9.

written contracts.<sup>279</sup> Campbell and Collins argue that whenever a contract is interpreted, the legal reasoning should involve or engage with the implicit dimensions of the relationship in order to make sense of the express contractual terms.<sup>280</sup> This is in line with contextual interpretation referred to in chapter three of this dissertation and advocated by the court in *National Joint Municipal Pension Fund v Endumeni Municipality*<sup>281</sup> when dealing with legal interpretation.<sup>282</sup> In line with this, Bhana writes that:

“[W]hilst still subject to legal constraint, judges must adjudicate now in a more realist medium which *explicitly* mandates transformation of the civil, political, social and economic order by way of a constitutionalised system of law. In other words, South African law operates now in terms of a ‘transformative constitutionalism’ ideology where a more full-bodied constitutional self, as grounded in the basic values of freedom, dignity and equality, is able to realise his or her vision of the ‘good life’. Accordingly, judges can no longer camouflage the essentially political nature of the underlying judicial ideology. They are now necessarily subject to a ‘more plastic’ legal constraint in the performance of the adjudicative function and accordingly, ought palpably to be more amenable to a ‘policy-oriented and consequentialist’ approach, rather than the predominantly formalist approach. Liberal legalism therefore, as received from the apartheid era, presents an uneasy fit with our substantively progressive and transformative constitutional framework.”<sup>283</sup>

In illustrating the usefulness of contextualism, Brownsword uses the following example:

<sup>279</sup> Campbell & Collins “Discovering the Implicit Dimensions of Contracts” in *Implicit Dimensions of Contract* 35.

<sup>280</sup> Campbell & Collins “Discovering the Implicit Dimensions of Contracts” in *Implicit Dimensions of Contract* 34. The authors write that lawyers are aware of the fact that contracts have implicit (meaning implied, tacit or unexpressed) dimensions. However, despite this, the law or “legal reasoning” as they refer to it, has not developed adequately to incorporate these dimensions into its analysis of contracts and the remedies available in the event of a dispute. D Campbell & H Collins “Discovering Implicit Dimensions of Contracts” in D Campbell, H Collins & J Wightman (eds) *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 35.

<sup>281</sup> 2012 4 SA 593 (SCA).

<sup>282</sup> In elaborating on this, the authors refer to Wittgenstein’s reference to “language games” used by courts to interpret the meanings of words. The question to be answered is which language game is applicable when interpreting a contract. The document might be regarded as a description of the reciprocal undertakings of the parties. In this case, the description should be interpreted according to the ordinary meaning of words. In other words, by use of literal interpretation. This is because this “language game” relies on those meanings for the purpose of description. On the other hand, if the document or contract is a record of instructions to each party designed to implement a purpose such as the sale of goods and services, the “language game” changes to one that determines meaning by reference to purpose. In order to determine the purpose of the parties to the contract, they note that it is essential to place the express terms of the contract in context of the implicit understandings of the contract. Therefore, meaning can only be correctly attributed to contracts by reference to purpose of the contract, which relies on the implicit dimensions of the contract.

<sup>283</sup> Bhana (2015) *SALJ* 130-131 (original emphasis). Brownsword notes that a contextual approach to interpretation refers to three elements. The meaning of a contract is that which would be conveyed to firstly a reasonable person, who secondly, is put in the situation of the parties at the time they concluded the agreement and who thirdly, is informed of the background knowledge that the parties would have had at that time. In other words, contracts must be interpreted in a way that “keeps faith” with the reasonable expectation of the parties to the contract. See R Brownsword “After Investors: Interpretation, Expectation and the Implicit Dimension of the ‘New Contextualism’” in D Campbell, H Collins & J Wightman (eds) *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 104.

“Context...can assist our understanding at more than one level. First, at a level of general orientation or focus, it enables us to select the relevant intended meaning – for example, when the words are, say ‘civil service’, context enables us to take this as a reference to a mode of public administration or to a mode of marriage ceremony. Secondly, assuming that our general orientation is appropriate, there is a level of corrective effect that context can supply – for example, when we are talking about public administration, context will enable us to recognise ‘silver service’ as a slip of the tongue when ‘civil service’ is what is actually intended...What is distinctive about contextualism, as against literalism, is that the *corrective* effect of context is applied much more robustly as well as being fully integrated into the process of construction.”<sup>284</sup>

With regard to classical contract law remedies, the courts have regard to the terms of the contract and whether the obligations were performed incorrectly or late.<sup>285</sup> The method used in determining liability is therefore rather strict as no external or surrounding circumstances are considered. Campbell and Harris assert that the remedies used in classical contracts are simply not applied in long-term contracts and rely on empirical studies which confirm this.<sup>286</sup>

The nature of classical contract law causes an adversarial relationship between parties and may lead to alienation from one another and is therefore detrimental to future business dealings. This in turn increases the likelihood of disputes, which results in contracts being costly and therefore the playground of those parties who are financially able to entertain contractual disputes. There is thus no obligation to act in good faith as confirmed by our courts.<sup>287</sup>

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<sup>284</sup> Brownsword “After Investors” in *Implicit Dimensions of Contract* 111 (original emphasis).

<sup>285</sup> Bradfield *Christie’s Law of Contract* 585.

<sup>286</sup> D Campbell & D Harris “Flexibility in Long-term Contractual Relationships: The Role of Co-operation” (1993) 20(2) *Journal of Law and Society* 166 168.

<sup>287</sup> See for example *Brisley v Drotzky* 2002 4 SA 1 (SCA) and *Afrox Healthcare Ltd v Strydom* 2002 6 SA 21 (SCA). In a paper in which the common and civil contract law systems are compared, Galletti writes that the common law approach has been to exclude duties of good faith. The adversarial system used in common law countries mean that there is no duty on a contractor to consider the economic interests of another party. The courts will therefore objectively approach contractual duties without implying any terms and without recognising a duty of good faith. The absence of a duty of good faith, she notes, is not a barrier to judges ensuring that their interpretation of contracts amounts to the fair framework for people’s dealings. In this regard she refers to South African Steyn J who wrote that there is no material difference between good faith and the reasonable expectations of parties. See S Galletti “Contract interpretation and relational contract theory: a comparison between common law and civil law approaches” (2014) 47(2) *The Comparative and*

MacNeil writes that classical contract law treats as irrelevant the identity of the parties to the contract. It commodifies the subject of the contract, it limits the sources which can be used in establishing the substantive content of the transaction and only limited contract remedies are available.<sup>288</sup> It also draws a clear distinction between being bound and not being bound to a contract.<sup>289</sup> Lastly, the involvement of third parties in a contract is not encouraged since it causes too many poles of interest which may complicate and eventually destroy discrete relations.

Regarding the law and the ineffectiveness of the current classical contract law Campbell and Collins write that:

“For some people, the concern may be with the disfunction of the law. If the law seeks to protect and enforce contractual agreements, the recognition that it has a partial and incomplete understanding of those agreements suggests that it fails in many instances to achieve its goals by enforcing not the agreement of the parties in all its relevant dimensions but a truncated perception of that agreement. From another functional perspective, the law of contract promotes and controls social practice of entering self-regulated transactions, and misunderstandings of this practice create the risk that legal regulation will either fail adequately to support the practice when required or misdirect its controls so that they are ineffective.”<sup>290</sup>

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*International Law Journal* 248 252-253 and J Steyn “Contract law: Fulfilling the reasonable expectations of honest men” (1997) 113 *The Law Quarterly Review*.

<sup>288</sup> Currently, in South African law, a contract can be declared invalid based on illegality due to the fact that it offends against public policy. This appears to be the only ground on which substantive matters can be included in the interpretation of contracts. It has been noted that the extent to which good faith and public policy differs is difficult to determine as our courts have held that contractual terms cannot be escaped or enforced based on good faith. See A Hutchison “Agreements to Agree: Can there ever be an enforceable duty to negotiate in good faith?” (2011) 128(2) *SALJ* 273 291. However, the Constitutional court in *Barkhuizen v Napier* 2007 SA 323 (CC) para 73-74 held that “[p]ublic policy imports the notions of fairness, justice and reasonableness. Public policy would preclude the enforcement of a contractual term if its enforcement would be unjust or unfair. Public policy, it should be recalled, ‘is the general sense of justice of the community, the boni mores, manifested in public opinion’...while public policy endorses the freedom of contract, it nevertheless recognises the need to do simple justice between the contracting parties.” On good faith, the court held at para 80 that good faith is not unknown to our common law and that it underlies contractual relations in our law. Kruger, in writing on the influence of public policy in contracts notes that public policy means that a judge, when engaging with it, is equipped with a “basket” of policy considerations. From this basket, he/she is required to choose the considerations or factors most relevant to the facts of the case at hand and to balance these factors against one another. The outcome of this identification and balancing process is what he notes the courts term public policy. See M Kruger “The Role of Public Policy in the Law of Contract, Revisited” (2011) *SALJ* 712-740.

<sup>289</sup> In this sense he refers to the strict rules of unambiguous offer and unambiguous or unequivocal acceptance as also required by the South African law of contract. See I MacNeil “Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law” (1978) 72(6) *Nw.U.L.Rev* 854 863 – 864.

<sup>290</sup> Campbell & Collins “Discovering Implicit Dimensions of Contracts” in *Implicit Dimensions of Contract* 27.

Bradfield writes that the basic idea that people must be bound to the agreements they conclude means that it “would obviously be ridiculous if total strangers could sue or be sued on contracts with which they were in no way connected.”<sup>291</sup> The doctrine prevents anyone not directly involved, in other words, someone who is not a party to a contract, from litigating with the other party on the matter. This doctrine has been carried over to the public procurement context, where only tenderers who have submitted a tender or have been involved in the tender process can approach a court for legal redress. This doctrine prohibits not only the application of section 38(d) of the Constitution which allows anyone who acts in the public interest to bring a matter to the court’s attention, but also denies the fact that the public has an interest in public procurement matters. To this end, the private law of contract cannot simply be applied to a public law context. The public law sphere and even more so in a public procurement context, an acknowledgement of the public interest is paramount. A relational approach to public procurement may be the solution to this problem and is discussed further below.<sup>292</sup>

#### 4.2 Relational contract law

As explained in paragraph two above, relational contract theory, contrary to classical contract law is based on substantive values rather than doctrine - values such as solidarity, trust, reciprocity and co-operation.<sup>293</sup> Although it arises from mutual interests, it can be said that individual interests indeed play a role since the relation would not have been formed if each individual did not have pecuniary or other interests. They merely identified that these interests can be achieved more effectively if a partnership is

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<sup>291</sup> Bradfield *Christie’s Law of Contract* 302.

<sup>292</sup> See para 5.

<sup>293</sup> Campbell & Harris note that co-operation in a long-term relationship is very different from that in a discrete contract. This is because the precise co-operation required over a long period of time cannot necessarily be defined in advance. The parties therefore accept a general and “productively vague” norm of fairness in their conduct. Campbell & Harris (1993) *Journal of Law and Society* 167.

established. Relational theory is also based on social habits and customs that become internal to a contract. Even unwritten norms, in other words, expectations and obligations not expressly included in the agreement become binding (these are the external norms referred to by MacNeil). As Collins states, the question to be answered is whether the written document exhausts the obligations of the parties or whether it is supplemented by implicit undertakings.<sup>294</sup> Therefore, legal systems should develop techniques for determining the legal significance of contexts surrounding contracts.

A significant difference in relational contracts from classical contracts is that not all rights and duties are enumerated in the physical document. The outcome is therefore determined by the relations between the parties rather than expressed terms in a contract.<sup>295</sup> This is in line with MacNeil's idea that *the* contract is merely an example of relational contracting. Instead of an exclusive written agreement, there exists an unwritten agreement to co-operate with one another. Hawthorne notes that because the ambit of the agreement is the long-term relationship between the parties, emphasis is placed on the requirements of trust, mutual responsibility, solidarity and co-operation.<sup>296</sup> More specifically, MacNeil writes that of all the essential elements of relational contract theory,

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<sup>294</sup> D Campbell, H Collins & J Wightman *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 3.

<sup>295</sup> L Hawthorne "The First Traces of Relational Contract Theory – The Implicit Dimension of Co-operation" (2007) 19 *SA Merc LJ* 234 237. Gordon writes that obligations grow out of their commitment to each other, but may change as circumstances change. The purpose of contracting is not the allocation of risks, but to signify a commitment to co-operate. She notes that parties to a relational contract "treat their contracts more like marriages than like one-night stands." Gordon (1985) *Wisconsin Law Review* 569. According to Campbell & Harris a relational contract is analogous to a partnership. They note that "the parties are not aiming at utility-maximization directly through performance or specified obligations; rather, they are aiming at utility-maximization indirectly through long-term co-operative behaviour manifested in trust and not in reliance on obligations specified in advance." Campbell & Harris (1993) *Journal of Law and Society* 167.

<sup>296</sup> Galletti writes that a co-operative approach would entail that courts would more readily intervene in contractual gaps based on good faith and will regard a contextual approach to contractual interpretation as important as opposed to contrary to the will of the parties. Galletti (2014) *The Comparative and International Law Journal* 253.

the two most important are contractual solidarity and reciprocity.<sup>297</sup> Therefore, a minimum obligation in terms of which to perform exists.<sup>298</sup>

Remedies in relational contracts depend on how the parties want to solve the dispute. At the conclusion of the contract, they agree to allow for sufficient discretion to decide how conflicts will be resolved.<sup>299</sup> Gordon notes that in bad times parties are expected to lend one another mutual support and that an insistence on literal performance will be treated as “wilful obstructionism”.<sup>300</sup> If unexpected losses occur, the parties must equitably divide the losses and a possible sanction for bad behaviour could be a refusal to contract in future.<sup>301</sup> Allowing this kind of approach to dispute resolution may therefore allow more small businesses to participate in the process of resolution. The procurement process and contract will therefore be more inclusive of developing contractors.<sup>302</sup>

Feinman notes that relational contracts are “relational with a vengeance”.<sup>303</sup> The core of relational analysis is found in the context of a specific contract. However, context is not enough. The context must be filtered through the contractual norms starting with the internal norms. Since they are common to all relational contracts, they will be found in every analysis of a relational contract. However, as the case with the norms found in

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<sup>297</sup> MacNeil (1983) *Nw.U.L.Rev* 347 – 348. To this end, Hawthorne notes that “There appears to exist a hidden sub-culture which constitutes a powerful enforcement mechanism based upon social approval and various codes of conduct typical of particular contracts. This enforcement is effected by certain implicit dimensions, which are conceptions to be understood, though not expressed in words, and are deep rooted and settled. This social mechanism of enforcement does not fall within the ambit of the reigning paradigm of contract law which favours the literal enforcement of written contracts, but is found in relational contract theory embodied in the norms of solidarity and co-operation.” Hawthorne (2007) *SA Merc LJ* 234.

<sup>298</sup> Feinman (2000) *Nw.U.L.Rev* 743.

<sup>299</sup> Speidel (2000) *Nw.U.L.Rev* 823 – 824.

<sup>300</sup> Gordon (1985) *Wisconsin Law Review* 569.

<sup>301</sup> Gordon (1985) *Wisconsin Law Review* 569.

<sup>302</sup> Although the CIDB Standard for Uniformity refers to “emerging enterprises” and not developing contractors, it is submitted that these two concepts are interchangeable. The former is defined as “an enterprise which is owned, managed, and controlled by black people and which is overcoming business impediments arising from the legacy of apartheid”.

<sup>303</sup> Feinman (2000) *Nw.U.L.Rev* 742.

section 217 of the Constitution, each norm will carry a different weight depending on the nature of the contract.<sup>304</sup>

#### 4.3 Significance of relational contract theory

The law in itself is not an isolated or static field. Since it regulates human behaviour, contracts and buying and selling of goods and services, areas such as the social sciences and commerce are naturally involved. Moreover in the case of construction procurement, a further dimension is added in the form of the engineering and construction field of practice. In the case of construction procurement specifically, a number of role-players, stakeholders, large amounts of taxpayer money and thus a large public interest are affected in the procurement process and the resultant contract. There has also been a growing need for the recognition of good faith and a consideration of social implications in contractual dealings.<sup>305</sup> This is connected to the fact that all law, including construction procurement law, is subject to the Constitution, the principles enumerated therein and its spirit. Principles such as equity and equality where black contractors are concerned, have not been implemented to an extent where the right can be regarded as fulfilled amongst these contractors.<sup>306</sup> Furthermore, fairness refers to substantive fairness and thus links to equity. Lastly, the principle of dignity in the ability to conclude and arrange contractual relations to an extended degree (meaning not only arranged in a formal contract) provided that it does not offend against public policy has not yet been fulfilled. Hawthorne notes that the need for open norms such as good faith, reasonableness and public policy to be

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<sup>304</sup> Feinman (2000) *Nw.U.L.Rev* 742

<sup>305</sup> See para 9 below.

<sup>306</sup> The Construction Monitor of January 2017 indicates that although there has been an increase in the percentage black ownership in construction contractors, the state of the industry is that it is not representative of the demographics of the country. See <http://www.cidb.org.za/publications/Documents/Construction%20Monitor%20-%20January%202017.pdf> (accessed 14-10-2017). Moreover, employment equity is shown as having increased by a mere 6% between 2013 and 2017 and professional black staff accounts for a meagre 13% of all professional staff.

applied in contractual dealings is based on the fact that the rules of classical contract law are not flexible enough to cope with the complexity of modern society.<sup>307</sup> By this she means the prevalence of long-term contracts and the relational aspect of these agreements.

The concept of public policy is one which has not been given a precise definition by our courts and as discussed in this chapter, is one which the courts appear to be uncomfortable or perhaps unwilling to apply given its changing and evolving nature.<sup>308</sup> It is submitted that the doctrinal legal system as it applies to construction procurement law does not fully comply with the principles or spirit of the Constitution. Hawthorne notes that there is no doubt that the Constitution does not support the traditional orthodox contract law which promotes a formalistic system, but rather advocates for the recognition of substantive values and the existence of differing socio-economic circumstances.

Relational theory, as a conceptual tool may assist in a more flexible, legally and economically sound method of interpreting legal rules. It may thus go a long way in fulfilling constitutional imperatives. Relational theory, if incorporated into South African law, will act as a conceptual tool and not a doctrine or theory. Legal doctrine has been known to constitute rigid rules to be applied with few if any exceptions which is not the aim or purpose of relational theory. A legal theory, on the other hand, is an idea on which law is based and involves some speculation as to its accuracy. Contrary to this, relational theory is a manifestation of a long-standing socio-legal practice – the creation of unwritten

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<sup>307</sup> L Hawthorne “The ‘new learning’ and transformation of contract law: reconciling the rule of law with the constitutional imperative to social transformation” (2008) 23 *SAPL* 77 78.

<sup>308</sup> See for example *Jajbhay v Cassim* 1939 AD 537; *Sasfin v Beukes* 1989 1 SA 1 (A); *Afrox Healthcare Bpk v Strydom* 2002 6 SA 31 (SCA); *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 4 SA 302 (SCA) and *Brisley v Drotzky* 2002 4 SA 1 (SCA) where the concept public policy was described in different ways, yet synonymous with good faith. See also L Hawthorne “Public Policy: The origin of a general clause in the South African law of contract” (2013) 19(2) *Fundamina* 300-320 who discusses the varying description of public policy by our courts at length.

agreements and fostering long-term relations. Ireland<sup>309</sup> notes that the obligations which arise from “informal, latent, implicit agreements and understandings” supplement and at times modify those contained in express terms. Many of these expectations not only involve good faith, trust and relationality but are also context-specific, arising from particular customs, practices and market conventions. Therefore, they can only be identified with reference to the specific contexts from which they arise. The concept of implicit contract, is thus seen as a useful analytical tool which can assist in overcoming the deficiencies of classical contract law.

As is discussed below,<sup>310</sup> empirical studies have been done which prove that parties to contracts seldom rely on written contracts for various reasons. In addition to this, it will be argued that the working of relational theory is in line with the Constitution and the obligations placed on the state in fulfilling its duties.<sup>311</sup> Moreover, it is not possible for parties to a contract to provide for every eventuality which may arise. Based on the evolving nature of long-term relationships and the possible unpredictable nature of a particular sector, additional duties may arise which have not been provided for in the contract. Therefore, relational theory should be regarded as a conceptual tool which is described in the Oxford Dictionary as an idea of a class of objects, a general notion; a theme, a design. In this case, it is an idea of a class of processes and contracts, that of construction procurement law.

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<sup>309</sup> P Ireland “Recontractualising the Corporation: Implicit Contract as Ideology” in D Campbell, H Collins & J Wightman (eds) *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 284.

<sup>310</sup> See para 5.

<sup>311</sup> See para 7 below.

## 5 The need for a relational procurement law

It has been claimed by Mitchell that contracting parties inhabit two different worlds – an artificial world created by the law and the real world in which they perform their contractual duties.<sup>312</sup> Furthermore, the artificial or “paper” contract does not reflect the actual or “real” contract.<sup>313</sup> The latter is the agreement as understood by the parties based on their desire to achieve their economic goals and is informed by values or norms created amongst themselves. The “paper” contract is the formal contract in which allocation of risks and obligations are set out, which often seems far removed from the “real” contract.<sup>314</sup> Mitchell basis this assertion on empirical studies which indicated that contractors made little use of legally enforceable contracts and even less so in the case of disputes. She writes further that the influence of the legal approach to relational contracts is that the law attaches importance to the point of view of the “reasonable person” about what the contract means and not that of the actual parties to the contract.<sup>315</sup>

Collins writes that the non-use of contracts alleged by commentators is misleading because the importance of the formal contract should nevertheless not be understated. He notes that it is true that the law is seldom used to enforce “self-regulation”, but this does not mean that contractual terms are unimportant. The reasons for not resorting to legal action may be varied. These may include the cost involved in litigation especially if the debtor is in a weak financial position and the potential damage to business reputations and

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<sup>312</sup> C Mitchell “Contracts and Contract Law: Challenging the Distinction Between the ‘Real’ and ‘Paper’ Deal (2009) 29(4) *Oxford Journal of Legal Studies* 675 676.

<sup>313</sup> S Macaulay “The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules” in D Campbell, H Collins & J Wightman (eds) *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 51 51. By referring to “real” deal, Macaulay means those actual expectations that exist in and out of a contract and the general expectation that a partner will behave in a certain manner. He notes that the question the courts ask when interpreting the real deal is whether the parties signed or accepted the contract and if they did what the “plain meaning” of the wording is.

<sup>314</sup> Mitchell (2009) *Oxford Journal of Legal Studies* 676 - 677.

<sup>315</sup> Mitchell (2009) *Oxford Journal of Legal Studies* 683.

long-term business relations in the event of a dispute. The contract is used as security during negotiations towards a settlement of a dispute, even though the parties may have no intention of using it. He is of the opinion that a fundamental problem with the assertion that contracts are not at all used in exchange relations, is that it fails to recognise a three dimensional context of relational contracts.<sup>316</sup> He notes that an argument exists that:

“It is desirable for legal reasoning to incorporate a recognition of implicit dimensions of contracts in its regulation of transactions, but also, and more fundamentally, that such a process of legal recognition of implicit dimensions is necessary and inevitable in any system of law. In order for legal reasoning to understand and regulate the social practice of making contracts, it has to appreciate that contractual behaviour relies upon several contexts for its meaning and purpose. As well as the explicit agreement between the parties, the participants also conduct themselves by reference to their economic interests in having the deal successfully completed to the benefit of both parties, and by reference to their expected or desired long-term business relationship.”<sup>317</sup>

Collins further notes that two diverging views of justice exist when it comes to vindicating rights in contract law. On the one hand, procedural justice which is achieved once the procedure for concluding a legally binding contract with all the necessary express terms has been completed, enforcement of the agreement will satisfy procedural justice. On the other hand, completion of this procedure does not bring about substantive justice. This is because the agreement does not in fact constitute the complete agreement between the parties and that implicit obligations outside the written document exist.<sup>318</sup>

Although Mitchell notes that the “real” and the “paper” deal are very different, she is of the view that this does not always mean that an authentic agreement can be found in either the formal contract or the relational contract. At times it may be difficult to draw a clear

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<sup>316</sup> H Collins *Regulating Contracts* (1999) 137. From a practical viewpoint, Macaulay notes that big corporations consist of a large number of people and as such those who negotiate the contract and those who draft it are often not the same people. This naturally leaves room for differing and even contradictory assumptions and expectations between parties. Macaulay “The Real and the Paper Deal” in *Implicit Dimensions of Contract* 55.

<sup>317</sup> H Collins “The Research Agenda of Implicit Dimensions of Contracts” in D Campbell, H Collins & J Wightman *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 8.

<sup>318</sup> Collins “The Research Agenda of Implicit Dimensions” in *Implicit Dimensions of Contract* 10-11.

distinction between the two. What is needed instead is a type of legal reasoning sensitive to the operation of relational norms. An integrated approach is therefore called for.<sup>319</sup> This is somewhat in line with Collins' idea that exchange or transactional behaviour is based on three dimensions of normative systems.<sup>320</sup> These are the business relation,<sup>321</sup> the economic deal<sup>322</sup> and the formal contract.<sup>323</sup> It has been noted that a deeper understanding of the legal framework in business dealings has the capacity to improve the quality of contract law insofar as the law underpins or contributes to commercial contracts.<sup>324</sup>

The presence of three different normative frameworks or dimensions to a relational contract may be confusing. To this end, Collins uses the example of a breach of contract in failing to deliver goods. In such a case, the business relation may require that a party ignores the breach in order to preserve the business relation. It may also encourage the party guilty of breach to make amends. The economic deal may dictate that considerations of economic interest prevail when considering a response to the breach. It may lead to a compromise of interests in which late delivery is accepted or the goods entirely rejected. However, more often than not, a compromise of interests would mean that the response to breach should create a situation in which economic viability for all parties is preserved.

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<sup>319</sup> Mitchell (2009) *Oxford Journal of Legal Studies* 677.

<sup>320</sup> Collins *Regulating Contracts* 128.

<sup>321</sup> This, Collins writes, precedes the transaction and continues after its completion. It consists of the trading relation between the parties and involves enquiries, discussion of plans and solving problems that may have already arisen. He notes that surrounding this business relation, the parties may encounter social relations such as business lunches, family links or friendship networks, ethnic identity or membership of clubs. This is the part of the entire relational experience that provides a source of trust between the parties and encourages them to enter into a transaction. It also has the purpose of preserving and enhancing the trust between parties. See Collins *Regulating Contract* 129.

<sup>322</sup> This is the part of the transaction in which obligations are created, economic incentives are established and non-legal sanctions are determined. Collins notes that economic rationality provides the normative framework in terms of which parties will establish and assess their contractual behaviour. Collins *Regulating Contract* 129–130.

<sup>323</sup> This normative framework (each of the three dimensions are said to constitute a normative framework according to which the parties behave) as Collins describes it, consists of the standards provided by the self-regulation contained in the contract. In other words, the express norms parties record in the contract. Collins *Regulating Contract* 131.

<sup>324</sup> Mitchell (2009) *Oxford Journal of Legal Studies* 684.

The last dimension of the relation entails asserting rights of the parties where a “winner takes all” approach may be followed.<sup>325</sup> This description, Collins notes, is the most common observation of contractual behaviour.

As noted, Hawthorne relies on MacNeil’s assertion that there exists a hidden sub-culture which constitutes an enforcement mechanism based on social norms and codes of conduct particular to certain contracts. This mechanism, she writes, does not fall within the ambit of classical contract law which supports the literal enforcement of rules but is to be found in relational contract theory.<sup>326</sup> Interestingly, she does, however, prefer that although it does not provide for it, classical contract law perhaps has the capacity to provide for a mechanism to accommodate the realities of context-based long-term contracts based on the principle of good faith.<sup>327</sup> However, this may not be a plausible solution based on the

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<sup>325</sup> Collins *Regulating Contracts* 133–134. He notes further at 137 that the contractual framework does not disappear when a party to the contract chooses not to invoke a contractual norm and instead emphasise a business relation norm. The contractual framework may be used at any time. He notes though that all three frameworks or dimensions will usually be available for parties to use to negotiate their position and at different times throughout the relational exchange, some dimensions may take priority over others. Collins *Regulating Contracts* 137-138.

<sup>326</sup> L Hawthorne “Justice Albie Sachs’s contribution to the law of contract: Recognition of relational contract theory” (2010) 25(1) *SAPL* 80 85. This intersection between law and society, she notes, is the beginning of a paradigm shift from formal legal enforcement to the recognition of solidarity and co-operation in the interpretation of contracts. This will in turn give effect to the constitutional imperative of substantive justice. She further notes that the recognition of the principle of Ubuntu, which relates to a “fellow feeling” or the relationship formed amongst people who live or work together, can introduce co-operation into contracts which will protect weaker parties and create a duty to co-operate. In the same vein, Cornell writes that “ubuntu thinking” is crucial to the purpose of the Constitution which is to develop an interpretation of the Bill of Rights that goes beyond the limited notion of such a bill as only a defense against state intrusion. See D Cornell “A call for a nuanced constitutional jurisprudence: Ubuntu, dignity, and reconciliation” (2004) 19(1) *SAPL* 666 675.

<sup>327</sup> Hawthorne “Relational Contract Theory” in *Essays in Honour of AJ Kerr* 139-154. She writes that in the event of unequal or inequitable contract terms, a contractant has recourse to doctrinal protection in the form of estoppel, rectification, mistake, misrepresentation, duress and undue influence. She thus concludes that “the concept of good faith is inescapably connected to implicit dimensions of contracts.” She acknowledges that long-term contracts are based on co-operation and that strict insistence on execution of terms may negatively affect co-operation between parties. To this end, she is of the view that classical contract law addresses this issue by recognising a fiduciary duty of good faith and loyalty in specific contracts of partnership, agency and insurance. This of course is not provided for in a public procurement context and the manner in which good faith has been applied by our courts does not lend itself to a relational interpretation of contract terms.

confirmation by South African courts that good faith is not a “free-floating” principle to be used to enforce or set aside terms of a contract agreed to consensually.<sup>328</sup>

Quinot notes that the private law doctrine of privity limits *locus standi* in that only those with a direct interest in public procurement matters may approach a court for relief.<sup>329</sup> The substantive interests of those not directly involved in a procurement matter but nonetheless influenced, namely the public, are also unjustifiably limited.<sup>330</sup> Section 38 of the Constitution sets out the various categories of individuals who have *locus standi* to approach a court for legal redress. Subsection (d) which provides that those acting in the public interest is one of those categories. It is common cause that public procurement matters are in the public interest as public funds are expended when the government contracts for goods, works or services. Therefore, the public interest in such matters is clear.

It has been noted that the Constitution is meant, in the main, for societal transformation.<sup>331</sup> Swanepoel notes that one of the mandates of societal transformation was the insertion of section 38 which has significantly broadened the scope for *locus standi*.<sup>332</sup> Despite this, the private law of contract is still applicable to public procurement matters, therefore the

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<sup>328</sup> *Brisley v Drotsky* 2002 4 SA 1 (SCA) paras 14-15. Although a minority judgment in *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 4 SA 302 (SCA) held that good faith is part of public policy and therefore that the application thereof is in the public interest, this view was rejected by the court in *Brisley v Drotsky* and was held to have been merely the opinion of a single judge and not legally binding. The position of good faith in South African contract law as set down in *Brisley v Drotsky* was again confirmed in *Afrox Healthcare Ltd v Strydom* 2002 6 SA 21 (SCA). Although it was argued in both *Brisley* and *Afrox* that the court should on the basis of good faith declare the applicable contractual terms invalid, the court held at para 32 of the *Afrox* judgment that when it comes to the enforcement of contract terms, the court has no discretion whatsoever and does not act based on abstract ideas but on expressly specified legal rules. Hawthorne notes that the Constitution contains values which may conflict at times such as good faith and freedom of contract as seen in these two judgments. See L Hawthorne “Closing the open norms in the law of contract” (2004) 67 *THRHR* 294 294. See also E van der Sijde *The Role of Good Faith in the South African Law of Contract* LLM thesis University of Pretoria (2013).

<sup>329</sup> G Quinot *State Commercial Activity – A Legal Framework* (2009) 202-207.

<sup>330</sup> 204.

<sup>331</sup> CF Swanepoel “The public-interest action in South Africa: The transformative injunction of the South African Constitution” (2016) 41(2) *Journal for Juridical Science* 29 30.

<sup>332</sup> Swanepoel (2016) *Journal for Juridical Science* 31.

doctrine of privity finds application. The result is that the public is barred from challenging public procurement matters despite a section 38(d) right to do so due to the doctrine. Moreover, the public is not regarded as having an interest in such matters at all for purposes of litigation based on a lack of direct involvement or interest.<sup>333</sup> However, in *Secureco (Pty) Ltd v Ethekewini Municipality*,<sup>334</sup> the court acknowledged a public interest in a tender process by stating that the question of public interest is one to be considered in this case. The court held that it was in the public interest to set the unlawful tender aside.<sup>335</sup>

As noted above,<sup>336</sup> one of the common contract norms, which it is argued in this chapter,<sup>337</sup> is a foundational norm of public procurement, is harmonisation with the social matrix. What this means is that whatever the norms of a particular society are, will become the norms of the contracts concluded in that society. The South African society and its norms are informed by the Constitution. It is argued in this chapter, that the South African Constitution is a relational document. All law, including the private law of contract and public procurement law must comply with it. A further value or norm of the Constitution is involvement of the public in the regulation of the country and its laws. Therefore, it is only fitting that the public should be able to challenge public procurement matters based on their inherent public interest. A relational procurement law will certainly assist in this based on the common contract norms. It is acknowledged that differences between private and public procurement exist, however, apart from that discussed above and for the purpose of

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<sup>333</sup> This has been the manner in which *locus standi* has been approached by our courts. See *Areva NP Incorporated in France v Eskom Holdings* (CCT20/16, CCT24/16) [2016] ZACC 51 (21 December 2016) in which the court held that a tenderer who challenges a tender process but did not submit a tender in its own right, did not have *locus standi*. See also *Trans Creations KZN CC v City of Cape Town* (19367/2014) [2015] ZAWCHC 32 (23 March 2015) where the court relied on s 38(a) which allows for *locus standi* for anyone acting in his or her own interest and not s 38(d).

<sup>334</sup> (1100/2015) [2016] ZAKZDHC 14 (1 April 2016).

<sup>335</sup> See para 13(e).

<sup>336</sup> See para 4.2.

<sup>337</sup> See para 7 below.

this dissertation, no further fundamental differences between private and public procurement exist which may impact upon the working of a relational procurement law.

The above indicates that the nature of contracts, especially long-term contracts which are most prevalent in the construction industry, are much more relational than is acknowledged or allowed for in classical contract law. Therefore, there exists a need for a law or part of the law to be developed in order to adequately regulate public procurement contracts. What follows will be an explanation of construction procurement law as an example of a relational contract, thereby indicating that relational contract theory is in fact, at least to some degree, present in the practice of South African law.

## **6 Construction procurement law as a relational construct**

As noted in chapter two,<sup>338</sup> the new Standard for Infrastructure Procurement and Delivery Management came into operation on 1 July 2016. However, the Construction Industry Development Board (CIDB) prescripts have not yet been repealed. Therefore, they are still applicable at the time of writing this dissertation. Section 5(4)(a) of the Construction Industry Development Board Act (CIDB Act)<sup>339</sup> provides that the Construction Industry Development Board (CIDB) must publish a Code of Conduct<sup>340</sup> for “all construction related procurement and all participants involved in the procurement process”. The preamble of the Code of Conduct states that good corporate governance is valued by the construction industry. The key elements identified in the preamble are discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. It further

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<sup>338</sup> Para 6.1.

<sup>339</sup> 38 of 2000.

<sup>340</sup> Published as Board Notice 127 of 2003 in Government Gazette (GG) No. 25656 of 31-10-2003.

states that the development of the construction industry will be promoted by participants that have *inter alia* clearly stated and enacted corporate values, ensure that they perform efficiently and in accordance with the key elements of good governance, engage in long-term relationships, give due recognition to human rights, respect the well-being of employees by treating them fairly and with cultural sensitivity, practice and encourage greater social responsibility, promote collaborative partnerships with communities and guard against abuse of power by the stronger party in contractual relationships. Moreover, it states that:

“A common code of conduct to guide and regulate behaviour of parties engaged in construction-related procurement is necessary to establish the standards of behaviour that participants may expect from each other and against which their behaviour can be measured.”<sup>341</sup>

Part two of the Code sets out the principles governing the conduct of both public and private parties in construction-related procurement. They are required to behave equitably, honestly and transparently, discharge duties and obligations timeously and with integrity, comply with all applicable legislation and associated regulations, satisfy all relevant requirements established in procurement documents, avoid conflicts of interest and not maliciously or recklessly injure or attempt to injure the reputation of another party. Furthermore, specific duties for each party involved in the process are set out by the Code. To ensure that these patterns of behaviour are applied, section 27 of the CIDB Act provides for an inquiry into any breach of conduct committed in terms of the Code.

The key elements of corporate governance along with the elements of expected behaviour by participants of the procurement process align with those established by MacNeil as common norms of relational contracts.<sup>342</sup> For example, it is apparent that the elements

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<sup>341</sup> See CIDB Code of Conduct at 17.

<sup>342</sup> See para 2 of this chapter.

mentioned above relate or are similar to those of reciprocity, implementation of planning,<sup>343</sup> flexibility,<sup>344</sup> solidarity,<sup>345</sup> restraint of power<sup>346</sup> and harmonisation with the social matrix.<sup>347</sup>

As noted,<sup>348</sup> MacNeil writes that “contract” denotes the kind of relations found in a relational contract and “the contract”, meaning the actual document, merely serves as an example of such relations. Therefore, the public procurement process constitutes such relational exchange and therefore “contract” as MacNeil refers to it. The subsequent physical contract resulting from the process is an example of the relationship already formed between the procuring organ of state and tenderers. Various relations are thus formed between the procuring organ of state and tenderers.

## 7 Relational procurement law in South Africa

Macneil writes that:

“Any contract law system necessarily must implement certain norms. It must permit and encourage participation in exchange, promote reciprocity, reinforce role patterns appropriate to particular kind of exchange relations, provide limited freedom for exercise of

<sup>343</sup> Required by the new Standard for Infrastructure Procurement and Delivery Management issued as National Treasury Instruction Note 4 of 2015/2016 in terms of section 76(4)(c) of the Public Finance Management Act 1 of 1999. See <http://www.treasury.gov.za/legislation/pfma/TreasuryInstruction/Treasury%20Instruction%20No.%204%20of%202015%202016%20on%20Std%20for%20Infr%20Proc%20and%20Delivery%20Mngmt.pdf> (accessed 14-10-2017).

<sup>344</sup> This can be seen in the elements of transparency, accountability and fairness.

<sup>345</sup> In giving due recognition to human rights and treating participants to the process fairly, in other words treating them in accordance with the interest they hold in the procurement process or contract. This is also evident in the requirement to promote collaborative partnerships and long-term relationships with participants.

<sup>346</sup> In guarding against abuse of power by a stronger party. Gordon writes that in the case of classical contracts, an attempt is made to curb the problem of power by giving parties only those rights bargained for or formally agreed to in the contract. However, “what starts out as a mere inequity in market power can be deepened into persistent domination on one side and dependence on the other.” Gordon (1985) *Wisconsin Law Review* 570.

<sup>347</sup> In practicing and encouraging greater social responsibility and treating other participants to the procurement process with cultural sensitivity.

<sup>348</sup> Para 1 above.

choice, effectuate planning, and harmonize the internal and external matrixes of particular contracts”.<sup>349</sup>

In support of this, Macauley writes that:

“If we want our courts to carry out the expectation of the parties to contracts, both those that they express in writing and those that are left unrecorded or even unspoken, we must accept a contract law that rests on standards rather than on clear, quantitative rules”.<sup>350</sup>

Having established that there exists a need for a relational law of contracts, to which the public procurement process and the resultant contract will be subject, the question which arises is how relational contract law will be applied and/or enforced by our courts.

As noted, the public procurement and therefore the construction procurement process is undoubtedly a relational one.<sup>351</sup> The fact that public procurement constitutes an exchange, and that relational theory dictates norms belonging to a long-term relationship not necessarily based on a formal contract indicates that the construction procurement process falls within the ambit of relational contract theory. Perhaps in this instance, in ensuring legal certainty it may be useful to refer to only a relational theory rather than a relational contract theory in the case of public procurement, since no formal contract has been concluded at this stage. If MacNeil’s synthesis of relational contract theory is applied, the process will have both internal and external norms. The internal norms of the construction procurement process will have two aspects. Firstly, the values in section 217 of the Constitution will constitute internal norms. In other words, fairness, equity, transparency, competition and cost-effectiveness will form the basis of the construction procurement process and the consequent contract. The second aspect will be those

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<sup>349</sup> MacNeil (1978) *Nw.U.L.Rev* 862.

<sup>350</sup> Macauley “The Real and the Paper Deal” in *Implicit Dimensions of Contract* 52.

<sup>351</sup> See para 8 of this chapter where the relational norms of the construction procurement process are discussed.

internal norms which the parties agree to. For example, those set out in the CIDB Code of Good Conduct. To some extent the constitutional internal norms and the legislative internal norms may overlap. Any values or norms prescribed by the relevant professional associations will form the external norms to the construction procurement relation.<sup>352</sup>

It is submitted that the above suggestion is not an implausible one in the South African context. In fact, our Constitutional Court has acknowledged, although in a minority judgment, the existence and potential application of relational contract theory in our law. Sachs J in *Barkhuizen v Napier*<sup>353</sup> in adjudicating on the enforceability of a standard term insurance contract held that these types of contracts are drafted in advance by the insurer or supplier and presented to the consumer on a “take-it-or-leave-it” basis.<sup>354</sup> This is also the case in construction procurement contracts where standard form contracts such as the JBCC,<sup>355</sup> NEC,<sup>356</sup> and FIDIC<sup>357</sup> forms of contract are used. He notes further that these contracts contain common contract terms that weigh heavily in favour of the insurer and often limit the insured’s normal contractual rights. The insured is often unable to object to the standard terms and even more often unaware of their existence or not able to appreciate the terms fully.<sup>358</sup> The contract is merely handed over or posted to the insured

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<sup>352</sup> Schwartz notes that courts could possibly view relational contracts as little societies in which values evolve over time. The criteria for resolving disputes can be based on the interpretation that best reconciles with these local values. A second way is to base “decisional criteria on what parties probably expect of each other.” Parties to a contract seldom accept obligations that are not in their best interest. Consequently, each party will suppose that the other commits to practices which are in the interest of both parties. Norms that derive from these expectations will be efficient – they will maximise the parties’ welfare. Therefore, judges who derive the norms from the relationship “will act as the internal relational approach directs.” See A Schwartz “Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies” (1992) 21(2) *The Journal of Legal Studies* 271 276.

<sup>353</sup> 2007 5 SA 323 (CC).

<sup>354</sup> Para 135.

<sup>355</sup> This is a standard form contract created by the Joint Building Contracts Committee.

<sup>356</sup> This is the New Engineering Contract, a standard form contract commonly used by construction contractors.

<sup>357</sup> This is a standard form contract created by The International Federation of Consulting Engineers.

<sup>358</sup> Para 135.

to sign. This process indicates an imposition of will rather than a mutual consent to the contract.<sup>359</sup> Significantly, the judge notes that:

“A strong case can be made out of the proposition that clauses in a standard form contract that are unreasonable, oppressive or unconscionable are in general inconsistent with the values of an open and democratic society that promotes human dignity, equality and freedom...[w]hat is needed is a principled approach, using objective criteria, consistent both with deep principles of contract law and with sensitivity to the way in which economic power in public affairs should appropriately be regulated to ensure standards of fairness in an open and democratic society”.<sup>360</sup>

An important factor which had to be decided in this case, according to Sachs J, was the enforceability of terms which may be brought into the formal contract but which did not form part of the actual consensus or real agreement between the parties.<sup>361</sup> To this end, this judgment finds application to the possible field of relational procurement law.<sup>362</sup>

In the interpretation of contracts, “[w]hat public policy seeks to achieve is the reconciliation of the interests of both parties to the contract on the basis of standard that acknowledge the public interest without unduly undermining the scope for individual volition.”<sup>363</sup>

Moreover, it is significant that:

“[I]n long-term international commercial contracts, reasonableness rather than purely formal compliance is regarded as the yardstick against which duties of requisite good faith are tested. This renders the issues of good faith one of discretion and understanding, rather than one of formalistic principles.”<sup>364</sup>

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<sup>359</sup> Para 138.

<sup>360</sup> Para 140.

<sup>361</sup> Para 148.

<sup>362</sup> It is interesting to note that the judge held that it is not only the indigent and illiterate who are ignorant of the contents of a contract. The rich, too, have the same rights to fair treatment in their capacity as consumers. Therefore, a possible argument that the enforceability of standard contract terms may not be applicable to larger contractors in the construction procurement process does not hold water. The judge notes that “[i]f, in our new constitutional order, the quality of public policy, like the quality of mercy and justice, is not strained, then the wealthy must be as entitled to their day in court as the poor.” See para 149.

<sup>363</sup> Para 174.

<sup>364</sup> Para 167 in the court’s reliance on the South African Law Reform Commission Report on consumer protection in contracts in South Africa.

Hawthorne clearly states that the very reason why relational contract theory was developed was that classical contract law failed to adequately provide a framework in terms of which long-term contracts could operate.<sup>365</sup> In *South African Forestry Company Limited v York Timbers Limited*<sup>366</sup> the Supreme Court of Appeal held that although it was not entitled to impose on clearly expressed intentions of the parties its own notion of fairness, it was indeed entitled to do so where the contract is ambiguous. In such a case, the general principle that all contracts must be based on good faith is applicable and the intention of the parties is interpreted based on the assumption that they negotiated in good faith.<sup>367</sup> This, Hawthorne notes, is the operation of relational contract theory which justifies the application of implicit dimensions of a contract by inserting norms derived from trade usage, intention of the parties and as a course of dealing between the parties.<sup>368</sup>

Naturally, if relational theory were to be applied in a public procurement context, it would have to be determined whether there are any limits or parameters of the external norms to be imported into the process or the contract and if so, what these limits are. This would not be applicable to the internal norms as these would be determined by the parties themselves. Galletti, in referring to the Scottish example, notes that the Scottish Report on Interpretation in Private Law of 1997 identified “context” in contracts to be those norms which arise from the juridical act itself.<sup>369</sup> Those which constitute “surrounding circumstances”, in other words the external norms, are those which are external to the

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<sup>365</sup> Hawthorne (2007) *SA Merc LJ* 243.

<sup>366</sup> 2004 All SA 168 (SCA) para 32.

<sup>367</sup> Para 32.

<sup>368</sup> Hawthorne (2007) *SA Merc LJ* 243–244. Campbell discusses the English court’s acknowledgement and use of relational contract theory in its judgment *Yam Seng Pte Ltd v International Trade Corporation Ltd* 2013 EWHC 111 (QB). The court held at para 142 that “[s]uch ‘relational’ contracts, as they are sometimes called, may require a high degree of communication, co-operation and predictable performance based on mutual trust and confidence and involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties’ understanding and necessary to give business efficacy to the arrangements. Examples of such relational contracts might include some joint venture agreements, franchise agreements and long term distributorship agreements.” See D Campbell (2014) *The Modern Law Review* 475-492. See also C Goetz & E Scott “Principles of Relational Contracts” (1981) 67(6) *Virginia Law Review* 1089 1091 who refer to these examples of relational contracts.

<sup>369</sup> Galletti (2014) *The Comparative and International Law Journal* 250.

juridical act. The limits of the external norms would be to exclude the parties' direct and individual statements of intention, the negotiating stage and the subsequent conduct. However, only individual statements of intentions may be excluded from the normative framework of the contract. It should therefore not be considered for purposes of interpreting contracts. This is due to the fact that relational theory is by its very nature based on the intention of the parties which can only be determined by that which is written in the contract, their oral evidence and their conduct.

As noted above, the norms applicable to the construction procurement process will be those found in section 217 of the Constitution, those prescribed by the CIDB Code of Good Conduct and lastly those dictated by the industry such as those expected by trade societies or associations. An analysis of a construction contract will therefore commence with these internal norms along with MacNeil's common contract norms, then move to a consideration of the external norms. As with all law, common norms to all relational contracts will also be developed by our courts over time. The starting point of an analysis would be to determine whether the contract to be interpreted in fact constitutes a relational procurement contract.

It is further submitted that classical contract law cannot be entirely ignored in relational procurement theory. As noted, some contractual terms are included as a safety net to parties in the event of a breakdown of the relationship and also to set clear internal norms. The courts can therefore assist in interpreting the external norms to the relation. Therefore, although there is a need for relational exchanges to be recognised as a separate category of law, or at least of contract law, a hybrid system (meaning a combination of relational and classical contract law) will be best employed in doing so. Credence is therefore given

to both legal certainty to parties who prefer this and the inclusion of relational norms according to which the exchange will occur.

In further support of the proposition, as judge Sachs in *Barkhuizen v Napier* stated, standard term contracts, often used in construction procurement contracts, have been constructed in a way which favours the party with more bargaining power. This leaves room for abuse of power especially in the case of procurement since the process and contract is between a government entity and a private body who has less resources to enforce its rights in the case of a dispute. Furthermore, construction contracts are drafted in the engineering equivalent of “legalese”. In other words, they are couched in construction terms which may be challenging even for our courts to interpret. They may therefore be inclined to not make any pronouncements around substantive terms of a contract based on deference.

Section 39 of the Constitution enjoins our courts to develop the common law in line with the Bill of Rights. Included in the Bill of Rights is section 9, the right to equality, which it has been established, refers to substantive equality.<sup>370</sup> By incorporating relational norms into construction procurement, a less adversarial system is created. Smaller contractors who are not able to enforce their rights by way of litigation may thus be given an opportunity to resolve disputes with the government and subcontractors more amicably. The development of small contractors therefore promotes the implementation of substantive equality as a constitutional imperative. Moreover, section 217 of the

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<sup>370</sup> I Currie & J de Waal *The Bill of Rights Handbook* 6 ed (2013) 213 – 215.

Constitution reiterates the need for equity and requires that public procurement be fair, which does not exclude substantive fairness.<sup>371</sup>

It has also been held by our courts that the invitation, evaluation and award of public tenders is a form of administrative action.<sup>372</sup> Therefore, section 33 of the Constitution is applicable. As such, the construction procurement process must be *inter alia* reasonable. This requires that the conduct be rational and proportional of which the purpose of the latter element is to avoid an imbalance between the adverse and beneficial effects of the administrative action, in this case, the values which underpin behaviour in the construction procurement process.<sup>373</sup>

Furthermore, section 195 of the Constitution which provides for the conduct of public administration states in subsection 1(a) that a high standard of professional ethics is required. Subsection (3) in turn requires that national legislation must ensure the promotion of these values in subsection (1).<sup>374</sup> There is therefore a constitutional obligation on the government to act ethically, including the performance of contractual duties, and a corresponding constitutional obligation on our courts when developing the common law of contracts to consider foreign law such as incorporating relational theory of the USA into

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<sup>371</sup> P Bolton *The Law of Government Procurement in South Africa* (2007) 47.

<sup>372</sup> See *Umfoloji Transport (Edms) Bpk v Minister van Vervoer* 1997 2 All SA 548 (A) paras 552-553; *Transnet Ltd v Goodman Brothers (Pty) Ltd* 2001 2 BCLR 176 (SCA) para 23; *Logbro Properties CC v Bedderson NO* 2003 2 SA 460 (SCA) para 5; *Metro Projects CC v Klerksdorp Municipality* 2004 1 SA 16 (SCA) para 12.

<sup>373</sup> See C Hoexter *Administrative Law in South Africa* (2012) 340 – 346 for a discussion on the rationality and proportionality elements of reasonableness in the administrative law context. Brownsword writes that when interpreting commercial contracts, a literal interpretation can give rise to two untenable situations. Firstly, where the language suffers from ambiguity and secondly where the application of a literal meaning of the words would lead to absurdity. Therefore, literalism must have a solution to these problems. He suggests that courts must draw on reasonableness in solving this. Contextualism, on the other hand, takes the meaning of the terms of a contract from the context in which the agreement was made. The fundamental feature of contextualism, he writes, is that it seeks out the meaning of the agreement that best fits with its context. See Brownsword "After Investors" in *Implicit Dimensions of Contracts* 110.

<sup>374</sup> In the construction procurement law context, this has been done in the CIDB Code of Conduct in the requirement that all participants in the procurement process must act with transparency, accountability, responsibility and fairness.

South African construction procurement law.<sup>375</sup> Relational procurement law will therefore promote the broader goal of realising transformative constitutionalism.<sup>376</sup> This perhaps leads to a possibility that relational contract theory can form not only a basis for relational procurement law, but also the basis on which public law matters in South Africa in general are dealt with. Maser proffers that Constitutions are relational contracts because they secure co-operative relationships among members of a group and these relationships differ and change.<sup>377</sup> Although the author by referring to “constitutions” means municipal charters in an American context, this idea can be attributed to the South African context. In other words, it is submitted that the South African Constitution in itself is a relational document. It is a document intended to last a long period of time, and binds all parties in the country in both the public and private spheres. The Bill of Rights consistently refers to the “progressive realisation” of rights which indicates that the Constitution is intended to serve the country for a long period of time.<sup>378</sup> The manner in which the Constitution is applied must be based on its values and must be done in a spirit of co-operation. This is

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<sup>375</sup> Section 39(2) of the Constitution further states that courts in developing the common law, must promote the spirit, purport and object of the Bill of Rights. This should include the dignity imbedded in the freedom of contract parties have in deciding which norms to hold themselves bound to in the exercise of delivering goods and services to the government. It should further involve equality in how the rights of both parties (that of the government and the winning private contractor) are applied and vindicated. This involves reasonableness in how the express and implicit terms of a contract are applied in order to avoid unfair treatment of private contractors based on a traditionally uneven power relationship with the government. This way fundamental rights in the Constitution are vindicated while giving effect to s 39(2) in developing the common law.

<sup>376</sup> This has been a contested term in South African constitutional law as a precise definition has not yet been established, but it is broadly considered to be realisation of the values of the Constitution – transforming South African law and society by realising constitutional goals. Transformation has been referred to by former Pius Langa CJ as social and economic revolution. See J P Langa “Transformative Constitutionalism” (2006) 17(3) *Stellenbosch Law Review* 351 352. Bhana writes that to this end, those who undertake legal work must be aware of conservative legal culture as it manifests in their professional practices. They must ensure that it does not undermine the constitutionalisation of the common law. This, to Bhana, means that judicial commitment to legal principle such as *pacta sunt servanda* and the “contract law machine” in general must be justifiable in terms of a substantively progressive and transformative Constitution, especially in terms of the founding values of freedom, dignity and equality. The same would apply to the rules of interpretation. See Bhana (2015) *SALJ* 131-132. Justice Moseneke writes that the most important purpose of the change sought by the Constitution is freedom and achievement of equal worth and social justice. Social justice, in turn, is closely related to fair access to *inter alia* vital socio-economic goods and services. By parity of reasoning, private power cannot be immune from constitutional scrutiny especially when private power approximates public power or has a wide public impact. Moseneke (2009) *Stellenbosch Law Review* 12.

<sup>377</sup> S Maser “Constitutions as Relational Contracts: Explaining Procedural Safeguards in Municipal Charters” (1998) 8(4) *Journal of Public Administration Research & Theory* 527 527.

<sup>378</sup> See ss 26(2) and 27(2) of the Constitution.

evident in the weighing up of rights and values which is present throughout the Constitution. For example, the values in section 217 must be weighed against one another in order to achieve a fair result. The same is applicable in the case of socio-economic rights.<sup>379</sup> No right in the Constitution is absolute, therefore competing rights must always be evaluated and respected in light of co-operation between the parties involved.

Section 2 of the Constitution states that it is the supreme law of the land and that any law inconsistent with it is invalid. This would of course include the private law of contract in which relational contract theory is based and by analogy based on the arguments presented in this chapter, it would include relational procurement law. Section 1 of the Constitution provides that this country, in which the Constitution is supreme, is based on a democratic state founded on human dignity, equality and freedom. The state is naturally bound by the Constitution and as such must apply and vindicate the rights enshrined in the Bill of Rights. Relational procurement law, based on norms of fairness, equity, transparency, competition and cost-effectiveness in section 217(1) of the Constitution can therefore assist courts in determining whether duties of both the government and private parties have been performed adequately.

Further Constitutional values to those mentioned above, include lawfulness,<sup>380</sup> transparency,<sup>381</sup> accountability,<sup>382</sup> reasonableness<sup>383</sup> and fairness.<sup>384</sup> Section 8(1) of the Bill of Rights in turn binds all organs of state. Subsection 2 provides that a natural or juristic person is bound by the Bill of Rights to the extent that it is applicable, considering

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<sup>379</sup> For example the right to healthcare versus the ability of the state to provide such healthcare. See *Soobramoney v Minister of Health (KwaZulu-Natal)* 1998 1 SA 765 (CC). The same is applicable in the right to housing. See *Government of the Republic of South Africa v Grootboom* 2001 1 SA 46 (CC).

<sup>380</sup> Section 33.

<sup>381</sup> Section 217.

<sup>382</sup> Section 195.

<sup>383</sup> Section 33.

<sup>384</sup> This includes procedural and substantive fairness in sections 9, 33 and 217 of the Constitution.

the nature of the right and the duty imposed by the right. Section 8(3) provides that when, for purposes of this dissertation, an organ of state applies the Bill of Rights to a natural or juristic person such as a contractor, a court in giving effect to a right in the Bill of Rights must apply, or if necessary, develop the common law. As noted, relational procurement law will be based on the same principles on which the Constitution was founded, therefore it has the potential to assist courts in vindicating rights in the Bill of Rights. By the same token, the same principles apply in general public law since the state is an actor as in the case of public procurement law. Consequently, our courts may be less hesitant in applying standards of reasonableness when taking into account implicit dimensions of not only contracts, but administrative acts as well.

Moreover, the argument has been made that the common law of contract is in the process of being “constitutionalised”.<sup>385</sup> This means that private law contracts are moving towards being interpreted in constitutional terms which include reasonableness and good faith. This will inevitably blur the lines between private and public law. Such a development may be positive for the law of public procurement since the concluded contract, after the tender process has been completed, will then solely be formed and judged by the rules of public law which align with those of a proposed relational procurement law.

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<sup>385</sup> This topic has been debated in academic journals at great length. See for example D Tladi “Breathing constitutional values into the law of contract: Freedom of contract and the Constitution” (2002) 35(2) *De Jure* 306-317; O Cherednychenko “The Constitutionalisation of Contract Law: Something New under the Sun?” (2004) 8(1) *Electronic Journal of Comparative Law* 1-17; B Mupangavanhu “Yet another Missed Opportunity to Develop the Common Law of Contract? An Analysis of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* [2011] ZACC 30” (2013) 1 *Speculum Juris* 148-173; M Lourens & J Frantzen “The South African Bill of Rights – public, private or both: a viewpoint on its sphere of application” (1994) 27(3) *Comparative and International Law Journal of Southern Africa* 340-356; D Moseneke “Transformative Constitutionalism: Its Implications for the Law of Contract” (2009) 1 *Stellenbosch Law Review* 3-13; M Kruger “The Role of Public Policy in the Law of Contract, Revised” (2011) *SALJ* 712-740; D Bhana & A Meerkotter “The Impact of the Constitution on the Common Law of Contract: *Botha v Rich NO (CC)*” (2015) *SALJ* 494-509; D Bhana “The Implications of the Right to Equality in Terms of the Constitution for the Common Law of Contract” (2017) 1 *SALJ* 141-161; L Hawthorne “The ‘new learning’ and transformation of contract law: reconciling the rule of law with the constitutional imperative to social transformation” (2008) 23 *SAPL* 77-99.

## 8 Conclusion

Relational contract theory is a theory developed in the USA in response to the inadequacy of classical contract law to provide for the intricacies of long-term contracts. At present, it is a theory which advocates for an additional, complementary system of law which adequately provides for a framework in which long-term contracts can operate based on a set of norms. Both express and unexpressed norms are part of the theory, therefore, parties to a contract are bound to express, implied and tacit terms. The difference from classical contract law is that the norms applicable to the contract are the common contract norms which MacNeil has identified as role integrity, reciprocity, implementation of planning, effectuation of consent, flexibility, contractual solidarity, linked norms: restitution, reliance and expectation interests, restraint of power, harmonisation with the social matrix and propriety of means.

Relational contract theory is applicable to relational contracts which are characterised by a long duration of time and a relationship formed between the parties. In these relational contracts, a distinction is made between internal and external norms. Internal norms are those which the parties decide to include in their formal contract. The common norms identified by MacNeil are present in all long-term contracts, therefore they automatically become internal norms. External norms, on the other hand, are those external to the surroundings of the parties to the contract. These are norms prescribed by the industry in which the parties function and those norms prescribed by professional associations and societies they belong to.

When parties partake in a relational contract, legal rights arise from this relationship. The law is there to provide stability, facilitate co-operation between the parties and allow for enforcement mechanisms in the case of a breach of contract. It is also an indication of the social norms, customs and practices we prescribe to and become the norms according to which we measure behaviour including contractual behaviour. Therefore, the law is an important indicator of contractual norms.

It has been established that public procurement constitutes an exchange and a relationship is formed between the procuring organ of state and all tenderers in a tender process. This is owing to the fact that the tender process is usually a time consuming one. Furthermore, the construction industry constitutes a set number of contractors who register on a database and continuously tender for government contracts as their main source of income. Infrastructure delivery as the goal of the industry is defined as “the combination of all planning, technical, administrative and managerial actions associated with the construction, supply, renovation, rehabilitation, alteration, maintenance, operation, or disposal of infrastructure”.<sup>386</sup> Moreover, the Code of Good Conduct prescribes norms such as fair treatment, respect, cultural sensitivity, social responsibility and avoidance of abuse of power. A clear duty is placed on construction contractors to form long-term relationships. Therefore, construction procurement is undoubtedly of a relational nature. What remains is a recognition by our law that the process and the consequent contract is of relational nature and an amendment of the law in order to provide for the specific requirements of relational procurement.

It has been noted that classical contract law, due to its formal and doctrinal nature does not adequately provide for long-term contracts based on social norms to operate within its

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<sup>386</sup> National Treasury Instruction 04 of 2015/2016 3.

strict framework. There is thus a need for an alternative system of law to regulate these contracts. A relational procurement law under which construction procurement will resort is a plausible solution to this problem. The relational framework has already been set in the CIDB Code of Conduct which applies to all participants in the construction procurement process. This is further enumerated in the new Standard for Infrastructure Delivery which is binding on all construction contractors. What is required is a recognition of construction procurement as a separate category of contracts deserving of a separate regulatory framework. In addition to this, empirical studies have proven that contractors rely more often than not on the “unwritten” agreement between themselves rather than the written agreement. There is therefore already a tendency to operate on a relational level amongst each other.

Although it is submitted that a relational procurement law is necessary, it is also acknowledged that classical contract law has a contribution to make to the new legal framework for construction procurement. As such the proposition is that a medium between a formal and relational contract is found in terms of which parties can operate. The purpose of the formal contract being merely a safety net in the event of a breakdown in the relationship.

When it comes to enforcement of a construction procurement relation and its norms, our courts have already acknowledged that there exists a need for the realisation of substantive justice. In other words, as Sachs J in *Barkhuizen v Napier* noted, a principled criteria should be applied in contract law with sensitivity to the way in which public affairs should be regulated to ensure fairness in an open and democratic society.<sup>387</sup> Furthermore, the court in *South African Forestry Company Limited v York Timbers Limited* held that the

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<sup>387</sup> Paras 50-52.

notion of fairness may be imported into a contract in which the express intentions of the parties are ambiguous. All contracts should in such a case be assumed to have been negotiated in good faith.<sup>388</sup>

If a procurement relational theory were to be developed, it should be referred to as merely relational procurement law as opposed to a relational contract law since no contract has been concluded yet. It is further submitted that the internal norms would be those set out in section 217 of the Constitution, namely, fairness, equity, transparency, competition and cost-effectiveness. Along with this will be the norms required by the Code of Good Conduct and any other norms the parties themselves determine. The external norms to the relation will be those prescribed by the professional associations which contractors belong to. A court, in enforcing these norms, would determine whether the situation which presents itself indeed constitutes a construction procurement relation, then determine what the internal norms are, and lastly what the external norms were intended to be.

In further support of the proposition of a relational procurement law, section 39 of the Constitution places an obligation on our courts to develop the common law in line with the Bill of Rights. The courts are further permitted to take account of foreign law. The common law, meaning the classical contract law, may therefore be developed based on the American relational contract theory. Further rights in the Bill of Rights which may be realised are section 9, right to (substantive) equality, and section 33 of the Constitution which provides for the right to just administrative action which must be reasonable, meaning rational and proportional. Furthermore, section 195 of the Constitution which regulates public administration, requires that it should be performed ethically and regulated in a manner which ensures and promotes ethical values. Therefore, from a constitutional

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<sup>388</sup> Para 32.

point of view, importing relational theory into our law may assist in realising the broader goal of a transformed society. This is evidenced by the fact that relational theory is based on the same principles as those of the South African Constitution. Therefore, in applying relational procurement law, it is ensured that the values of equality, dignity, freedom, fairness, reasonableness and lawfulness are fulfilled.

It is submitted that the Constitution is a relational document, therefore the values and spirit in terms of which all individuals, corporations and public bodies must act are aligned with those of relational theory. The incorporation of relational procurement law is therefore a solution to the achievement of not only a well regulated area of law but also a gateway to ensuring fulfilment of Constitutional goals.

Two specific dimensions of relational theory will be discussed in the following chapters. Specifically in the construction procurement context, large infrastructure projects are often undertaken, in the form of public-private partnerships. Such projects involve a great number of role players and extend over a long period of time. These projects also have a great influence on the economic wellbeing of South Africa based on the large amounts of taxpayer money involved. In the next chapter, the influence of relational theory on public-private partnerships, if any, will be examined.

Based on South Africa's discriminatory past, a large number of contractors have been prevented from participating in tendering for government contracts. After 1994, many pieces of legislation were enacted in an attempt to start to correct this. It has expanded in such a way that it has become one of the important goals of public procurement – the achievement of equality. Therefore, following an exposition of relational theory as it

manifests in public-private partnerships, will be a discussion on its influence on the implementation of public procurement as a policy tool in South Africa.

## CHAPTER 5

### PUBLIC-PRIVATE PARTNERSHIPS IN INFRASTRUCTURE CONTRACTS

#### 1 Introduction

A public-private partnership (PPP) has been loosely defined as a long-term agreement between the government and a private party in terms of which the government pays the private party to deliver infrastructure on behalf of the government<sup>389</sup> or as a co-operative institutional arrangement between the private and public sector.<sup>390</sup> PPPs hold major advantages for the efficient procurement of infrastructure, involve a great number of role players and as such are an influential tool in public sector infrastructure. Amongst these role players, a number of significant relationships are formed over an extended period of time. It is thus submitted that PPPs are the largest manifestation of relational theory in South African public procurement law. Moreover, National Treasury has reported that the value of all PPPs since their inception in South Africa in 1998 amounts to R65.3 billion.<sup>391</sup> In addition to this, the government has incurred liabilities to the value of R10.9 billion in 2016 and 2017 due to government default in PPP agreements. Furthermore, PPPs account for R16.5 billion or 1,7% of the total public sector infrastructure budget in South Africa. PPPs are therefore of great economic significance for South Africa, thus justifying an examination thereof.

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<sup>389</sup> CO Aigbavboa, M Liphadzi & WD Thwala “An exploration of public-private partnership in infrastructure development in South Africa” presented at the 8<sup>th</sup> Construction Industry Development Board Postgraduate Conference 10-11 February 2014, University of the Witwatersrand, Johannesburg 101-109 102.

<sup>390</sup> G Hodge & C Greve *The Challenge of Public-Private Partnerships: Learning from International Experience* (2005) 1.

<sup>391</sup> See Public-Private Partnerships Budget (2017) 159 <<http://www.treasury.gov.za/documents/national%20budget/2017/review/Annexure%20E.pdf>> (accessed 14-10-2017).

This chapter will look at the nature of PPPs, how they are regulated, what they are by definition and how they function in practice. Next, the difference, if any, between general public procurement and PPPs will be discussed. Following this, the advantages and challenges of PPPs will be explained and a brief exposition of the implementation of preferential procurement in PPPs will be provided. Next, the need for PPPs will be discussed. Lastly, based on the social and economic significance of PPPs it will be proposed that a relational approach to PPPs affects the manner in which they are or can be understood and implemented which will ensure greater success in PPP projects. It will be suggested that relational procurement law is an adequate legal framework in which PPPs can successfully function.

## 2 The nature of public-private partnerships

Over the years, there has been a global movement towards privatisation.<sup>392</sup> According to Grimsey and Lewis, there has been an increasing dissatisfaction, especially in developing countries, with the performance of state-owned enterprises.<sup>393</sup> In response to increasing pressure on government budgets, a need has arisen to decrease government expenditure and a means of doing so has been to look to the private sector to fund the provision of infrastructure. The authors attribute the development of PPPs to three factors. Firstly, a change in attitude to the way in which public services are provided to the public. They note that PPPs are simply a method of procurement of infrastructure services and therefore an embodiment of a new public management which embraces privatisation, outsourcing and downsizing public sector activities.<sup>394</sup> The second factor to have contributed to the growth

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<sup>392</sup> A distinction between privatisation and PPPs is made in para 6 below.

<sup>393</sup> D Grimsey & MK Lewis *Public-Private Partnerships: The Worldwide Revolution in Infrastructure Provision and Project Finance* (2004) 30.

<sup>394</sup> 52.

of PPPs is the idea and refinement of the “private financing model”, meaning the practice of the private sector funding traditionally public sector functions such as infrastructure, housing or health services, and its various techniques to suit PPPs.<sup>395</sup> In the last instance is the concept of partnering which, according to the authors, was developed in the civil engineering industry and has provided an intellectual element to the construction of PPPs.<sup>396</sup> The most important components of partnering are mutual objectives which have been reduced to writing, conflict resolution methods which have been agreed upon and a mutual continuous search for improvement.<sup>397</sup> Lack of these components often lead to conflicts which cause disruption in delivery of the asset which in turn results in additional costs and time overruns, decreased quality, low morale and ultimately litigation.<sup>398</sup>

PPPs have been defined as “arrangements whereby private parties participate in, or provide support for, the provision of infrastructure, and a PPP project results in a contract for a private entity to deliver public infrastructure-based services.”<sup>399</sup> The United Kingdom equivalent of a PPP, referred to as a Private Finance Initiative (PFI) is succinctly defined by Arrowsmith as follows:

“[T]he Government engages a contracting partner both to build the asset and to operate it, with the private partner providing the support services during the contract period; and the Government does not pay for the asset at the time of construction. Instead, the contracting partner is remunerated by payments made throughout the contract period, either by the government itself, by other users of the asset (an arrangement sometimes referred to as a concession), or by a combination of both. Thus in the case of a hospital, the private contractor will both build the hospital and provide the support services, with the Government using the services hospital to provide medical care with the government medical staff and paying the contracting partner for use of the facility.”<sup>400</sup>

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<sup>395</sup> 52.

<sup>396</sup> 52.

<sup>397</sup> 66.

<sup>398</sup> 67.

<sup>399</sup> 2.

<sup>400</sup> S Arrowsmith *The Law of Public and Utilities Procurement* (2005) 2.16 – 2.17.

Grimsey and Lewis note that it is a common misconception that PPPs primarily involve private sector financing of public sector infrastructure.<sup>401</sup> They are of the view that:

“The essence of a PPP is that the public sector does not buy an asset; it is purchasing a stream of services under specified terms and conditions. This feature is the key to the viability (or not) of the transaction since it provides the right economic incentives.”<sup>402</sup>

They note further that most importantly, a PPP is a “strongly incentive-compatible contracting arrangement” and that its cost-effectiveness compared to that of a general procurement process is higher based on the design, financing structure and management of the PPP which is created upfront.<sup>403</sup>

A number of common elements of PPPs globally have been identified.<sup>404</sup> Firstly, the presence of participants of which one is a government entity. Each of the parties is capable of contracting on its own behalf and all parties must commit to the partnership. Secondly and most importantly for purposes of this dissertation, is the existence of a relationship between the parties. Grimsey and Lewis note that in PPP relationships, genuine continuity of behaviour is important which results in enduring relations.<sup>405</sup> In the third instance, each of the parties must contribute resources to the partnership. Fourthly, PPPs involve a sharing of risks whether it is financial or otherwise. The authors note further that in a PPP context, the government entity and private party are equal partners unlike the norm in which the government entity is in a more advantageous or commanding

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<sup>401</sup> Grimsey & Lewis *Public-Private Partnerships* 6.

<sup>402</sup> 6. See also ER Yescombe *Public-Private Partnerships: Principles of Policy and Finance* (2007) 6.1 who notes that public procurement in the PPP context is when the public authority enters into a contract with a supplier from the private sector. This must be distinguished from “public sector procurement” which means direct procurement by a public authority and not via a PPP.

<sup>403</sup> 6.

<sup>404</sup> 13. Similarly, Geddes identifies the characteristics of a PPP as being a medium to long-term relationship; a relationship based on shared aspirations; it can involve various partners; it involves sharing of risks, rewards and resources and the aim is to deliver a service which is in the public interest on a continuously improving basis. See M Geddes *Making Public-Private Partnerships Work: Building Relationships and Understanding Cultures* (2005) 2. These factors are discussed in further detail in para 7 below.

<sup>405</sup> 14.

position. Lastly is the element of continuity. This involves the existence of rules for the relationship which underpin the working of the PPP. This creates certainty as to the responsibility of each party in a relationship with shared values and a mutual understanding of the objectives.<sup>406</sup>

Authors of public administration Koliba, Meek and Zia<sup>407</sup> note that various types of governance networks exist depending on the parties they consist of and the goals they aim to achieve. PPPs they note are formed when organisations from different sectors partner with each other to achieve a public purpose. The reason why PPPs form according to them is that it gives the government an opportunity to learn business practices from the private party, to commercialise public problems in order to entice the private sector to become involved, there are less bureaucratic rules to overcome by transferring the service to the private party and it replaces the traditionally adversarial relationship between the government and the private sector with a more like-minded and common goal driven one.<sup>408</sup>

### 3 The legal regulation of PPPs in South Africa

In this section, the legal regulation of PPPs in South Africa will be discussed. Firstly, a definition of PPPs will be provided, then the working of PPPs in South Africa will be

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<sup>406</sup> The authors note that except in cases where ownership of the asset remains with the private party, at the end of the PPP the public body or government entity takes ownership and resumes responsibility for the operation and management of the asset. However, the government entity, may still means of a specific type of PPP such as an operate-manage or a lease-renovate-operate-transfer agreement with the private party. Based on this, "relationships between the government and the market can be viewed as a continuum." See Grimsey & Lewis *Public-Private Partnerships* 54.

<sup>406</sup> C Koliba, JW Meek & A Zia *Governance Networks in Public Administration and Public Policy* (2011) 23.

<sup>406</sup> 21.extend the PPP by means of a specific type of PPP such as an operate-manage or a lease-renovate-operate-transfer agreement with the private party. Based on this, "relationships between the government and the market can be viewed as a continuum." See Grimsey & Lewis *Public-Private Partnerships* 54.

<sup>407</sup> C Koliba, JW Meek & A Zia *Governance Networks in Public Administration and Public Policy* (2011) 23.

<sup>408</sup> 21.

explained. Following this will be a brief discussion on the working of preferential procurement in PPPs as applied in South Africa since the use of procurement as a policy tool is discussed in more detail in chapter six.

### 3 1 Definition of PPPs in South Africa

PPPs are regulated by Regulation 16 to the Public Finance Management Act (PFMA)<sup>409</sup> and section 120 of the Municipal Finance Management Act (MFMA).<sup>410</sup> Section 120 provides that where a PPP involves a municipal service,<sup>411</sup> Chapter 8 of the Municipal Systems Act (MSA)<sup>412</sup> must also be complied with. In addition to Regulation 16 of the PFMA, National Treasury has established a PPP unit which has issued a PPP manual for parties who intend to form PPPs to comply with.

Regulation 16 of the PFMA defines a PPP as follows:

“A commercial transaction between an institution<sup>413</sup> and a private party in terms of which the private party<sup>414</sup> –

- (a) performs an institutional function<sup>415</sup> on behalf of the institution; and/or
- (b) acquires the use of state property for its own commercial purposes; and

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<sup>409</sup> 1 of 1999.

<sup>410</sup> 56 of 2003.

<sup>411</sup> Defined in section 1 of the Municipal Systems Act as “a service that a municipality in terms of its powers and functions provides or may provide to or for the benefit of the local community irrespective of whether (a) such a service is provided, or to be provided, by the municipality through an internal mechanism contemplated in section 76 or by engaging an external mechanism contemplated in section 76 and; (b) fees, charges or tariffs are levied in respect of such a service or not;”.

<sup>412</sup> 32 of 2000.

<sup>413</sup> Defined in Regulation 16.1 as “a department, a constitutional institution, a public entity listed, or required to be listed in Schedules 3A, 3B, 3C and 3D to the Act, or any subsidiary of any such public entity.”

<sup>414</sup> Regulation 16.1 defines a private party as “a party to a PPP agreement, other than – (a) an institution to which the Act applies; (b) a municipality or a municipal entity under the ownership control of one or more municipalities, or (c) the accounting officer, accounting authority or other person or body acting on behalf of an institution, municipality or municipal entity referred to in paragraph (a) or (b);”.

<sup>415</sup> An institutional function is defined in Regulation 16.1 as “(a) a service, task, assignment or other function that an institution is entitled or obliged to perform – (i) in the public interest; or (ii) on behalf of the public services generally; or (b) any part or component of or any service, task, assignment or other function performed or to be performed in support of such a service, task, assignment or other function;”.

- (c) assumes substantial financial, technical and operational risks in connection with the performance of the institutional function and/or use of state property; and
- (d) receives a benefit for performing the institutional function or from utilising the state property, either by way of:
  - (i) consideration to be paid by the institution which derives from a revenue fund or, where the institution is a national government business enterprise or a provincial government business enterprise, from the revenues of such institution; or
  - (ii) charges or fees to be collected by the private party from users or customers of a service provided to them; or
  - (iii) a combination of such consideration and such charges or fees;"

It has been noted by Aigbavboa, Liphadzi and Thwala that a PPP should be seen as a catalyst for providing basic infrastructure services with the purpose of improving the quality of the lives of citizens.<sup>416</sup> The private party uses its own funds for construction and must ensure that the infrastructure is provided on time and within the budget agreed upon. It has also been said<sup>417</sup> that in a PPP project, the government invites private parties, by way of a competitive tender process, to participate in a PPP by being responsible for the design, build, finance and operation of an asset in order to provide a service to or on behalf of the government. The payment of the services will come either from the public sector or from the consumers of the service.

As required by Regulation 16.8, the PPP must provide value for money, appropriate risk transfer to the private party and affordability.<sup>418</sup> It has been said that the most significant advantage of a PPP is that the private party provides the funding for the project.<sup>419</sup> The government pays for the service once it is provided and therefore does not need the funds

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<sup>416</sup> See Aigbavboa, Liphadzi & Thwala (2014) 102.

<sup>417</sup> See J Labuschagne "Public-private possibilities" (2016) *Institution of Municipal Engineers of South Africa* 63 63.

<sup>418</sup> Regulation 16.1 states that affordability "means that the financial commitments to be incurred by an institution in terms of the PPP agreement can be met by funds – (a) designated within the institution's existing budget for the institutional function to which the agreement relates; and/or (b) destined for the institution in accordance with the relevant treasury's future budgetary projections for the institution;". Value for money, in turn, refers to "the provision of the institutional functions or the use of state property by a private party in terms of the PPP agreement results in a net benefit to the institution defined in terms of cost, price, quality, quantity, risk transfer or a combination thereof."

<sup>419</sup> Labuschagne (2016) *IMIESA* 63.

for construction of the asset involved.<sup>420</sup> Therefore, National Treasury describes a PPP as “a contract between a public sector institution and a private party, in which the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a project”.<sup>421</sup>

National Treasury indicates that a PPP is not simply the outsourcing of functions where substantial risk is assumed by the private party. Neither is it a donation to the government. It is not a divestiture of state assets or the privatisation thereof. A PPP is also not the commercialisation of a public function and it does not constitute borrowing by the state.<sup>422</sup>

In what follows, the working of a PPP in South Africa, as prescribed by legislation will be explained.

### 3.2 The working of PPPs in South Africa

It is important to note that Regulation 16 indicates two types of PPPs. Firstly a PPP where the private party performs an institutional function<sup>423</sup> and secondly where the private party acquires the use of state property for its own commercial purposes.<sup>424</sup> Sections (c) and (d) of the definition of PPPs above refer to the combination of the two, therefore a hybrid form of PPP. In order to adequately describe the working of a PPP, the diagram used by National Treasury in Practice Note Number 02 of 2004 will be used.

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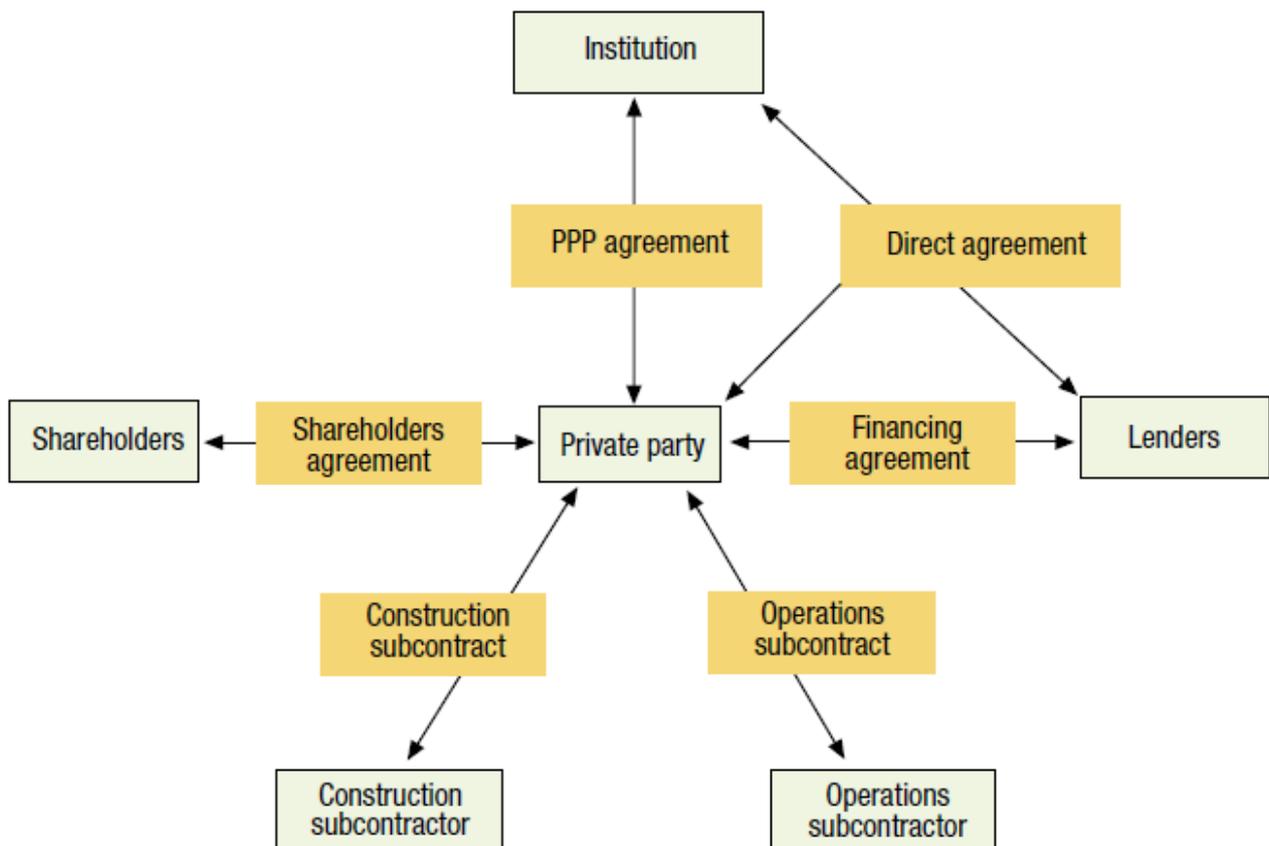
<sup>420</sup> Labuschagne (2016) *IMI/ESA* 63.

<sup>421</sup> National Treasury PPP Practice Note Number 02 of 2004: Manual Module 1: South African Regulations for PPPs 4.

<sup>422</sup> 5.

<sup>423</sup> See part (a) of the definition above.

<sup>424</sup> See part (b) of the definition above.



In the above diagram, the government institution concludes a PPP agreement with a private party. The private party in turn, in order to raise funds for the asset involved to be constructed, borrows money from lenders such as banks. At the same time, the private party also concludes shareholders agreements with shareholders who financially contribute to the PPP and will receive a dividend once the private party is paid for its service by the government institution. In order to construct the asset, the private party concludes contracts with a construction subcontractor and an operations subcontractor. It is not clear what the function of the latter is, however, it is submitted that the function of the operations subcontractor is in all likelihood to manage the operations of the construction.

According to National Treasury, the delivery of infrastructure via the use of a PPP is a six stage project. The first phase involves the project inception at which stage the PPP is registered with the relevant treasury which is generally National Treasury unless this

function has been delegated. At this stage, a project officer<sup>425</sup> and transaction advisor<sup>426</sup> is appointed.<sup>427</sup> During the second phase, the feasibility study, it is important to determine whether the PPP is in the best interests of the government institution. The accounting officer or authority appointed by the institution is tasked with this responsibility which entails an explanation of the benefits of the proposed PPP and sets out in detail the financial, technical and operational responsibilities and risks to be allocated.<sup>428</sup> According to National Treasury, the three tests applicable to a PPP are firstly whether the government institution can afford the PPP, secondly whether value for money will be attained and lastly whether substantial technical, operational and financial risk is transferred to the private party.<sup>429</sup> After the feasibility study has been successfully completed, National Treasury will approve this phase of the PPP project.

The third phase of the PPP project involves procurement. After the relevant procurement documents have been approved by National Treasury, the documents are advertised and a normal competitive bidding process is followed. The procurement procedure is subject to section 217 of the Constitution which requires the process to be fair, equitable, transparent, competitive and cost-effective.<sup>430</sup> In addition to this, the process must provide for preferences to be awarded to groups of contractors.<sup>431</sup> More specifically, during this process bidders are pre-qualified and a request for proposals is advertised along with a draft of the PPP agreement. Once bids are received, they are compared with the feasibility

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<sup>425</sup> Defined in Regulation 16.1 as “a person identified by the accounting officer or accounting authority of an institution, who is capable of managing and is appropriately qualified to manage a PPP to which that institution is party from its inception to its expiry to termination;”.

<sup>426</sup> Defined in Regulation 16.1 as “a person or persons appointed in writing by an accounting officer or accounting authority of an institution, who has or have appropriate skills and experience to assist and advise the institution in connection with a PPP, including the preparation and conclusion of a PPP agreement;”.

<sup>427</sup> See Regulation 16.3.1.

<sup>428</sup> See Regulation 16.4.1.

<sup>429</sup> National Treasury PPP Practice Note Number 02 of 2004: Manual Module 1: South African Regulations for PPPs 8.

<sup>430</sup> See s 217(1) of the Constitution of the Republic of South Africa, 1996.

<sup>431</sup> See s 217(2) and (3) of the Constitution and Regulation 16.5.3 to the PFMA. Preferencing in PPPs is discussed in para 3.3 below.

report of the accounting authority and the preferred bidder is selected. A report is then prepared in which it must be proven that value for money will be achieved through use of the preferred bidder in the PPP project.<sup>432</sup> After this, the third approval by National Treasury is given and negotiations with the preferred bidder are entered into. Once negotiations are completed, the PPP agreement is finalised and another approval by National Treasury is required. Once this approval is obtained, the PPP agreement is signed by the relevant parties.

During the fourth to sixth phase of the process, the PPP agreement is managed by the accounting authority appointed by the government institution. This authority ensures that the agreement is correctly implemented, managed, enforced, monitored and reported on.<sup>433</sup> Provision is made in Regulation 16.8 for the amendment and variation of PPP agreements for which further approval is required and to be granted only if value for money, affordability and risks transfer substantially remains the same.<sup>434</sup>

### 3 3 Preferential procurement and PPPs

In line with the application of the Preferential Procurement Policy Framework Act (PPPFA)<sup>435</sup> and Broad Based Black Economic Empowerment Act (BBBEE Act)<sup>436</sup> in the sphere of public procurement, preferential procurement finds application in the PPP process as well. According to National Treasury,<sup>437</sup> preferential procurement is to be

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<sup>432</sup> National Treasury PPP Practice Note Number 02 of 2004: Manual Module 1: South African Regulations for PPPs II. See further Regulation 16.6.1 which describes in detail the requirements to be met before approval can be given.

<sup>433</sup> Regulation 16.7.

<sup>434</sup> Regulation 16.8.2.

<sup>435</sup> 5 of 2000.

<sup>436</sup> 53 of 2003.

<sup>437</sup> PPP Practice Note Number 03 of 2004 5.

applied at two stages during the PPP process. Firstly, when a transaction advisor is appointed and secondly, during the procurement of the private party. At the same time, it is noted that preferencing is applied at every stage of the PPP process.<sup>438</sup> It would appear that a balanced scorecard for the entire PPP process is created for the purpose of achieving Broad-Based Black Economic Empowerment (BBBEE) goals. In other words, goals are set out for the implementation of BBBEE at each stage of the PPP project cycle. The BBBEE Act describes BBBEE in section 1(c) as follows:

“[T]he viable economic empowerment of all black people, in particular women, workers, youth, people with disabilities and people living in rural areas, through diverse but integrated socio-economic strategies that include, but are not limited to-

- (a) increasing the number of black people that manage, own and control enterprises and productive assets;
- (b) facilitating ownership and management of enterprises and productive assets by communities, workers, co-operatives and other collective enterprises;
- (c) human resource and skills development;
- (d) achieving equitable representation in all occupational categories and levels in the workforce;
- (e) preferential procurement from enterprises that are owned or managed by black people; and
- (f) investment in enterprises that are owned or managed by black people;<sup>439</sup>

During the first stage, when a transaction advisor is appointed, where the contract is worth more than R1 million as prescribed by the PPPFA,<sup>440</sup> a maximum of 10 points may be awarded for preference. National Treasury notes that a transaction advisor constitutes a consortium of professionals with the appropriate skills and experience to assist the government institution with the PPP.<sup>441</sup> It is noted that the 10% preference points will be based on a balanced scorecard for which a transaction advisor must achieve a minimum

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<sup>438</sup> 16.

<sup>439</sup> S 1(b) defines black people as a generic term for Africans, Coloureds and Indian South African citizens who are such by birth or descent, who became citizens by naturalisation before 27 April 1994 or on or after this date who would have been entitled to citizenship by naturalisation prior to that date. Preferential procurement in general will be analysed in further detail in chapter 6.

<sup>440</sup> See Regulation 6 to the PPPFA. National Treasury PPP Practice Note Number 02 of 2004 at 5 refers to 10% of the bid. In line with the regime prescribed by the PPPFA, reference should be made to points rather than percentages as discrepancies may arise where the total amount may not be 100 as is indicated in the PPPFA. Therefore, provided the total percentage referred to remains 100%, 10% of a bid above the value of R1 000 000 is correct.

<sup>441</sup> PPP Practice Note Number 03 of 2004 16.

of 60% of the total points.<sup>442</sup> A two envelope system is used where BBBEE and functionality are assessed first.<sup>443</sup> According to the Practice Note, four elements are looked at, for which a minimum score of 60% must be achieved. The four elements consist of firstly the percentage of black people who are leaders in the transaction consortium. Secondly, the percentage of black equity in the consortium, thirdly, the transaction advisor is expected to present a credible plan for structuring effective BEE for the PPP and indicate the necessary skills and experience in the team. In the fourth instance, a plan for skills transfer within the consortium must be demonstrated which will directly benefit black professionals who are inexperienced in the field of PPPs.<sup>444</sup>

It is noted that BBBEE is applied during the feasibility study phase of the PPP project cycle. However, it appears that during this phase, the BBBEE elements to be complied with by bidders and the minimum points to be achieved are merely set out. Therefore, BBBEE is not strictly applied during this phase of the project.<sup>445</sup>

During the procurement phase of the PPP project, a competitive bidding process for the selection of a private party is conducted. Approval by National Treasury of this phase of the project will be granted only where the BBBEE balanced scorecard for the project has been complied with.<sup>446</sup> The procurement stage involves a request for qualification stage and a request for proposals stage. The scorecard created for the PPP project must be advertised in the request for qualification to enable bidders to indicate how they intend to

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<sup>442</sup> PPP Practice Note Number 03 of 2004 5.

<sup>443</sup> The two envelope system is discussed in chapter 6.

<sup>444</sup> PPP Practice Note Number 03 of 2004 18.

<sup>445</sup> 19 – 20. Examples of BBBEE requirements to be set out during this phase are an expectation on the bidder to draw up a list of BBBEE output it intends to achieve, a plan of the impact of each BBBEE output or initiative and to identify BBBEE strengths and constraints it may experience. See PPP Practice Note Number 02 of 2004 20.

<sup>446</sup> See PPP Practice Note Number 03 of 2004 22.

comply with the scorecard.<sup>447</sup> Bidders will further be required to indicate written commitments from subcontractors<sup>448</sup> in order to prove how they intend to comply with BBBEE requirements. Once a request for proposals is advertised, a revised BBBEE scorecard must be included where applicable. The revised scorecard is based on the initial scorecard with consideration of the responses received after publication of the request for qualification.<sup>449</sup> Furthermore, the funding structure to be used by the bidders must be included. This means the sources of black equity such as balance sheet funds, loans and equity funds must be demonstrated, the cost of skills development and socio-economic programmes to be undertaken by bidders. All shareholder's agreements and subcontracts should reflect similar information.<sup>450</sup>

The Practice Note indicates that in the agreement between the private party and shareholder's, black equity,<sup>451</sup> active equity,<sup>452</sup> the cost of black equity and cash flows returns to black shareholders must be indicated.<sup>453</sup> On the other hand, private party management and employment preferencing must be addressed in the agreement between the private party and its lenders. More specifically this should include black management control, black women<sup>454</sup> in management control<sup>455</sup>, employment equity and skills development.

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<sup>447</sup> 23.

<sup>448</sup> Defined as "the counter-parties of the Private Party to the Subcontracts including the Construction Subcontractor and the Operations Subcontractor."

<sup>449</sup> 23.

<sup>450</sup> 24.

<sup>451</sup> Defined at 1 as "the voting equity in the Private Party held by Black Shareholders from time to time."

<sup>452</sup> Defined at 1 as "in relation to the Black Equity or in relation to any issued shares in the share capital of any Subcontractor held by Black People and/or Blank Enterprises, in which such Black Equity or share is/are held by Black People and/or Black Enterprises who will participate directly in the day-to-day management and operations of the project." Black people are in turn defined as African, Coloured or Indian South African citizens.

<sup>453</sup> 9.

<sup>454</sup> Black women are indicated as being female African, Coloured and Indian South African citizens.

<sup>455</sup> Management control means "in relation to any enterprise, the ability to direct or cause the direction of the business and management policies or practices of that enterprise."

It would appear that subcontracts in a PPP project are an ideal opportunity to promote BBBEE initiatives as the BBBEE elements noted above can be implemented in both the construction subcontracts and the operations subcontracts. In addition to this is the procurement of black small, medium and micro enterprises (SMMEs)<sup>456</sup> which in turn will have a socio-economic impact.<sup>457</sup>

#### 4 PPPs versus general public procurement

As noted, the procurement of a private party to a PPP forms a single phase of the PPP project cycle. It therefore forms part of a larger, long-term project. In the case of general public procurement, a single competitive tendering process is used in order to acquire the goods or services needed. Grimsey and Lewis note that rather than there being separate design, construction, financing, operation and maintenance arrangements, these functions are combined by one contractor.<sup>458</sup> In other words, in general procurement, as opposed to a PPP, the government entity may specify the requirements for the asset or service and ownership of the asset remains with the government entity. The asset or service is then paid for on completion.<sup>459</sup> Moreover, the World Bank rules on PPPs provide that:

“[C]ontracts for PPPs have as objective the provision of a service by the Service Provider, for which, the Service Provider may have all responsibilities from design of the facilities, the funding, and its construction and at times operation for the provision of the service. In other words, in conventional procurement the approach is ‘input’ oriented – the Contractor is hired to deliver as product a construction (or plant) in accordance with a pre-established design and paid based on how much ‘input’ is put into the final product; while on PPP the approach is ‘output’ oriented – the Service Provider is hired to deliver a service for which he will construct the facility he deems adequate for delivery of the required ‘output’ and the

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<sup>456</sup> Defined in the Practice note 2 – 3 as “any business, trade, undertaking or other enterprise which is directly owned and managed by one or more nature persons and which has: (a) less than [x] full-time equivalent employees; (b) an annual turnover less than [Rx] (indexed to CPIX); and (3) gross asset value (fixed property included) of less than [Rx] (indexed to CPIX), to be determined by the Institution, taking account of the sector, on a project by project basis.”

<sup>457</sup> PPP Practice Note Number 03 of 2004 9.

<sup>458</sup> Grimsey & Lewis *Public-Private Partnerships* 1.

<sup>459</sup> Hodge & Greve *The Challenge of Public-Private Partnerships* 64 Table 4.1.

revenue normally proceeds (directly or indirectly) from the final beneficiary of the services.”<sup>460</sup>

In the legislation which regulates PPPs in South Africa, it appears that Regulation 16 to the PFMA makes a distinction between PPPs and procurement. Section 217 of the Constitution is referred to only in Regulation 16.5 which specifically provides for the competitive tendering procedure which is followed during the PPP project. Despite this, if PPPs were viewed from a relational perspective, they would constitute public procurement.<sup>461</sup> Moreover, section 217(1) of the Constitution provides that “when organs of state contract for goods or services”, PPPs resort under this section, thereby constituting a form of public procurement. Despite the fact that the tendering process is merely one phase of the PPP, due to its complex nature a PPP will naturally not be similar to a traditional public procurement process. Extensive planning is required, and the increased risk and duties on the private party result in long-term execution of the project. However, in a PPP, the government is still “contracting for goods or services”, therefore engaging in public procurement.

Given the characteristics of PPPs in the involvement of private parties and the retention or transfer of ownership, it is important to distinguish this from privatisation and outsourcing. The latter is defined by Arrowsmith *et al*<sup>462</sup> as “the process of contracting out of functions to the private sector or other entities, rather than carrying out these functions in-house using government employees.” Functions which are commonly outsourced are for example cleaning services, maintenance of vehicles or equipment, printing and publishing of

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<sup>460</sup> Procurement Arrangements Applicable to Public-Private Partnerships (PPP) contracts financed under World Bank Projects (2010) 14 <[https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/ppp\\_testdumb/documents/GuidanceNote\\_PPP\\_September2010.pdf](https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/ppp_testdumb/documents/GuidanceNote_PPP_September2010.pdf)> (accessed 14-10-2017).

<sup>461</sup> This is discussed in para 7 below.

<sup>462</sup> S Arrowsmith, J Linarelli & D Wallace *Regulating Public Procurement: National and International Perspectives* (2000) 63.

government documents and even at times professional advice on legal or information technology matters.<sup>463</sup> A factor considered in deciding between the use of a competitive tendering process or outsourcing is value for money. In other words, the question to be answered is whether in-house or external provision will provide the goods or services at the best possible terms.

## 5 Advantages and challenges of PPPs

Based on the high financial risk and economic impact of PPPs, it is important to determine whether they holds sufficient advantages to justify the continued use of PPPs. Therefore, in this section, the advantages and challenges of PPPs will be discussed.

### 5 1 Advantages

Naturally, the biggest advantage of PPPs is that they deliver much needed infrastructure to the public who enjoy the provision of infrastructure. It has been noted, that PPPs may lead to reduced taxes.<sup>464</sup> However, the actual cost to the public at large may be more than it would have been, had the government raised sufficient funds to provide the service. This is since governments are able to borrow money at a lower interest rate than the private sector as they are seen as better credit risks.<sup>465</sup> However, private borrowers have to repay the money borrowed and make a profit from the service offered. Therefore, the service used may cost more than it would have, if it had been provided by the government.<sup>466</sup> In

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<sup>463</sup> 63 – 64.

<sup>464</sup> Hodge & Greve *The Challenge of Public-Private Partnerships* 82.

<sup>465</sup> 83.

<sup>466</sup> 83. Tvarno writes that the idea of a PPP is to reduce cost and price, increase quality, reduce the risks and failures and share the responsibility and capacity. She writes that “[t]hose objectives result in a shift of

addition to this, governments also gain from engaging in PPPs. It has been noted that it may acquire the favour of the business community who may potentially form future partnerships with the government and therefore form a relationship.<sup>467</sup> A further advantage of PPP projects is that the risk of the success of the project including funding the project rests on the private party. The government institution merely monitors the project without taking on any of the responsibility assigned to the private party in the PPP agreement.<sup>468</sup> Another advantage highlighted is the capacity within a PPP structure to contribute to accountability by clarifying responsibilities of both the private party and government institution.<sup>469</sup>

Arrowsmith notes that PPPs have the possibility of saving money due to the integration of the various phases of the process into one. In other words, by combining the construction, operation and management of the asset, money is saved by the private party providing a more efficient solution for the construction, operation and management of the asset especially because these phases are managed by one provider.<sup>470</sup> She notes that a PPP also provides an opportunity for innovation in service delivery on the part of the private party. In addition, waste caused by governments due to lack of skills and practical or legal constraints as to how to effectively utilise spare assets may be avoided.<sup>471</sup>

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content in the contract. Normally, a traditional public contract is based on demands and concrete descriptions. To fulfil the objectives, the PPP contract focusses on needs and functions, and it must be built on trust and transparency through open books and cooperation between the parties." See C Tvarno "Law and regulatory aspects of public-private partnerships: contract law and public procurement law" in G Hodge, C Greve & A Boardman (eds) *International Handbook on Public-Private Partnerships* (2010) 216-217.

<sup>467</sup> 84.

<sup>468</sup> B Metcalfe "The challenge for government parties in assuring PPP projects" (2013) *Civil Engineering* 30 30.

<sup>469</sup> M Fombad "Accountability challenges in public-private partnerships from a South African perspective" (2013) 7(1) *African Journal of Business Ethics* 11 11. The author indicates at 12 that the financial, technical and operational risks transferred to the private party must be clearly indicated.

<sup>470</sup> Arrowsmith *The Law of Public and Utilities Procurement* 2.17

<sup>471</sup> 2.17

## 5 2 Challenges

Johnson points out that one of the challenges in PPP projects is the risk of re-negotiation of the contract.<sup>472</sup> Prior to the conclusion of the PPP agreement, negotiation with the preferred bidders is permitted. This threatens the integrity of the process by a possible change in the requirements set out in the feasibility study and corresponding request for qualification and proposals. In the end, value for money and affordability as cornerstones of a PPP project may be compromised. This also has the potential to create the impression to bidders that although they present their offers in the bids, there is the opportunity to renegotiate the terms of the contract and may therefore submit abnormally low bids.

Furthermore, Fombad notes that additional challenges are the lack of public consultation in the PPP project process, corruption, apparent lack of competition, ineffective contract management, failure to monitor performance and failure to ensure value for money and equitable risk allocation.<sup>473</sup> Concerns also arise when there is a change in government officials who work on a particular PPP project. The same is applicable to those managing the private party over the time period of the PPP.<sup>474</sup> There is therefore the risk that knowledge may be lost and a break in communication between the parties to the PPP may occur. An interesting drawback of PPP projects noted by Fombad is the lack of accounting or recording of increases in debt or assets by government institutions which invariably

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<sup>472</sup> V Johnson "Service delivery agreement: Renegotiations and amendments" (2005) 7(3) *Local Government Bulletin* 13 13-14.

<sup>473</sup> According to the author lack of competition is due to the high cost involved in bidding for the role of the private party in a PPP project. What contributes to this is the fact that although government institutions intend to promote BBBEE through PPP projects, competition remains limited because of the limited pool of black equity in South Africa, a lack of experience and skill, too little capital and over-priced projects. The result is that the successful bidder becomes "the monopolist supplier to the government". See Fombad (2013) *African Journal of Business Ethics* 15.

<sup>474</sup> See Aigvavboa, Liphadzi & Thwala (2014) 103.

impact upon the fiscus of the country.<sup>475</sup> She uses the example of the Gautrain Rapid Rail Project which had an initial cost in the year 2000 of R3.5 to 4 billion. However, by 2011 the costs had increased to a shocking R30 billion. Fombad refers to this as an “off-the-balance-sheet” nature of PPPs which provides motivation for parties to move towards the use of PPPs.<sup>476</sup>

## 6 The need for PPPs

Authors on the workings of governments, Goldsmith and Eggers,<sup>477</sup> note that due to increasingly complex societies, governments have been forced to develop new models of governance. They argue that when the government collaborates with other parties, or even with other governmental entities within a different sphere, service delivery is of a better quality and more efficient. According to the authors, there are four most influential trends which have changed the way the public sector functions. The first trend is that of third-party government which involves the increasing use of private parties by governments to deliver services and fulfil policy goals, much like PPPs. Secondly, is what they refer to as “joined-up government” which is the tendency for government entities at various levels or spheres of government to work together. In the third instance, is the trend of the so-called “digital revolution” which refers to technological advances which now enable numerous organisations to collaborate in real time which was previously impossible. Lastly, is increased consumer demand for more control over the quality of services received by governments and the need for these services to match those delivered by the private sector contributes to this change in government functioning.<sup>478</sup> They note that:

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<sup>475</sup> 16.

<sup>476</sup> Fombad (2013) *African Journal of Business Ethics* 15.

<sup>477</sup> S Goldsmith & WD Eggers *Governing by Network: The New Shape of the Public Sector* (2004) 8.

<sup>478</sup> 10.

“The push and pull is gradually producing a new model of government in which executives’ core responsibilities no longer centre on managing people and programs but on organizing resources, often belonging to others, to produce public value. Government agencies, bureaus, divisions, and offices are becoming less important as direct service providers, but more important as generators of public value within the web of multiorganizational, multigovernmental, and multisectoral relationships that increasingly characterize modern government.”<sup>479</sup>

This idea of the government collaborating with others, they refer to as “governing by network”.<sup>480</sup> They refer to the role of the government in the relationship between the public and private sector as one which has shifted from being a service provider to a service facilitator.<sup>481</sup> As government relies more and more on private parties to provide the service it would traditionally have provided, the performance of the private party therefore depends a great deal on the government’s ability to manage its partnership.<sup>482</sup>

A number of advantages to a governance network model or governance network means of procurement have been noted. Firstly, Goldsmith and Eggers refer to “specialisation” as an advantage which means that contracting with another party to perform the work the initial party would have performed frees that party to continue work in its area of expertise. Although it may be questionable whether this advantage is applicable to a public-private partnership, it is submitted that it could allow for the government to focus on urgent areas of importance rather than spend valuable resources on a project which can be performed by the private sector.<sup>483</sup> Secondly, they list innovation as an advantage of governing by network. These networks enable the government to choose between a greater range of providers, thereby encouraging experimentation when it comes to innovative solutions offered by private parties.<sup>484</sup> In the third instance, governing by network allows the necessary speed and flexibility required for the government to provide services more

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<sup>479</sup> 8.

<sup>480</sup> 9.

<sup>481</sup> 10.

<sup>482</sup> 21.

<sup>483</sup> 28 – 29.

<sup>484</sup> 29 – 31.

efficiently. The authors are of the view that the “hierarchical decision-making structure” of governments is inflexible and cause service delivery to slow down. In addition to this, the rigidity of procurement systems and government officials make fast delivery and the ability to make changes in the process difficult.<sup>485</sup> Lastly, governmental networks allow the government to increase their reach, meaning that they are able to provide more services to more citizens more efficiently because a private party provides the start-up capital for the PPP. The government is therefore able to spend money on other services.

However, it has been noted that successful network management requires grappling with skill-set issues, technology issues, communication issues and cultural issues and the most important step in ensuring a successful PPP is having a good understanding of these challenges.<sup>486</sup> The lack of a common goal between the government entity and the private party,<sup>487</sup> insufficient oversight of the performance of the private party,<sup>488</sup> a break in communication between the parties,<sup>489</sup> fragmented coordination between various role players in the government entity (such as various departments involved in a PPP for example the departments of transport and public works working alongside one another),<sup>490</sup> capacity shortages within the government entity meaning a lack of skilled government officials,<sup>491</sup> lack of governmental data required for PPPs<sup>492</sup> and most importantly relationship instability between all parties<sup>493</sup> have been indicated as challenges.

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<sup>485</sup> 31.

<sup>486</sup> 40.

<sup>487</sup> 40 – 41.

<sup>488</sup> 43 – 44.

<sup>489</sup> 44 – 45.

<sup>490</sup> 45 – 46.

<sup>491</sup> 48 – 49.

<sup>492</sup> 47 – 48.

<sup>493</sup> 50.

## 7 A relational approach to PPPs

From the above it is clear that a PPP is what MacNeil has called an exchange relationship.<sup>494</sup> The burden on the government to provide a service is lightened by the private party providing the service and also the capital for the project. The private party in return receives payment for the service rendered in the form of payment by citizens who use the service. PPPs do not appear to be inherent in the South African construction procurement process, but rather an option for long-term, complex procurement matters. In other words, it is not necessarily an automatic manner of procuring infrastructure.

In addition to an exchange, there also exists various relations amongst the role players of a PPP. A complex web of relations amongst the role players are established and the project lasts for an extended period of time - those between the government entity and the private party,<sup>495</sup> the subcontractors and the private party, the lenders and the private party and also shareholders and the private party. The common contract norms identified by MacNeil<sup>496</sup> are also found in PPPs. Some of these norms overlap in the case of PPPs. Norms such as role integrity and mutuality are found in the consistency of each party in the PPP to ensure that the mutually beneficial goal is achieved. Due to the number of role players, there naturally exists the possibility of conflict which should be curbed by social solidarity in a mutual desire to complete the project successfully. Furthermore,

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<sup>494</sup> I MacNeil "Relational contract theory: challenges and queries" (2000) 94 (3) *Nw.U.L Rev* 877 878. He notes that a relational contract is one which "means relations among people who have exchanged, are exchanging, or expect to be exchanging in the future – in other words, exchange relations."

<sup>495</sup> Zou, Kumaraswamy, Chung & Wong note that the quality of the relationship between the government and the private party has shown to be an important success factor in PPP projects. Therefore it is important to analyse, evaluate, improve and sustain the quality of the relationship they have. See W Zou, M Kumaraswamy, J Chung & J Wong "Identifying the critical success factors for relationship management in PPP projects" (2014) 32 *International Journal of Project Management* 265 265. They define relationship management as "a set of comprehensive strategies and processes of partnering with selected counterparties, and the project stakeholders, to create superior value for the PPP project through developing sustainable relationships." See Zou, Kumaraswamy, Chung & Wong (2014) *International Journal of Project Management* 266.

<sup>496</sup> See para 2 of chapter 4.

implementation of planning and effectuation of consent can be seen in the various phases of a PPP where approval is required to continue with each phase. A large project such as a PPP is naturally the result of much planning in advance.

Regulation 16.1 of the PFMA defines a PPP as including an allocation of risk. Therefore a division of risks between parties occurs. The definition of value for money further provides that there must be a benefit received from the PPP. Regulation 16.7 which provides for the management of PPPs requires that proper implementation be ensured, that there should be liaison with the private party and that any disputes with the private party must be resolved. There is therefore a duty on the government entity to form a relationship with the private party. A PPP is therefore a form of a relational contract in the process of providing goods, works and services to the government. Relational procurement law will therefore be applicable to PPPs in South Africa.

It is further submitted that the rules for PPPs in South Africa are not as detailed as the Supply Chain Management (SCM) rules which regulate general or traditional public procurement. This leaves room for the PPP process to be based on a practice of relational norms. It is further submitted that this was perhaps the intention in enacting broad terms for the regulation of PPPs. The extended period of time of a PPP also lends itself to changing circumstances which calls for role players to be flexible in their approach in order to still achieve the goals set out at the inception of the PPP.

In 2009, Edelenbos and Klijn<sup>497</sup> conducted a study on different PPP management styles and found that a distinction could be made between PPPs which are seen as innovative contracting and PPPs which are seen as partnerships. In the latter instance, collaboration between the public and private parties continues throughout the project which is based on mutual trust rather than contract since it is geared toward the realisation of joint goals.<sup>498</sup> The latter management style is what the authors refer to as process management, and the former as project management.<sup>499</sup> In process management or PPPs which are seen as partnerships, the focus is on the process of collaboration, providing room for the dynamics of the process, and the communication strategy is one of “dialogue, decide and deliver” rather than “decide, announce and defend”.<sup>500</sup>

The authors further found that process management is based on openness.<sup>501</sup> Meaning that access to the project is relatively simple or easy for those who are interested. In the case of project management, it was found that this style is based on “closedness” which means that minimal information is provided regarding the process of the projects. In process management, much time is given to promoting support for the project amongst role players whereas under project management, decisiveness is more prominent. This means that the emphasis is on making progress by increasing decision-making in the project and making clear and definite decisions. A desire to satisfy shared needs, steering the process according to the competencies of the role players which is referred to as relation orientation - being relation oriented – and being flexible in project leaders adjusting to the changing circumstances of the project.

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<sup>497</sup> J Edelenbos & E Klijn “Project versus Process Management in Public-Private Partnerships: Relation between Management Style and Outcomes” (2009) 12(3) *International Public Management Journal* 310 312.

<sup>498</sup> See Edelenbos & Klijn (2009) *International Public Management Journal* 312 Table 1.

<sup>499</sup> See Edelenbos & Klijn (2009) *International Public Management Journal* 314 Table 2.

<sup>500</sup> See Edelenbos & Klijn (2009) *International Public Management Journal* 314 Table 2.

<sup>501</sup> Dima notes that generally trust, openness and fairness are the foundations of a successful PPP. See J Dima “Success and failure mechanisms of public-private partnerships (PPPs) in developing countries: Insights from the Lebanese context” (2004) 17(5) *International Journal of Public Sector Management* 414.

Contrary to this, it was found that project management gives rise to each party having its own strategy as to how the project should be conducted, it is result orientated and is based on persistence – achieving goals which remain unchanged regardless of changing circumstances. The process management style of PPPs is thus synonymous with a relational approach as advocated in chapter four. Based on empirical research of infrastructure PPPs in the Netherlands, the authors found that the process management, in other words, a more relational approach to PPPs led to better outcomes.<sup>502</sup>

In 2006, Edkins and Smyth conducted a study on relational versus legal management of the relationships in PPPs in the UK.<sup>503</sup> They define relational contracting as an externally market induced change that requires internal adjustment behaviour and an adjustment of behaviour between customers and suppliers and clients and contractors.<sup>504</sup> They note that:

“The term *relational contracting* has become a generic term used in partnering, supply chain management, and other formal and informal alliances. Practice has been informed by client-driven agendas to improve performance in cost and value terms. Thus relational contracting is frequently viewed as a procurement driven tool, which is learned from the client and passed down the construction supply chain... Relationship management offers an alternative to transaction approaches to exchange, reversing the management emphasis of cost reduction and meeting contract conditions via the minimum number of points of contract to management. It seeks to proactively understand the client through close contact in order to maximise the potential to satisfy the client and stakeholders.”<sup>505</sup>

To this end, the authors note that trust<sup>506</sup> is a key measure for establishing the performance of contracts through relationship management.<sup>507</sup> This they define as

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<sup>502</sup> See Edelenbos & Klijn (2009) *International Public Management Journal* 321.

<sup>503</sup> See A Edkins & H Smyth “Contractual Management in PPP Projects: Evaluation of Legal versus Relational Contracting For Service Delivery (2006) 132(1) *Journal of Professional Issues in Engineering Education & Practice* 82-93.

<sup>504</sup> See H Smyth & A Edkins “Relationship management in the management of PFI/PPP projects in the UK” (2007) 25(3) *International Journal of Project Management* 232-236.

<sup>505</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 83-84. In their research, they refer to “project management” which is “a paradigm through which to evaluate project management relationships for partnerships as it conceptually involves a stage of activity beyond relational contracting, which all the parties involved with long term concession contracts could be expected to endorse and perhaps pursue.” See Smyth & Edkins (2007) *International Journal of Project Management* 234.

<sup>506</sup> Defined by the authors as “a disposition and attitude concerning the willingness to rely upon the actions of or be vulnerable toward another party, under circumstances of contractual and social obligations, with the

“[A]n internally induced set of changes that requires proactive change and development of relationships within the firm and at the interface with other parties involved with projects, which has an external impact on the market.”<sup>508</sup>

Internal relations must be developed first and as these develop, so will external relations.<sup>509</sup> On the other hand, legal contracting, they refer to as “going by the rule book” which is technocratic or bureaucratic rather than relational.<sup>510</sup> These two opposites, they write, do not stand in stark contrast to one another. Instead, they can be located on a conceptual continuum. The authors note that people use intangible relationship factors when performing their functions and duties and positive behavioural evidence encourages them to use the path of least resistance in administrative bureaucracy.<sup>511</sup> People do not typically resort to the law or directly use contract terms unless problems arise. This is often also the path chosen in the performance of contracts. Contracts like PPPs encourage relational contracting and organisations which are involved in PPPs are expected to provide scope for relationship development by using factors from relationship management. This will build high trust which is sustainable throughout the project, provided all parties are committed to developing the relationship.

When a breakdown in the relationship occurs, people are less likely to rely on the relational aspects of the contract and require benchmarks for behaviour. In this case, an express contract provides guidance.<sup>512</sup> This in line with that proposed in chapter four.<sup>513</sup> A hybrid system of relational procurement law will best ensure that contract outcomes or

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potential for collaboration.” See Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 84.

<sup>507</sup> The authors note that trust is particularly important in PPPs since governments and private parties have been advocating non-adversarial ways of working and the long-term nature of the contracts requires a trusting relationship to improve the effectiveness of the project. This has led to a consideration of relational contracting in PPPs. See Smyth & Edkins (2007) *International Journal of Project Management* 232 233.

<sup>508</sup> Smyth & Edkins (2007) *International Journal of Project Management* 236.

<sup>509</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 84.

<sup>510</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 85.

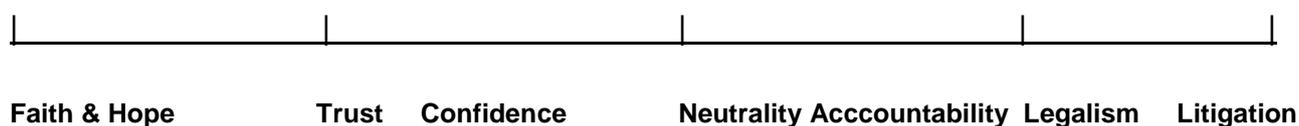
<sup>511</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 85.

<sup>512</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 85.

<sup>513</sup> See para 9.

goals are achieved. In other words, the process is based on relational norms, however, at least for the transition period from classical contract law to a completely relational procurement law, an express contract should be in place in the event of a breakdown of the relationship between the parties. This is especially important in the case of PPPs where several relationships are formed due to the complex nature of PPPs and the high number of role players and stakeholders in the process.

Similar to MacNeil who places relational contracts on a continuum which illustrates the difference between relational and discrete or transactional contracts, Edkins and Smyth note that PPP relations operate on a legal versus relational continuum.<sup>514</sup> In the centre of the continuum is neutrality. On the one side, is faith, hope, trust and confidence and are elements of the induction of the PPP project through intangible components of the relationships.<sup>515</sup> On the other side of the continuum is accountability, legalism and litigation and represent determination through tangible contract terms.



In explaining the continuum, the authors note that confidence is closest to the centre point of neutrality since the absence of confidence can cause trust to minimise or be eroded. High levels of confidence allow for relationships to deepen. On the legal side of the continuum, accountability suggests that the relationships are not showing sufficient evidence to ensure satisfactory performance. Accountability is used in this case as a step closer to legal contracting since it indicates an absence of trust. Where accountability is

<sup>514</sup> See Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 85 Fig 6.

<sup>515</sup> These elements are expectations in the relationship performance of others and form components of trust. It entails faith in the unseen capabilities of other parties to perform, hope in the seen capabilities that other parties will perform and confidence in the other party based on past performance. See Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 84.

used to obtain evidence of performance, it is used to hold others accountable in the sense of holding up proceedings and increasing transaction costs. This is different from using accountability as feedback in order to improve performance.<sup>516</sup>

On the legalism side of the continuum, legalistic behaviour is used to ensure compliance with rules, procedures and contract terms. Such behaviour, they note, imposes costs.<sup>517</sup> It creates an environment where people “cover their backs” and are more concerned with meeting prescribed rules than the benefits the project was intended for. This leads to a breakdown in trust and therefore relationships. They write that:

“Legal contracting tends to ‘dispense’ with relationships as a means to perform and improve performance, rule book and contractual issues becoming the primary means. Transaction management and legal contracting use relationships as deposit boxes for communications to ensure that subsequent actions of the other party are guided by the rules and contract terms. The movement along the continuum from accountability to legalism can resort in other parties acting adversely in response to communications. At a personal level the individuals may simply feel undervalued, possibly influencing behaviour. At a business-to-business or organization-to-organization level such accountability and legalism tend to cause transaction costs to increase, which is a major management issue in the management of projects.”<sup>518</sup>

Invariably such a situation causes an adverse environment between parties and leads to disputes and litigation which increase transaction costs.

Irfan notes that PPPs in developing countries have often been referred to as “partnerships” rather than PPPs.<sup>519</sup> Partnerships in turn require collaboration.<sup>520</sup> According to Minnie,<sup>521</sup>

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<sup>516</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 85.

<sup>517</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 85.

<sup>518</sup> Edkins & Smyth (2006) *Journal of Professional Issues in Engineering Education & Practice* 85-86.

<sup>519</sup> See S Irfan *Understanding Inter-Organisational Relationships in Public-Private Partnerships: A study of Educational PPPs in Pakistan* PhD thesis University of Edinburgh (2015) 21 para 2.2.3.

<sup>520</sup> See Smyth & Edkins (2007) *International Journal of Project Management* 233.

<sup>521</sup> See JA Minnie *Critical Success Factors for Public-Private Partnerships in South Africa* PhD thesis University of Stellenbosch (2011) 59 para 2.3.

this partnership should be one of mutualism and not of commensalism<sup>522</sup> as he finds the South African National Treasury definition of PPPs to be. International legal rules also refer to PPPs as partnerships. The European Commission (EC) Rules on PPPs provide that in order to implement a successful PPP, it is necessary to recognise firstly that it constitutes a partnership and secondly that acknowledgement of each partner's objectives in the PPP are essential.<sup>523</sup> Furthermore, participation of all partners are necessary and recognition of the characteristics of each partner contributes to successful achievement of goals. Furthermore, the World Bank rules for PPPs<sup>524</sup> notes that PPPs create long-term partnerships between the government and the private party. This continuous reference to partnership denotes a recognition of a relationship amongst parties who intend to exchange in the future. Therefore, international rules on PPPs recognise a relational approach to the implementation of PPPs.

In addition to this, the United Nations Commission on International Trade Law (UNCITRAL) published Model Legislative Provisions for Privately Financed Infrastructure Projects<sup>525</sup> in which it is recommended in Part One that the constitutional, legislative and institutional framework for PPPs should ensure fairness, transparency and long-term sustainability of projects. Under the authority to regulate infrastructure services, it is recommended that regulatory competence should be entrusted to functionally independent bodies with a level of autonomy to ensure that decisions are taken without political interference. The Organisation for Economic Co-Operation and Development (OECD) has

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<sup>522</sup> This he defines as a relationship between two living organisms in which one benefits and the other is neither harmed nor helped. See Minnie *Critical Success Factors* 59 para 2.3.

<sup>523</sup> European Commission Guidelines for Successful Public-Private Partnerships (2003) 34 <[http://ec.europa.eu/regional\\_policy/sources/docgener/guides/ppp\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/guides/ppp_en.pdf)> (accessed 14-10-2017).

<sup>524</sup> Procurement Arrangements Applicable to Public-Private Partnerships (PPP) contracts financed under World Bank Projects (2010) 14 <[https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/ppp\\_testdumb/documents/GuidanceNote\\_PPP\\_September2010.pdf](https://ppp.worldbank.org/public-private-partnership/sites/ppp.worldbank.org/files/ppp_testdumb/documents/GuidanceNote_PPP_September2010.pdf)> (accessed 14-10-2017).

<sup>525</sup> See Model Legislative Provisions on Privately Finance Infrastructure Projects (2004) <[http://www.uncitral.org/pdf/english/texts/procurem/pfip/model/03-90621\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/procurem/pfip/model/03-90621_Ebook.pdf)> (accessed 14-10-2017).

also published Recommendations of the Council on Principles for Public Governance of PPPs<sup>526</sup> which states that understanding PPPs means that there is active participation, consultation and engagement with stakeholders and involvement of consumers in defining the project and monitoring the quality of service provided. More specifically, the involvement of labour unions, NGOs and civil society which have concerns that PPPs may have social, economic and environment consequences is imperative.

Based on the above, the relationships established throughout PPP projects are long-term and must be sustainable. Elements of fairness, transparency and trust are both advocated and required to ensure successful PPPs. Furthermore, emphasis is placed on mutuality – understanding each other and the expectations each partner has, therefore a level of solidarity is found. As noted, empirical research has confirmed this and the need for these elements in PPPs. Therefore, PPPs are inherently relational. Based on the complex nature of the projects and the number of parties involved, PPPs can be placed on the highly relational side of MacNeil's relational continuum. In other words, relational PPPs are already present not only in South Africa, but worldwide. In the absence of a detailed legal framework, relational procurement law will fill this gap in which relational PPPs can function in South Africa.

## **8 Conclusion**

PPPs have been utilised in South Africa since 1998 which is a relatively short period of time. Despite this, it has had an enormous effect on the economy in amounting to billions of rands. PPPs are effectively a co-operative relationship between stakeholders – primarily

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<sup>526</sup> See Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships (2012) <<http://www.oecd.org/governance/budgeting/PPP-Recommendation.pdf>> (accessed 14-10-2017).

between a government institution and a private party. It is a complex network of relationships where each party seeks to obtain a benefit from the relationship – they all plan to exchange to their benefit in the future.

In South Africa, PPPs are regulated by Regulation 16 to the PFMA and section 12 of the MFMA. According to Regulation 16, a PPP constitutes a commercial transaction between a government institution and a private party in terms of which the private party performs a public function on behalf of the government institution. The private party uses its own funding, assumes the technical and operational risk of the project and receives payment from the end consumer who uses the service it provides. PPPs are therefore different from traditional procurement where a contract is awarded to a private party by the government and the financial burden rests on the government. Traditional procurement or a competitive tendering procedure, forms part of the entire PPP project. A PPP is therefore an alternative method of procuring large scale infrastructure. It can also be used when the government does not necessarily have the resources to provide the function it is normally responsible for. Furthermore, in traditional or general procurement, the procuring government entity provides the specifications for the tender, awards the contract and pays for the goods and services provided by the private party. In the case of a PPP, the responsibility of specifications, financial and building risk lies solely with the private party. In other words, the private party takes over the responsibility of the government. However, because the government is still “contracting for goods and services” as provided for in section 217(1) of the Constitution, a PPP is still a form of procurement. It is merely an alternative vehicle for implementing complex projects.

Despite the various challenges found in PPPs, they provide the government with an opportunity to transfer responsibility of service delivery, albeit for a limited period of time and with adequate supervision, allowing it to focus on other more urgent priorities. The private sector in turn builds experience, its expertise and an opportunity to make a profit from the funds received from the public which uses the service. A PPP is also a method of providing medium term employment to the private sector. A PPP holds significant potential for greater implementation of preferencing. It consists of various phases and numerous subcontracts which create an opportunity for preference to be applied. It is therefore essentially a network of role-players who each contribute something of value for the common goal of delivering infrastructure to the public and receive a benefit in return in the form of relief of responsibility or payment for work done.

Along with the complex nature of a PPP, comes complex relationships. A PPP by virtue of its name is a partnership. Various international instruments refer to it as a specific type of partnership which is required to be sustainable, mutual and for there to be a recognition of and respect for each party's expectations and abilities. Empirical research has been conducted on relationships in PPPs and it was found that these relationships are indeed what determines the success of the project. A need for elements such as co-operation, trust, reciprocity, transparency and fairness was identified. As noted, Regulation 16 requires the competitive tendering process as part of the PPP to be fair, equitable, transparent, competitive and cost-effective. Therefore, section 217 is applicable to PPPs. Moreover, since PPPs are a form of procurement and more specifically construction procurement, the Construction Industry Development Board Code of Good Conduct which prescribes the behaviour of and relationship between construction procurement participants, is applicable as well. These norms are synonymous with those of relational contract theory, therefore PPPs are a prime example of this. Based on this, PPPs are in

fact inherently relational and have been since their inception. What is required is a recognition in South African law of a relational procurement law in order to ensure its implementation.

Conceptualising a PPP as a governance network based on a relational theory where common norms form the basis of the partnership, may contribute to a better common understanding of each party's rights and obligations. An acknowledgement of a possible misunderstanding between parties may make role-players vigilant of these rights and obligations which in turn may contribute to decreasing the number of litigation matters in PPPs. An acknowledgment of the essential norms of a PPP in all relevant PPP documentation will make these norms legally binding and enforceable which in turn ensures better compliance with legal norms.

In the following chapter, the influence of relational theory on the implementation of procurement as a policy tool will be examined.

## CHAPTER 6

### PREFERENTIAL PROCUREMENT AND RELATIONAL PROCUREMENT LAW

#### 1 Introduction

Since 1994, the use of public procurement as a policy tool or preferential procurement has become increasingly important in South Africa. For many years, public procurement has been used primarily for the procurement of goods, services and works at the best price. However, it can also be used to promote collateral goals or objectives. These have been referred to as horizontal objectives.<sup>527</sup> The aim in broadening the scope of what public procurement can achieve is to advance the needs of a particular country in developing the socio-economic standing of its citizens or to promote its local industries for example. Since much research has been conducted on this subject, the aim of this chapter is to not only determine how preferential construction procurement is implemented in South Africa but also to explore how a relational approach to the use of procurement as a policy tool assists the legal regulation, understanding and implementation thereof in the construction industry.

In order to do this, preferential procurement as applied in South Africa in general will be discussed. This will entail an explanation of the entities bound by the Preferential Procurement Policy Framework Act<sup>528</sup> (PPPFA) and how preference is implemented. Following this, the most significant change the 2017 PPPFA Regulations<sup>529</sup> has brought about will be discussed. Next, the implementation of preferential procurement in the

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<sup>527</sup> See S Arrowsmith & P Kunzlik *Social and Environmental Policies in EU Procurement Law – New Directives and New Directions* (2009) 12.

<sup>528</sup> 5 of 2000.

<sup>529</sup> Government Gazette (GG) 40553 of 20-01-2017.

construction industry will be examined and lastly the effect of relational procurement law on preferential procurement in the construction industry will be explained.

## 2 The use of procurement as a policy tool<sup>530</sup>

As noted, along with the primary goal of obtaining goods, works and services at the best price, public procurement has also been used to promote economic, social and environmental goals.<sup>531</sup> For example, a government in awarding a contract may insist that the products provided be environmentally friendly or may promote the development of historically disadvantaged groups or people with disabilities by giving them preference in the award of government contracts. This, Arrowsmith, Linarelli and Wallace refer to as the “social” use of public procurement.<sup>532</sup> Such objectives have in the past been referred to as secondary or collateral objectives.<sup>533</sup> The reference to “secondary” was later pointed out by Arrowsmith and Kunzlik to be problematic since this “label” detracts from the importance of these initiatives or goals. Therefore, the social and other use of public procurement besides that of best price is referred to by them as “horizontal” policies.<sup>534</sup>

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<sup>530</sup> This topic has been discussed at length, see for example P Bolton “New preferential procurement regulations released” (2011) 13(3) *Local Government Bulletin* 7; “Government procurement as a policy tool in South Africa” (2006) 6(3) *Journal of Public Procurement* 193-217; “An analysis of the preferential procurement legislation in South Africa” (2007) 16(1) *PPLR* 36-67; “The use of government procurement as an instrument of policy” (2004) 121(3) *SALJ* 619-635; “The regulation of preferential procurement in state-owned enterprises” (2010) 1 *TSAR* 101-108; P Bolton & G Quinot “Social policies in procurement: South Africa”, ch 16 in S Arrowsmith & RD Anderson (eds), *The WTO Regime on Government Procurement: Challenge and Reform*. Therefore, as noted, the focus in this chapter will primarily be the manner in which preferential procurement is applied in the construction industry and how a relational perspective of this influences how it is regulated.

<sup>531</sup> S Arrowsmith, J Linarelli & D Wallace *Regulating Public Procurement – National and International Perspectives* (2000) 11, 237.

<sup>532</sup> 11.

<sup>533</sup> 237. The authors note that “[s]uch policies may have a number of dimensions, being concerned with maximising unharnessed economic potential, redressing inequality and/or securing social harmony.” See Arrowsmith, Linarelli & Wallace *Regulating Public Procurement* 257.

<sup>534</sup> See Arrowsmith & Kunzlik *Social and Environmental Policies in EU Procurement Law* 12.

As of late, procurement has been used not only as a means to further social policies but also as an incentive to promote innovation and human rights.<sup>535</sup> Various methods to award preference to certain groups have been employed over the years.<sup>536</sup> There have also been various forms of reasoning behind the use of public procurement as a policy tool. Trepte<sup>537</sup> has divided policy considerations in procurement into three classifications. These are strategic, protective and proactive policies. Strategic policies are those which are geared towards reviving or stimulating the economy. For example by way of increasing the number of tenders so as to create employment opportunities. In other words, these policies are created with a specific strategy in mind. Protective policies are those which are aimed at protecting local markets. For example, a specification in a tender invitation that only locally manufactured goods be provided. Lastly, proactive policies are those which go beyond the primary goal of procurement which is to attain value for money. They do so in an attempt to satisfy alternative or wider social goals.

Horizontal policies of a social nature have been especially important in the South African public procurement context. This will be examined next.

### **3 Preferential procurement in South Africa**

Based on South Africa's political past in which discriminatory policies and practices prevented the majority of the country to participate in government contracting, new legislation was enacted after 1994 in order to redress this. The most relevant piece of

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<sup>535</sup> See for example P Bolton "Public Procurement as a Tool to Drive Innovation in South Africa" (2016) 19 *Potchefstroom Electronic Law Journal* 1-35 and "Public Procurement and Human Rights: A Survey of Twenty Jurisdictions" (2016) <<http://www.hrprocurementlab.org/wp-content/uploads/2016/06/Public-Procurement-and-Human-Rights-A-Survey-of-Twenty-Jurisdictions-Final.pdf>> (accessed 14-10-2017).

<sup>536</sup> See Arrowsmith & Kunzlik *Social and Environmental Policies* 127-146.

<sup>537</sup> P Trepte *Regulating Procurement – Understanding the Ends and Means of Public Procurement Regulation* (2004) 139-176.

legislation was the PPPFA. In applying a points system when awarding government contracts, the Act seeks to encourage the involvement of historically disadvantaged individuals to tender for government contracts. In what follows, the manner in which the Act must be implemented will be discussed in order to determine whether preferential procurement in the construction industry is in line with the Act.

### 3 1 Entities bound by the Act and its Regulations

Regulation 2 of the 2017 Regulations states that those entities bound by the Regulations are those which qualify as “organs of state” as defined by the Act. Section 1 of the Act defines an organ of state as:

- (a) a national or provincial department as defined in the Public Finance Management Act, 1999 (Act No. 1 of 1999);
- (b) a municipality as contemplated in the Constitution;
- (c) a constitutional institution defined in the Public Finance Management Act, 1999 (Act No. 1 of 1999);
- (d) parliament;
- (e) a provincial legislature;
- (f) *any* other institution or category of institutions included in the definition of “organ of state” in section 239 of the Constitution and recognised by the Minister by notice in the *Government Gazette* as an institution or category of institutions to which this Act applies;<sup>538</sup>

The Construction Industry Development Board (CIDB) resorts under subsection (f) of the above section, since it is an institution identified in national legislation in section 239(b)(ii) of the Constitution which refers to an institution identified in national legislation (the Public Finance Management Act)<sup>539</sup> which performs a public function or exercises a public power in terms of legislation (the Construction Industry Development Board Act).<sup>540</sup> The CIDB is

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<sup>538</sup> Original emphasis.

<sup>539</sup> 1 of 1999.

<sup>540</sup> 38 of 2000.

therefore bound by the PPPFA and its Regulations in its creation of construction procurement rules.

### 3.2 The 2017 Regulations

On 1 April 2017, new PPPFA Regulations came into operation and brought along a host of changes to the manner in which preferential procurement should be implemented. What follows is a brief discussion of the working of the points system used in the PPPFA to award preference. Following this, the most influential amendment to the PPPFA Regulations insofar as it affects construction procurement, will be explored.

### 3.3 Points system

Section 2 of the PPPFA provides for a points system in terms of which preference must be awarded. This system is set out in Regulations 6 and 7 of the 2017 Regulations which provide for an 80/20 points system in respect of contracts up to a value of R50 million and a 90/10 points system in respect of contracts above R50 million respectively. This means that 80 or 90 points must be awarded for the price<sup>541</sup> of a tender and 20 or 10 points for preference.

In addition, Regulations 6 and 7 indicate what preference points must be awarded for. It states that a tenderer must provide proof of its Broad-Based Black Economic

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<sup>541</sup> Regulation 1 provides that price includes all applicable taxes less all unconditional discounts.

Empowerment (BBBEE) status level of contributor<sup>542</sup> and that failure to do so will not lead to the tenderer being disqualified, but that points only for price out of 80 or 90 will be awarded. BBBEE is referred to in Regulation 1 as broad-based black economic empowerment as defined in section 1 of the Broad-Based Black Economic Empowerment Act (B-BBEEA).<sup>543</sup> The Act, in turn, defines BBBEE as “the economic empowerment of all black people<sup>544</sup> including women, workers, youth, people with disabilities<sup>545</sup> and people living in rural areas through diverse but integrated socio-economic strategies that include, but are not limited to-

- (a) increasing the number of black people that manage, own and control enterprises and productive assets;
- (b) facilitating ownership and management of enterprises and productive assets by communities, workers, cooperative and other collective enterprises;
- (c) human resource and skills development;
- (d) achieving equitable representation in all occupational categories and levels in the workforce;
- (e) public procurement; and
- (f) investment in enterprises that are owned or managed by black people

In the event that a tenderer intends to subcontract more than 25% of the value of the contract to a subcontractor which does not qualify for at least the same points that the tenderer qualifies for, such a tenderer will not be awarded points for its BBBEE status level unless the subcontractor is an exempted micro enterprise (EME)<sup>546</sup> that is capable of performing the work.<sup>547</sup> It is provided that the price indicated by a tenderer must be market

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<sup>542</sup> BBEE status level of contributor is defined in Regulation 1 as “the B-BBEE status of an entity in terms of a code of good practice on black economic empowerment issued in terms of section 9(1) of the Broad-Based Black Economic Empowerment Act”. Proof of BBBEE status level of contributor means (a) the BBBEE status level certificate issued by an authorised body or person; (b) a sworn affidavit as prescribed by the BBBEE Codes of Good Practice; or (c) any other requirement prescribed in terms of the Broad-Based Black Economic Empowerment Act. See Regulation 6(4)(a) and (b) and Regulation 7(4)(a) and (b).

<sup>543</sup> 53 of 2003.

<sup>544</sup> Black people are referred to in Regulation 1 as having the same definition as that in section 1 of the BBEEA. This Act in turn provides that “black people” is a generic term which means Africans, Coloureds and Indians.

<sup>545</sup> This is said in Regulation 1 to have the same meaning as that found in section 1 of the Employment Equity Act 55 of 1998. The Act defines people with disabilities as people who have a long-term or recurring physical or mental impairment which substantially limits their prospects of entry into, or advancement in employment.

<sup>546</sup> This is discussed further in para 2 2 2 below.

<sup>547</sup> Regulation 6(5) and 7(5).

related and if it is not, the tenderer cannot win the tender.<sup>548</sup> The Regulations do, however, provide that in such a case, the procuring organ of state may negotiate a market-related price with the highest scoring tenderer or cancel the tender. It may also negotiate with the second highest scoring tenderer if the highest scoring tenderer does not agree to a market-related price. Lastly, if the second highest scoring tenderer also does not agree, the third highest scoring tenderer may be considered or the tender may be cancelled.<sup>549</sup> If a market-related price is not negotiated at all, the tender must be cancelled.<sup>550</sup>

### 3 4 Subcontracting as a condition of tender and after award of a tender

This provision is a new addition to the Regulations which provides that if it is feasible to subcontract in a contract above R30 million, an organ of state must do so in order to advance designated groups.<sup>551</sup> If an organ of state intends to apply subcontracting in terms of this Regulation, it must advertise the tender with the specific condition that the successful tenderer must subcontract a minimum of 30% of the value of the contract to those groups identified in Regulation 4(1).<sup>552</sup> In addition to these groups are EMEs or SQEs which are 51% owned by black people who live in rural or underdeveloped areas or townships and EMEs or SQEs which are at least 51% owned by black people who are military veterans.<sup>553</sup> Feasibility is not defined in the Regulations, therefore it remains to be seen which criteria will be applied to determine whether subcontracting is feasible or not.

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<sup>548</sup> Regulation 6(9)(a) and 7(9)(a).

<sup>549</sup> Regulation 6(9)(b) and 9(9)(b).

<sup>550</sup> Regulation 6(9)(c) and 7(9)(c).

<sup>551</sup> Regulation 9(1). A designated group is defined in Regulation 1 as black designated groups, black people, women, people with disabilities or small enterprises as defined in section 1 of the National Small Enterprise Act 102 of 1996.

<sup>552</sup> Regulation 9(2).

<sup>553</sup> A military veteran is described in Regulation 1 as having the same meaning as that in section 1 of the Military Veterans Act 18 of 2011 which defines it as any South African citizen who (a) rendered military services to any of the military organisations, statutory or non-statutory, which were involved on all sides of South Africa's Liberation War from 1960 to 1994; (b) served in the Union Defence Force before 1961; or (c)

In addition to the above, Regulation 12 provides for subcontracting after a tender has been awarded. In other words, a distinction is made between providing for subcontracting as a tender condition and subcontracting after award of a tender which has generally been the case until the 2017 Regulations came into operation. The 2017 Regulations have therefore made subcontracting compulsory to a determined group of contracts. The 2011 PPPFA Regulations<sup>554</sup> provided a definition for subcontracting,<sup>555</sup> however, no further provision for subcontracting was made in the Regulations. This was also the case in the 2001 Regulations. Therefore, one can assume that subcontracting was a generally permitted practice, despite the absence of a theoretical framework for it. This is discussed further below.

The fact that subcontracting is provided for as a qualification criterion and after the award of a contract is indicative of a recognition or acknowledgement of the importance of subcontracting. Subcontracting has been general practice in construction procurement. The enactment of the subcontracting provisions in the 2017 Regulations thus solidifies a long-standing practice. Various reasons why subcontracting in construction procurement occurs exist.<sup>556</sup> There may be a need for specific expertise amongst subcontracts necessary for a specific project or there may be a need to increase the main contractor's contracting capacity or in order to comply with BEE requirements by engaging small, medium and micro enterprises (SMMEs) in construction procurement tenders.

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became a member of the new South African National Defence Force after 1994, and has completed his or her military training and no longer performs military service, and has not been dishonourably discharged from that military organisation or force: Provided that this definition does not exclude any person referred to paragraph (a), (b) or (c) who could not complete his or her military training due to an injury sustained during military training or a disease contracted or association with military training.

<sup>554</sup> GG 34350 of 08-06-2011.

<sup>555</sup> Defined in Regulation 1(r) as "the primary contractor's assigning, leasing, making out work to, or employing, another person to support such primary contractor in the execution of part of a project in terms of the contract;". The same definition was used in Regulation 1 of the 2011 Regulations in GG 22549 of 10-08-2001.

<sup>556</sup> CIDB Practice Note 7 "Subcontracting Arrangements" May 2007 2.

At present there are three types of subcontractors in construction procurement.<sup>557</sup> Firstly, a domestic subcontractor which is appointed by the main contractor at his discretion. Secondly, a nominated subcontractor which is nominated by the procuring entity and must be appointed by the main contractor. Lastly, a selected subcontractor which is selected by the main contractor in consultation with the procuring entity in terms of the contract requirements.

CIDB prescripts note a number of challenges in subcontracting.<sup>558</sup> Firstly, subcontractors often experience problems regarding non-payment from main contractors. Secondly, there is a lack of (legal or labour) representation of subcontractors in the case of disputes. This is problematic based on the inability of subcontractors to enforce their rights in arbitration or litigation which are the main forms of dispute resolution in construction procurement. It is also an expensive exercise for subcontractors to legally enforce their rights since they do not have the financial capacity that main contractors have. Thirdly, sole authoritarian rights are given to the main contractor, leaving the subcontractor in a precarious position which leads to them having less bargaining power based on their dependence on main contractors for work. In the fourth instance, the main contract and the subcontract often tend to be removed from one another. Subcontractors allege that the conditions of the latter are less favourable than the former, leaving them with less rights. In a traditional subcontracting arrangement, the contract is concluded between the main contractor and the subcontractor. Therefore, the procuring entity from whom the main contractor won the tender is completely removed from this relationship.<sup>559</sup> The subcontractor can therefore only call on external sources for legal redress such as a court of law.

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<sup>557</sup> CIDB Practice Note 7 2-3.

<sup>558</sup> CIDB Practice Note 7 2.

<sup>559</sup> CIDB Best Practice Guideline D1 "Subcontracting Arrangements" March 2004 1.

The CIDB Code of Conduct describes the various role players in a construction procurement process of which one is a subcontractor. The subcontractor is:

“[A] natural or juristic person or partnership who is contracted by the contractor to assist the latter in the performance of his contract by providing certain supplies, services, or engineering and construction works.”<sup>560</sup>

The Code further indicates that the behaviour expected of subcontractors is the same as that of the main contractor insofar as it is relevant.<sup>561</sup> As noted in chapter four,<sup>562</sup> the behavioural norms stated in the Code of Conduct are synonymous with those of relational theory and by analogy, relational procurement law. Therefore, subcontractors must ascribe to the norms of relational procurement law.

The result of the enactment of subcontracting rules in the 2017 Regulations is not only that subcontracting has become compulsory in a certain group of contracts, but that the relationships in a subcontracting arrangement have changed. The Regulations effectively establish a relationship between the procuring government entity and the subcontractor. Therefore, a measure of protection is provided to subcontractors when contracting in projects above the value indicated in the Regulations. A further consequence is that the main contract and the subcontract can no longer be significantly different. Although it was never legally permitted to be different based on the Constitutional section 217 right to procedural fairness, the 2017 Regulations solidify this position.

Since the rules or norms of relational procurement law will be applicable to the new subcontracting Regulation, a tripartite relationship is created. A relationship between the procuring entity and the main contractor, a relationship between the main contractor and

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<sup>560</sup> CIDB Code of Conduct for all Parties Engaged in Construction Procurement GG 25656 of 31-10-2003 18.

<sup>561</sup> CIDB Code of Conduct 20.

<sup>562</sup> See para 7.

the subcontractor and most importantly a relationship between the procuring entity and the subcontractor exists. A procurement network is thus formed. This means that all three parties must act fairly and honestly toward one another. No single party therefore has power over the relationship. The norms of relational procurement law require that more accessible dispute resolution methods be employed. Therefore, subcontractors will no longer be the victims of financial monopoly. Applying relational procurement law will assist in complying with not only the new Regulation but also CIDB prescripts which require that subcontractors be treated fairly.<sup>563</sup>

The 2017 Regulations provide more extensive remedies than previous PPPFA Regulations. In line with a tenderer's right to make representations based on the section 33 right in the Constitution to just administrative action, this Regulation can be commended. Furthermore, the conciliatory nature of this provision indicates a desire for tenderers to perform their duties amicably and in line with the CIDB Code of Good Conduct. This is also in accordance with a relational procurement law which requires that tenderers act transparently and honestly which can also assist subcontractors in enforcing their rights.

Although Regulation 9 can be commended, a further amendment should be made. When 30% of R30 million is calculated, it amounts to R9 million. This means that a minimum of R9 million must be subcontracted. The CIDB uses a grading system in order to determine the works and financial capability of construction contractors. In terms of section 18(1) of the Act, subcontractors must adhere to this scheme and register on the Register of Contractors provided by the CIDB Act. Contractors are then graded according to their ability to complete a project of a certain value. Based on this grading system, a level six

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<sup>563</sup> CIDB Best Practice Guideline D1 1.

contractor and up would qualify as a subcontractor in terms of Regulation 9.<sup>564</sup> Grade six contractors are the “medium capacity:” contractors who can tender for work up to a value of R13 million. In other words, they are not SMMEs. Regulation 9 is specifically geared towards the development of black people, youth, women, those with disabilities and small businesses. However, based on the grading of construction contractors, this Regulation fails to adequately address the need to involve and develop SMMEs in construction procurement. It is therefore recommended that the threshold of R30 million be decreased in order to facilitate the involvement and long-term training of smaller contractors.

Regulation 9 further states that subcontracting 30% of a R30 million contract must occur *if feasible* to do so. However, the Regulations do not indicate what feasibility means neither does it provide a test for feasibility. Therefore, it remains to be seen under which circumstances this Regulation will be implemented. It appears as though this Regulation may permit some discretion as to when it will be feasible to implement which indicates a shift toward a more flexible and thus relational paradigm of contracting in public procurement. The question which remains is whether a Regulation making subcontracting mandatory is legally permissible or legally enforceable. In other words, does legal regulation or a legal framework exist in which subcontracting in public procurement can function. Currently, there exists no such framework for a provision newly included in the Regulations with no legal basis. However, a relational procurement law may provide an adequate solution. Relational norms such as fairness, equity, transparency, reciprocity, harmonisation with the social matrix, mutuality, restraint of power and balancing of expectations and interests are necessary to ensure an effective procurement network. Relational procurement law thus provides a framework in terms of which a cohesive subcontracting arrangement can function and also address the needs of subcontractors. In

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<sup>564</sup> See the new CIDB Regulations in GG 36629.

other words, in implementing Regulation 9 and subcontracting in construction procurement in general, relational procurement law best provides the legal framework in which it can operate.

#### **4 Preferential procurement in the construction industry**

In the construction procurement process, a number of methods have been used to implement horizontal policies. The legislation applicable to preference in construction procurement is the same as that in general public procurement. In addition, the CIDB as regulator of the industry has published best practice guidelines which provide for detailed procedures to be followed when applying preference in construction procurement. What follows is a brief overview of these since a detailed exposition of these procedures has been provided elsewhere.<sup>565</sup>

Firstly, set-asides have been used as a method to incorporate preference into the construction procurement process. In terms of this method a percentage of the total value of all contracts in the sector is set aside for particular groups. For example, a certain percentage of contracts may be set aside to be awarded for the employment of disabled people.<sup>566</sup>

Secondly, as is now the case in the PPPFA, is the practice of excluding tenderers based on qualification criteria. When submitting tenders, contractors are evaluated on prescribed criteria before the tender process commences in order to determine which tenderers are

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<sup>565</sup> See A Anthony *The Legal Regulation of Construction Procurement in South Africa* LLM thesis University of Stellenbosch (2011) 65-106.

<sup>566</sup> See CIDB Best Practice Guideline B1 "Formulating and implementing preferential procurement policies" March 2004 12 Table 4.

best suited to submit a formal tender. This is used as a sanction for non-compliance or as an incentive to comply in future. The procurement policy thus has a regulatory function.<sup>567</sup>

In the third instance, preferential procurement is implemented by means of what is referred to as offering back. A number of tenderers tender for a contract which is awarded to the tenderer who can match the offer of the tender submitted in the process.<sup>568</sup>

Preference can also be provided for at the short-listing stage of the procurement process. This occurs when a procuring entity prefers certain contractors when short-listing those who may submit offers for a tender. It is done by means of an electronic database for which tenderers are ranked based on their status as targeted<sup>569</sup> or preferred bidders.<sup>570</sup>

Product or service specification is also used to prefer certain tenderers in the construction procurement process. This means that a specification is included in a tender that requires tenderers to submit specific materials in providing the goods or services sought by the government. For example, biodegradable or otherwise environmentally friendly materials

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<sup>567</sup> See S Arrowsmith *The Law of Public and Utilities Procurement* (2005) 1245. Arrowsmith makes a distinction between this mechanism and set asides and notes that the distinction is a matter of degree in that set asides are used when contracts are reserved for a particular group. The qualification criteria mechanism, however, refers to an exclusion of contractors for failing to comply with a requirement. See Arrowsmith *The Law of Public and Utilities Procurement* 1245.

<sup>568</sup> CIDB Best Practice Guideline B1 3.

<sup>569</sup> Preferred tenderers are usually referred to as “targeted” tenderers in construction procurement. Targeted procurement is defined as “a system of procurement which provides employment and business opportunities for marginalized individuals and communities, enables procurement to be used as an instrument of social policy in a fair, equitable, competitive, transparent and cost-effective manner and permits social objectives to be quantified, measured, verified and audited. It is an international version of the Affirmative Procurement Policy”. The Affirmative Procurement Policy in turn, is defined as “a procurement policy which uses procurement as an instrument of social policy in South Africa to affirm the changed environment, government’s socio-economic objectives and the principles of the Reconstruction and Development Programme. See S Gounden *The Impact of the Affirmative Procurement Policy on Affirmable Business Enterprises in the South African Construction Industry* PhD thesis University of Natal (2000) 1.6 para 1.4 footnote 1 and 1.7 para 1.6 footnote 2.

<sup>570</sup> CIDB Best Practice Guideline B1 17 para 5.

should be provided. This is in line with an attempt to include environmental considerations in public procurement.

Preference is further provided for at the award stage of the construction procurement process. In other words, the award criteria for a tender may provide for preference to be awarded to tenderers who are considered to be “targeted”, meaning those who themselves implement horizontal policies. A price preference of 5-10% of the contract value can also be awarded to a tenderer who undertakes to develop historically disadvantaged individuals.<sup>571</sup> This is referred to as indirect preference and the former as direct preference.<sup>572</sup>

Examples of enterprises or contractors which may be favoured in the construction industry include Black Business Enterprises,<sup>573</sup> Black Women Enterprises,<sup>574</sup> Black-empowered Enterprises<sup>575</sup> and Small, Medium and Micro Enterprises.<sup>576</sup> Local Business Enterprises<sup>577</sup>

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<sup>571</sup> CIDB Draft Standard for Indirect Targeting for Enterprises Development through Construction Works Contracts 1.

<sup>572</sup> CIDB Best Practice Guideline B1 11 para 4.2.4.1.

<sup>573</sup> A black business enterprise is defined as an enterprise “a) whose management and daily operations are in the Control of one or more Black Persons, and b) which is at least 50,1 percent Owned by one or more Black Persons who are Principals”. CIDB Best Practice Guideline B2 “Methods and procedures for implementing preferential procurement policies” March 2004 8. However a different definition is provided in CIDB Best Practice Guideline B1 20 which is an “[e]nterprise which is in the control of one or more black persons and is at least fifty one percent owned by one or more black persons who are principals”.

<sup>574</sup> These are Black Business Enterprises which have at least half of its principals who are women and which are at least 25,1% owned by one or more women. CIDB Best Practice Guideline B2 8. As in the case of Black Business Enterprises, a different term and definition is provided in CIDB Best Practice Guideline B1 20. A Woman Business Enterprise is defined as an enterprise which is in the control of one or more women and is at least 51% owned by one or more women who are principals. A second definition for a Woman Business Enterprise is provided in the prescripts which is a sole trader, partnership or legal entity which adheres to statutory labour practices, is registered with the South African Revenue Service (SARS) and is a continuing and independent enterprise which provides a commercially useful function. The enterprise must further have at least a quarter of its principals who are women and which is at least 25,1% owned by one or more women who are principals. A commercially useful function is in turn defined as “[t]he performance of real and actual work, or the provision of services, in the discharge of any contractual obligation which shall include but not be limited to the performance of a distinct element of work which the business has the skill and expertise to undertake and the responsibility for management and supervision”. CIDB Best Practice Guideline B2 9.

<sup>575</sup> These are partnerships of legal entities which adhere to statutory labour practices, are registered with SARS and are continuing and independent enterprises which provide a commercially useful function and

and Local Labour<sup>578</sup> appear to be targeted at local government level only. At national and provincial government level, Community-Based Organisations may be favoured.<sup>579</sup>

Enterprises can be targeted based on their locality, their status as an SMME, their ownership, operational responsibilities and control or a combination of these by marginalised groups or a combination of these three.<sup>580</sup> Labour can be targeted based on gender, race, ethnicity, residency, age, disability, period of unemployment and level of skill.<sup>581</sup> Where labour is targeted by way of indirect preference, a tenderer may be required to use appropriate technology and methods of construction, manufacture or a combination thereof and to indicate in its tender that it intends to sub-contract in order to fulfill these goals.<sup>582</sup>

The CIDB further has a generic Specification for Social and Economic Deliverables<sup>583</sup> in which various preference goals are set out. These include providing employment opportunities including employment skills and development opportunities as well as

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which have at least one third of its principals who are black persons and which are at least 25,1% owned by one or more black persons who are principals.

<sup>576</sup> SMMEs are defined as sole traders, partnerships or legal entities which adhere to statutory labour practices, are registered with SARS and are Separate and Distinct Business Entities which include co-operative enterprises and non-governmental organisations and are managed by one owner or more which including its branches or subsidiaries are predominantly carried out in any sector or sub-sector of the economy mentioned in the Small Business Act 102 of 1996 and which can be classified as a micro, a very small, a small or medium enterprise in terms of the Small Business Act. CIDB Best Practice Guideline B2 10. CIDB Best Practice Guideline B1 20 provides a definition for a Small Business Enterprise as an enterprise which satisfies the definition of a micro or small business in terms of the Small Business Act.

<sup>577</sup> Defined as enterprises which have their sole office or head office located within the jurisdiction of the relevant municipality. CIDB Best Practice Guideline B2 20.

<sup>578</sup> This is referred to as “South African citizens who permanently reside within the municipal boundaries and earn wages and allowances that are no more than one and a half times the minimum wage established for construction related work”. CIDB Best Practice Guideline B2 20.

<sup>579</sup> These are defined as enterprises of which the management and daily business is in the control of one or more black persons and which are at least 50% owned by one or more black persons or empowerment shareholders. CIDB Best Practice Guideline B2 22.

<sup>580</sup> CIDB Best Practice Guideline B1 11 para 4.2.4.2.

<sup>581</sup> CIDB Best Practice Guideline B1 11 para 4.2.4.2.

<sup>582</sup> CIDB Best Practice Guideline B1 11 para 4.2.4.1.

<sup>583</sup> See CIDB Specification for Social and Economic Deliverables in Construction Works Contracts (2008) <<http://www.cidb.org.za/publications/Documents/Specification%20for%20Social%20and%20Economic%20Deliverables%20in%20Construction%20Works%20Contracts.pdf>> (accessed 14-10-2017).

business opportunities for target labour, utilising local resources, procuring sub-contractors for certain parts of contracts, providing support and mentoring services to targeted enterprises, providing for contracts to be concluded with joint ventures which have targeted partners and the promotion of HIV/AIDS awareness. This specification is applicable to construction contracts above R10 million.

The predominant and perhaps the best manner of implementing preference therefore seems to be by way of indirect preference – development of subcontractors. In the next section, the influence of relational procurement law on preference in construction procurement will be discussed.

## **5 Preference and relational procurement law in South Africa**

As noted, it appears as though the primary manner in which preferential procurement is implemented in the construction industry is by way of the development of smaller contractors by larger contractors. This is also required by the 2017 PPPFA Regulations in the provision that at least 25% of the contract can be awarded to a subcontractor who complies with BBBEE requirements.<sup>584</sup> An exchange therefore takes place. The main contractor who wins the government contract receives this benefit including payment from the government for work done, and the government receives the goods, works and services provided by the contractor. By the same token, the subcontractor in a tender receives training from a larger, more experienced contractor (the winning tenderer) and in turn the main contractor complies with the PPPFA and contract requirements. Moreover, the entire contract is aimed at long-term planning in order to receive future, long-term

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<sup>584</sup> See Regulation 9(2).

benefits. Therefore, the implementation of preferential procurement in this way constitutes a relational contract.

Furthermore, the common contract norms identified by MacNeil and discussed in chapter four,<sup>585</sup> are found in such an arrangement. The contract concluded between the government and the winning tenderer is one based on consent. It involves a great deal of planning in which all parties involved have mutual interests, are aware of one another's expectations and thus forge a sense of solidarity in order to successfully complete the project so that benefits are received. Based on the powerful position of the government, it is under an obligation to exercise restraint of power in order to maintain a relationship with the private party so that the goods, works and services are delivered. The same counts for the relationship between the main and subcontractor. Therefore, MacNeil's common contract norms are present in the implementation of procurement as a policy tool. Based on this working of preferential procurement, it was intended to be relational from the outset. In other words, in implementing preferential procurement, the intention is to establish long-standing relationships in order to develop contractors – both main and subcontractors – in the provision of goods, services and works to the government. The same argument is applicable to the development of smaller contractors by larger, experienced contractors.

Although public procurement may be used for collateral objectives such as the advancement of environmentally friendly practices, innovation, promotion of human rights and social goals, based on South Africa's past discriminatory policies and practices, the latter still does and should take priority. In other words, the development of black persons in South Africa is still the most important amongst the horizontal goals of public

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<sup>585</sup> See para 2 4.

procurement. The achievement of preferential goals in South Africa is in itself a progressive realisation. The right to equality in section 9 of the Constitution is a substantive concept, thus denotes equity and is implemented by way of affirmative action, BBBEE and public procurement which in turn are long-term goals and meant to serve the country in the long term until complete equality is achieved. Therefore, this implementation of the right to equality is an exchange between the government and private parties in the procurement context, over a long period of time.

Based on the fact that few large contractors exist, inevitably the same contractors provide the government with the goods, works and services it needs. Therefore a long-standing relationship is formed – one which holds benefits for all parties involved. Preferential procurement is therefore inherently relational. Traditionally, such a situation would be considered to undermine competition in the tendering process. Based on the fact that contractors are still developing their skills after 1994, a select group of contractors essentially control the construction procurement process in South Africa. This should be used as a tool to advance smaller contractors in the form of subcontracting and should not be regarded as anti-competitive.

The development of small contractors by larger contractors should be a standing requirement in construction industry policies. Doing so will not only ensure the implementation of preferential procurement but also the advancement of environmentally friendly products and perhaps even innovation in the development of contractor skills. The same argument can be made for the development of female construction contractors.

In addition to this, the CIDB Code of Good Conduct is applicable to all participants in the construction procurement process. As noted in chapter four,<sup>586</sup> relational norms are found in the Code and participants of the process are required to fulfill these norms. Therefore, these norms are applicable to preferential procurement as part of the construction procurement process.

The main goal of public procurement which is the achievement of value for money, should be interpreted to include not only best price but also the implementation of horizontal goals. In other words, implementing BBBEE in a government contract must be considered as part of value for money since a government objective to achieve socio-economic equality is advanced through public procurement contracts. Value for money should thus no longer in the main refer to best price.

When it comes to preferential procurement as prescribed by the PPPFA a very strict non-discretionary system is found. It can be seen from the various preferential procurement options used in construction procurement that much more discretion is provided for and this can be commended. The preferential system in the PPPFA is overly restrictive as leaving room for discretion in the manner in which procurement can be implemented as a policy tool simultaneously promotes innovation in procurement. The PPPFA merely provides for preference to be awarded based on a BBBEE scorecard for which prescribed goals must be achieved. The methods used in the construction industry appear to be flexible, provide a number of options for awarding preference and are better suited to the needs of the industry and the specific tenders that are awarded.

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<sup>586</sup> Para 7.

At present (14 November 2017) there exists no justifiable reason as to why the preferential procurement policy in South Africa should be as restrictive as that prescribed by the PPPFA except perhaps the need for some uniformity which can still be maintained by the points system, yet allowing creative means of awarding preference points to certain categories of tenderers as opposed to a restrictive list of requirements to be complied with in order to achieve a BBBEE status level. The idea of having more discretion in the application of procurement policy is in line with the notion of discretionary terms of relational contracts; the fact that relational contracts do not encompass all terms expressly but rather that some terms are left to the parties to the contract to determine during execution of the contract. It is clear that the entire preferential construction procurement system is geared towards the development of smaller businesses and historically disadvantaged contractors. Therefore, the preferential procurement system implemented in construction procurement is a relational one.<sup>587</sup>

## 6 Conclusion

Sections 217(2) and (3) of the Constitution allow for public procurement to be implemented as a policy tool by way of preferring some individuals or groups over others for the purpose of advancement based on South Africa's passed discriminatory policies and practices. As noted, the legislation which has been enacted for this purpose is the Preferential Procurement Policy Framework Act which binds all organs of state as defined by the Act to implement preferential procurement within the framework provided for in the Act. The CIDB as an organ of state bound by the Act is therefore obliged to use the points system

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<sup>587</sup> Defined by the electronic Collin English Dictionary as 1. a doctrine maintaining the existence of relations between things or 2. the theory that suggests that knowledge is conditioned by its sociocultural context; relativism. See Collins English Dictionary <<https://www.collinsdictionary.com/dictionary/english/relationism>> (accessed 14-10-2017).

referred to in the Act for implementing preferential procurement. As discussed in previous chapters of this dissertation, the CIDB is mandated by the CIDB Act to promote, standardise and unify procurement measures, including preferential construction procurement. To this end, the CIDB has published various best practice guidelines which paves the way for implementation of construction procurement as a policy tool within the broader construction industry. These prescripts include specific means of implementing preferential procurement such as set asides and indirect targeted procurement amongst other measures.

In April 2017, the new PPPFA Regulations came into operation which brought about a number of changes in the way in which preferential procurement must be implemented. Amongst other provisions, it permits the implementation of preferential policies at the qualification stage of the procurement process. The Act, however, permits points to be awarded for price and preference at the award stage of the process and at no other time. Therefore, it can be argued that such a regulation is *ultra vires*. However, it remains open for a tenderer to challenge this regulation.

Another noteworthy amendment has been the provision for subcontracting at the qualification stage of the procurement process as a condition of tender and after the award of a tender. The requirement of subcontracting as a condition of tender is applicable to tenders above a value of R30 million and if it is feasible to do so. Feasibility is not defined in the regulations, therefore, the circumstances under which this regulation will apply is uncertain. Once it is established what feasibility means for purpose of this regulation, this regulation may go a long way in ensuring the development of smaller contractors while promoting BBBEE. However, based on monetary value, Regulation 9 effectively allows for

subcontracting medium capacity contractors and not SMMEs which is the goal of the Regulation. Therefore, the threshold of R30 million should be significantly decreased.

The provision for subcontracting in the 2017 Regulations has been done without a legal framework in which it can function. It is a provision left open for interpretation as to its implementation. Regulation 9 does, however, create a tripartite procurement network of relationships between the procuring government entity, the main contractor and the subcontractor. Therefore, the various challenges experienced by subcontractors can be minimised in having the procuring entity involved in the relationship and the main and subcontracts will be equally favourable. Furthermore, because a procurement network is formed, the relational norms become applicable. Therefore, relational procurement law is the legal framework in which a subcontracting arrangement can function.

The various means of preferring contractors in the construction industry indicates creative methods of promoting construction procurement as a policy tool. Although creative, this is not in line with the framework provided in the PPPFA. These methods can therefore, based on black letter law, not be used. However, in accordance with the relational procurement law proffered in this dissertation, these various methods used in the industry can be commended. It was established in chapter four that the construction procurement process is a relational one. The CIDB Code of Conduct as a foundational document of the industry, prescribes various norms according to which all parties in the industry and therefore in the construction procurement process must behave. Most importantly, the Code prescribes social responsibility and collaboration of partnerships. These norms along with those found in section 217 of the Constitution therefore form the basis of a relational preferential procurement law in the construction industry. A preferential procurement

arrangement within a tender constitutes an exchange between the tenderer and the organ of state in that the tenderer receives payment for the work performed and the organ of state as a representative of the government contributes to its goals of transformation by way of conditions of tender in the form of BBBEE status levels of contribution and subcontracting to small, black contractors.

The framework provided for in the PPPFA is overly prescriptive and should allow for discretion in the use of procurement as a policy tool. This, along with achieving preferential procurement goals, promotes innovation in public procurement. A relational contract is one in which much discretion is permitted as not all contract terms are set out at the start of the relationship. Instead, the parties to the relationship are left to create their own contractual behaviour based on relational norms as discussed in this chapter and in chapter four. During the process of implementing preferential procurement, a large number of parties are involved, a great deal of planning is required, risks and benefits are divided and most importantly it occurs over an extended period of time. This, together with the basic norms referred to above establishes the preferential construction procurement arrangement in a tender as a relational one.

## CHAPTER SEVEN

### CONCLUSION

#### 1 Introduction

This dissertation is premised on section 217(1) of the Constitution which provides that when organs of state contract for goods or services, they should do so in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. These organs of state are not prevented from preferring certain individuals or groups of individuals when awarding government contracts in terms of section 217(2). In order to award such preference, national legislation must provide a framework in terms of which it must be awarded according to section 217(3). The Preferential Procurement Policy Framework Act (PPPFA)<sup>588</sup> and its Regulations<sup>589</sup> is the national legislation which provides for this framework.

It is trite that all law is subject to the Constitution as the supreme law in South Africa. As such all legislation which regulates public procurement must comply with section 217. Any law inconsistent with the Constitution is invalid in terms of section 1 of the Constitution. This dissertation is based on the hypothesis that the current legal framework for public procurement does not adequately provide for the needs and intricacies of a long-term process and subsequent contract commensurate with a public procurement system. Furthermore, the currently used private law of contract is ill suited to an area of law couched in public law principles with widespread public interest. The working of a suggested relational procurement law, based on the American relational contract theory is

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<sup>588</sup> 5 of 2000.

<sup>589</sup> Published in Government Gazette (GG) 40553 of 20-01-2017.

analysed in this dissertation in order to determine whether it better provides for a multi-faceted public procurement system in South Africa. The research question of this dissertation was thus whether a relational understanding of construction procurement in South Africa assists in formulating regulation for this area of public procurement and was answered by examining the following sections.

## 2 Construction Procurement Defined

### 2 1 Legal regulation of public sector procurement

As noted, section 217 of the Constitution provides for the legal requirements a public procurement system must comply with in South Africa. In order to give effect to section 217(3) the PPPFA and its Regulations have been enacted. Together with the PPPFA, the Broad-Based Black Economic Empowerment Act (B-BBEEA)<sup>590</sup> regulates black economic empowerment and therefore preferencing in government contracts. In addition to this, the Public Finance Management Act (PFMA)<sup>591</sup> and its Regulations<sup>592</sup> which regulate public finance at national and provincial government level and therefore public procurement are applicable. Similarly, the Local Government: Municipal Finance Management Act (MFMA)<sup>593</sup> and its Regulations<sup>594</sup> along with the Local Government: Municipal Systems Act<sup>595</sup> regulate public finance at local government level and therefore public procurement. Since the invitation, evaluation and award of tenders are of an administrative law nature,

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<sup>590</sup> 53 of 2003.

<sup>591</sup> 1 of 1999.

<sup>592</sup> PFMA Public-Private Partnership Treasury Regulation 16 GG 25773 of 28-11-2003; PFMA Supply Chain Management (SCM) Treasury Regulation 16A GG 27388 of 15-03-2005.

<sup>593</sup> 56 of 2003.

<sup>594</sup> MFMA Municipal SCM Regulations GG 27636 of 30-05-2005.

<sup>595</sup> 32 of 2000.

the Promotion of Administrative Justice Act<sup>596</sup> applies. Access to public information plays a role in public procurement processes, therefore, the Promotion of Access to Information Act<sup>597</sup> is applicable. Lastly, in order to curb corruption in procurement, the Prevention and Combating of Corrupt Activities Act<sup>598</sup> applies.

## 2 2 Legal regulation of construction procurement

The legislation applicable to public sector construction procurement are those which regulate general public procurement alongside the Construction Industry Development Board (CIDB) Act<sup>599</sup> and its Regulations.<sup>600</sup> The CIDB Act establishes the CIDB as a juristic entity which manages construction procurement in South Africa. It is empowered to publish further prescripts for the regulation of construction procurement. These prescripts and the CIDB Act therefore provide the sector-specific legal rules that regulate construction procurement.

## 2 3 Organs of state bound by section 217 of the Constitution

As noted, section 217(1) provides for the contracting of goods or services by organs of state in the national, provincial or local sphere of government or any other institution identified in national legislation. Section 239 of the Constitution, in turn defines “organs of state”. Therefore, organs of state for purposes of section 217 are departments of state or administration in the national, provincial or local sphere of government and those

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<sup>596</sup> 3 of 2000.

<sup>597</sup> 2 of 2000.

<sup>598</sup> 12 of 2004.

<sup>599</sup> 38 of 2000.

<sup>600</sup> GG 31603 of 14-11-2008.

institutions identified in national legislation. The CIDB is a public entity listed in Schedule 3 to the PFMA and is thus bound by section 217. All procurement in the construction industry must therefore be done in accordance with the principles of section 217 and the legislation applicable to public procurement

## 2.4 The current definition of construction procurement

Regulation 1 to the CIDB Act defines construction procurement as “construction procurement in the construction industry, including the invitation, award and management of contracts.” The CIDB Act itself provides various classes of construction works which can be procured and defines them as a combination of goods and services arranged for the development, installation, extension, repair, maintenance, renewal, removal, renovation, alteration, demolition or dismantling of a fixed asset.<sup>601</sup> Construction procurement thus appears to be the procurement of goods and services for these purposes, in other words, construction works.

## 2.5 Categorising construction procurement in the South African Constitution

As noted, section 217(1) refers to contracting of goods *or* services by the government. Works, or construction works have deliberately been excluded. The argument has been made that it is not necessary that section 217 specifically refers to works as these resort under services.<sup>602</sup> Contrary to this, the tendency in international instruments has been to distinguish between three categories when referring to public procurement, those of

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<sup>601</sup> See s 1(j) of the Act.

<sup>602</sup> See De la Harpe *Procurement Law: A comparative analysis* PhD thesis University of South Africa (2009) 23-24 para 2.2.1.

goods, services *and* works. The 2011 PPPFA Regulations seemed to follow suit in distinguishing between goods, services and works. However, the current 2017 Regulations have reverted back to the position under the 2001 Regulations which was to refer only to goods and services. This should, however, not be a barrier to an amendment of section 217. The impression it will create is that the three categories are individually or differently regulated from one another. In practice, this is indeed the case. In construction procurement specifically, construction procurement by its very definition means the procurement of a combination of goods and services. Therefore, construction works or merely works cannot resort under “services” in section 217. It would also accurately indicate construction procurement as a form of procurement on its own, with nuanced and complex rules which make its process somewhat different from general procurement. Creating such a divide amongst categories of procurement may further attract foreign contractors who identify similarities between their own and the South African procurement system and will portray a willingness on the side of the South African government to align its policies and legislation with international standards.

## 2.6 New Standard for Infrastructure Procurement and Delivery Management (SIPDM)

The new standard was published as a National Treasury Instruction Note<sup>603</sup> and came into operation on 1 July 2016. It applies to all organs of state in terms of section 239 of the Constitution, departments, constitutional institutions and public entities listed in Schedules 2 and 3 to the PFMA which includes the CIDB.

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<sup>603</sup> National Treasury Instruction Note 4 of 2015/2016 in terms of section 76(4)(c) of the PFMA and Regulation 3(2) of the MFMA SCM Regulations.

In essence, the Standard introduces new terminology and a new way of looking at the construction procurement process. To this end, reference is made to “infrastructure procurement” rather than “construction procurement” which appears to be an umbrella term for all activities which take place within the construction procurement process. The Standard aims to regulate the delivery of infrastructure, making infrastructure procurement merely one of the stages in this process. The National Treasury notes in the standard that construction, or rather, infrastructure procurement differs from general procurement in that the process is more complex and many unforeseen factors come into play throughout the procurement. Quality or functionality as it is referred to in the PPPFA Regulations plays an increasingly important role, weather conditions, changes in ground conditions, changes in owner, market failure to produce materials and accidental damage to existing infrastructure all influence the process. Therefore, the infrastructure procurement process is not as straightforward as when general goods or services are procured. Therefore, a procurement system which provides for the needs of this specific type of procurement is needed. Consulting Engineers of South Africa (CESA) in commenting on the new Standard, noted that too much emphasis is placed on price since the procurement of infrastructure is done in terms of general goods or services. More often than not, quality is more important than price and is treated as a challenge or an obstacle rather than an imperative. Therefore, the minimum requirements for functionality as prescribed by the PPPFA are insufficient according to CESA. A more flexible approach is therefore called for by industry role players.

## 2.7 Legal implication for the meaning of construction procurement

As noted, the new Standard refers to “infrastructure procurement” rather than “construction procurement” as is the case in the CIDB Act and its Regulations and CIDB prescripts. The definitions of these two terms also differ. Therefore, there exists a conflict in what is procured in the construction industry. Since the CIDB Act and its Regulations are still in force, these rules are still applicable, causing a parallel system to that created by the Standard. In practice, therefore, the new Standard may cause some confusion to construction contractors unless the terminology in either the Standard or the construction legislation is amended. However, since the Standard was published subsequently to the CIDB Act, it should be amended to be brought in line with the legislation.

Currently, the entire construction procurement system is in line with that prescribed by the CIDB Act. Contractors are registered according to classes of “construction works” in the Regulations to the Act which they can tender for. Based on the difference in definition between infrastructure and construction procurement, a number of construction types are omitted in the definition of infrastructure procurement. Therefore, although these exclusions are still part of the regime under the CIDB Act, they are not covered by the Standard unless they resort under the general term of “construction operations” which has been left open for interpretation.

Furthermore, if the Standard was to be amended, the structure of construction procurement would be as follows. As a point of departure, section 217 of the Constitution, would refer to the procurement of goods, services *and* works, indicating specific rules for construction works. By its very nature and according to the definition provided in the CIDB

Act, construction procurement constitutes a combination of goods and services which require a more flexible approach to its procurement than that of general goods or services. The term “construction procurement” can then refer to activities under both the current definition of construction procurement and that under “infrastructure procurement” which will ensure that most if not all activities in the construction industry will be regulated. Any activity or service which is not covered, can resort under “specialist works” already provided for in the CIDB Regulations.

It is not clear what the benefit is in changing the terminology in the new Standard. In order to maintain uniformity and clarity of what can be procured, the term “construction” should be retained when referring to anything related to construction procurement. The aim of this dissertation is to establish whether a relational understanding of construction procurement law aids the legal regulation or legal understanding of this area of law. MacNeil notes that a relational approach to exchange relations such as in a procurement context involves a good understanding of the various relationships involved. This relational theory should start at the definition of construction procurement in order to determine what is procured, who the parties involved are, what each party’s role is and the needs that are to be met. Any uncertainty or conflict in the definition of construction procurement may lead to an incorrect understanding of the various roles in the construction procurement process and therefore lead to unclear rights and obligations and unfulfilled legal requirements.

### 3 The legal nature of construction procurement rules

#### 3.1 Construction procurement versus general public procurement

The construction procurement process follows the blueprint of the general public procurement process. Few procedural matters are different. For example, two procurement procedures, those of the two-envelope procedures are more often used in construction procurement than in general procurement since quality is the main concern when utilising these procedures. Moreover, the process described in the SIPDM coincides with that prescribed by the PFMA and MFMA SCM Regulations, despite making reference to infrastructure procurement.

The difference in construction procurement relates to substantive content, meaning the prescription of additional legal rules to the construction procurement process. It generally also involves a great number of role players, adding to the risks, rights and obligations that are attributed in a subsequent contract.

Based on this, the call for a construction tender is treated in the same manner as that for a general tender. It is merely an offer to treat which becomes a contract once a tender is accepted. Throughout the procurement process, the administrative law or broader public law is applicable. Once a contract is concluded, the private law of contract becomes applicable. It is during this phase of the procurement process that many challenges are encountered since tenders and public law processes are treated with private law rules.

It was found that the evaluation of construction tenders differs slightly from that of general tenders in that they are evaluated on quality, price and preference. General tenders are of course evaluated on price and preference and quality is evaluated at the qualification stage of the procurement process. According to the 2017 PPPFA Regulation,<sup>604</sup> preference can also now be evaluated as a qualification criterion in general public tenders, however, this provision will likely be challenged in a court of law for being inconsistent with the Act. A number of reasons for cancelling a construction tender are not in line with general public procurement legislation such as the PPPFA. These should therefore be excluded.

### 3 2 Interpretation of construction procurement rules

As noted, the construction procurement process is regulated by section 217 of the Constitution, general public procurement legislation, the CIDB Act and its Regulations, CIDB prescripts and the new SIPDM. The construction procurement process in terms of the CIDB Act, prescripts and the SIPDM are highly convoluted and complex. Reference is made to words and definitions not used in general public procurement. Interpreting this terminology may thus be a challenge for our courts who themselves are not experts in construction procurement law. The Interpretation Act<sup>605</sup> and the various canons of interpretation should therefore be used. Section 2 of the Interpretation Act states that it is applicable to all “law” which in turn is defined as “any law, proclamation, ordinance, Act of Parliament or *other enactment having the force of law*” (own emphasis). Therefore, the Interpretation Act can be used in interpreting provisions in CIDB prescripts and the SIPDM.

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<sup>604</sup> See Regulation 4.

<sup>605</sup> 33 of 1957.

The Constitutional Court has held that whatever the nature of the document to be interpreted is, consideration must be given to the ordinary rules of grammar, the context of the words, the purpose of the provisions, the enactment at large and the material known to those who produced it.<sup>606</sup> Therefore, the context of construction procurement in general and the specific type of construction procurement at hand must be considered by the courts as well as the sector-specific needs of the industry. The challenge that the conflicting systems in the CIDB prescripts and the SIPDM presents, should be interpreted in light of the section 217 constitutional principles and teleological interpretation. The latter requires that a provision be interpreted in light of the context of the entire document. Where there is a conflict, as in the case between the CIDB prescripts and the SIPDM, it must be resolved by attempting to harmonise the two documents. This type of interpretation involves constitutional interpretation which entails interpreting a provision, document or statute in line with section 217, the history of the applicable document, its purpose in light of constitutional aims such as the delivery of construction works through a procurement system in line with section 217 and lastly interpreting the document(s) in light of other statutes such as the CIDB Act, its Regulations and other public procurement legislation. In such interpretation, a hierarchy of norms can be identified of which the Constitution is of course the highest. In principle, the norm of a higher rank can influence the interpretation of a norm in a lower rank, therefore, section 217 of the Constitution will be ranked the highest, those in general public procurement legislation, the CIDB Act and its Regulations next and those norms in the processes set out in the CIDB prescripts and the SIPDM last.

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<sup>606</sup> See *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA).

## 4 Relational theory and construction procurement law

### 4.1 Relational contract theory defined

Relational contract theory was created and developed in the American private law of contract. It is based on the premise that the classical private law of contract as it is currently applied inadequately provides for the needs of complex, long-term contracts. In relying on empirical research, the original authors of relational contract theory have found that in practice, very few parties adhere to the written contract and instead regulate their relationship on their own, more flexible terms.<sup>607</sup> Therefore, the need for a more flexible and practice based approach to contracts is needed.

In addition to this, it has also been acknowledged that contracts are not regulated by only the law. Since they are concluded between people, in a specific industry, for a specific purpose, various other industries or fields such as the social sciences and commerce come into play. A law of contracts which allows for flexibility in not only the rules that are applicable but also the various fields which talk to the actual nature of contracts as they are implemented in practice is thus the primary reason for the creation of relational theory.

Relational contract theory begins with the concept of exchange and is defined as the act of giving someone a commodity with the expectation that something of value will be given in return.<sup>608</sup> Exchange is based on economic exchange motivations in which various social norms are expressed. These exchanges are done by way of concluding contracts. MacNeil

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<sup>607</sup> Stewart Macaulay and Ian MacNeil are together regarded as the creators and developers of relational contract theory.

<sup>608</sup> I MacNeil *Cases and Materials on Contracts: Exchange Transactions and Relationships* (1971) 1.

defines a contract as relations among parties who plan to project exchange into the future.<sup>609</sup> The physical contract is merely an example of such a relation.

MacNeil further wrote that two types of relational contracts exist – discrete and relational. In effect, he places these two at opposite ends.<sup>610</sup> Discrete contracts are those which have prescribed or defined rules and obligations. Usually only two people are involved, it is not planned ahead of time and no relations between the parties exist. In other words, no expectation of a long-term relationship is created. The contract is short and quickly terminated.

On the other hand, relational contracts are evidenced by long-term relationships and the behaviour of the parties to the contract become the norms on which these contracts are based. There exists an expectation that further exchange will occur in the future and it often involves a large number of parties to the contract. The contract is of a long duration and risks, benefits and obligations are divided. Based on the long duration of the contract, certain norms, risks or obligations may not be defined at the conclusion of the contract. Therefore, this type of contract requires open terms and discretion on the part of all parties.

#### 4 2 Critique on relational contract theory

MacNeil has been criticised for his distinction between discrete and relational contracts.

This is based on the fact that there exists the opinion that there are no discrete contracts

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<sup>609</sup> | MacNeil *The New Social Contract: An Inquiry into Modern Contractual Relations* (1980) 4.

<sup>610</sup> | MacNeil “Relational Contract Theory as Sociology: A Reply to Professors Lindenberg and de Vos” (1987) 143(2) *Journal of Institutional and Theoretical Economics* 272 276.

and that all contracts are in fact relational. Therefore, no distinct “law of relational contracts” can exist. Eisenberg notes that instead of distinguishing the two types by the number of parties involved, reference should be made instead to the duration of the contract.<sup>611</sup> However, a more obvious distinction could be the creation of a long-term relationship in relational contracts which is absent in discrete contracts. Vincent-Jones, on the other hand, is of the view that what distinguishes discrete contracts from relational contracts is that they adhere to the “rule book”.<sup>612</sup> In other words, they are constructed according to the strict non-discretionary rules of the classic contract law.

#### 4 3 Development of relational contracts

From MacNeil’s initial strict distinction between discrete and relational contracts, arose a more nuanced difference.<sup>613</sup> He acknowledged, as Eisenberg alleged, that all contracts are in fact to some extent relational. However, some are much more relational than others and retain the characteristics he initially highlighted. He now places discrete and relational contracts on a relational continuum. On the least relational side of the continuum, is discrete contracts. On the other side of the continuum lies highly relational contracts which last for an extended period of time and cause long-term relationships to be created with the expectation and acceptance that future exchanges will occur. An example to illustrate this may be where a driver stops at a petrol station to fill a car with petrol where no relationship is formed and the contract is terminated quickly as opposed to a customer who continuously uses the same petrol station throughout the life cycle of the car based on

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<sup>611</sup> M Eisenberg “Why there is no law of relational contracts” (2000) 94(3) *Nw.U.L.Rev* 816.

<sup>612</sup> P Vincent-Jones “The limits of contractual order in public sector transacting” (1994) 14 *Legal Studies* 364-367.

<sup>613</sup> See I MacNeil “Values in contract: internal and external” (1983) 78(3) *Nw.U.L.Rev* 340-344.

good service received from the petrol attendant and other representatives of the station. The latter is an example of a relational contract.

#### 4.4 Discrete and relational norms

MacNeil is of the view that human behaviour gives rise to contractual norms according to which people conduct their contractual relations.<sup>614</sup> He created common contract norms which are the basis of any contract and will always be present. However, depending on the nature of a specific contract, the degree to which each of these norms are applicable, will differ. These norms describe how people behave and how they should behave in contract relationships.

The common contract norms he identified are integrity, mutuality, implementation of planning, effectuation of consent, flexibility, contractual solidarity, linked norms: restitution, reliance and expectation interests, creation and restraint of power, harmonisation with the social matrix and propriety of means.<sup>615</sup> Some of these norms will be more prevalent in discrete contracts and others more prevalent in relational contracts. For example, consent may be more prevalent in discrete contracts than in relational contracts since the latter require more flexibility and discretion.

MacNeil makes a further distinction between internal and external norms in contracts.<sup>616</sup> The former are those which the parties themselves decide will be applicable to their relationship and the latter entail norms prescribed by an external source such as the rules

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<sup>614</sup> MacNeil *Cases and Materials on Contracts* 1.

<sup>615</sup> See MacNeil *The New Social Contract* 40-58 and I MacNeil "Relational contract theory: challenges and queries" (2000) 94(3) *Nw.U.L.Rev* 879-880.

<sup>616</sup> MacNeil (1983) *Nw.U.L.Rev* 346.

of a specific industry or association the parties may belong to. Since common contract norms are the basis of all contracts according to MacNeil and will always be present, these automatically become internal contract norms.

Based on the norms required of parties to contract, a minimum obligation or minimum compliance to these norms is required. According to Feinman, the use of this normative structure results in a policy-like analysis of contracts as opposed to a doctrinal analysis as prescribed by classical contract law.<sup>617</sup> This makes relational contract theory an alternative to general contract law.

#### 4 5 Relational contract theory and the law

The exchange relations referred to above give rise to legal rights, which makes the law applicable to relational contracts. As noted, more than the law, exchanges aim to achieve goals such as the completion of construction projects or buying and selling things. Therefore, ascribing a purely legal definition to relational contracts would be unnecessarily narrow and would defeat its purpose of discretion and flexibility.

Although the law is not the only field applicable to relational contracts, it does provide an indication of social norms and practices in terms of which human affairs are conducted, contracts being part of this conduct. Therefore, the law tells society what its norms are and should be and therefore become the norms of exchange and the norms of relational contracts.

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<sup>617</sup> J Feinman "Relational contract theory in context" (2000) 94(3) *Nw.U.L.Rev* 737 743.

Furthermore, section 41 of the South African Constitution requires that a co-operative, effective, transparent and coherent government be maintained. Government institutions should co-operate in mutual trust and foster friendly relations in co-ordinating their actions and legislation with one another. Legal proceedings against one another should be avoided. The Constitution itself thus requires that government must act in accordance with principles akin to those of relational contract theory.

Public procurement concerns an exchange between a government entity and a tenderer and involves economic activities of the government and its relationship with other economic entities. The procurement process globally is based on norms similar to those of relational contract theory and specifically in South Africa ascribe to fairness, accountability, equity, competition, reciprocity, consent and co-operation based on section 217 of the Constitution. The process is more often than not one of a long duration and relationships are, whether intently or inadvertently, formed. Therefore, the public procurement process and by analogy the construction procurement process is an example of a relational contract.

#### 4.6 Classical contract law versus relational contract theory and the need for a law of relational contracts

In this section, an exposition of classical or general contract law vis-à-vis relational contract theory was provided. It was discovered that classical contract law, based on a doctrinal system of law with little flexibility is inappropriate for contracts of a public procurement nature. The long-term relationships in public procurement require a more flexible approach with open-ended norms which can be amended as the parties wish

throughout the duration of the contract. The prescriptive nature of the private law of contract is therefore not suitable. Although implicit and tacit terms may be read into a contract in terms of general contract law, these are limited to terms imputed by the law or those derived from the express terms of the contract. A further challenge which contract law poses is the parol evidence rule which does not permit any evidence outside the “four corners of the contract” to be permitted in an attempt to prove the terms of the contract.

Relational contract theory is based on the relational norms decided on amongst parties to a contract. These regulate the contractual relationship along with the common contract norms. Empirical research has shown that parties to a contract rarely if ever rely on contractual terms.<sup>618</sup> In other words, their relationship is self-regulated with recourse to the contract only when necessary or in the event of a dispute. The “real” deal and the “paper” deal are thus different. Relational contract law has therefore been used in practice for some time.

The argument is made that parties base the functioning of their relationship on accepted social norms. The law, it is argued, is an indication of what the social norms of a society are. Therefore, the norms according to which these parties behave in the execution of their agreements, can be translated into law by creating a law of relational contracts.

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<sup>618</sup> S Macaulay “The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules” in D Campbell, H Collins & J Wightman (eds) *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 51 51. See also C Mitchell “Contracts and Contract Law: Challenging the Distinction Between the ‘Real’ and ‘Paper’ Deal” (2009) 29(4) *Oxford Journal of Legal Studies* 675 676.

#### 4.7 Relational procurement law in South Africa

Having established a need for a relational system for contracts, the working of such a system must be explored. It is argued that based on the common contract norms which form the basis of any contract and will always be present, the inherent common norms of a relational procurement law would be the norms in section 217 of the Constitution together with those identified by MacNeil. These would form the internal norms. Fairness, meaning procedural and substantive fairness<sup>619</sup> involves *inter alia* the right of each party to be heard (*audi alteram partem*), the rule against bias (*nemo iudex in sua causa*), sufficient access and sufficient assistance to ensure access to public procurement opportunities will be furthered by a relational procurement law which advocates transparency, openness and accountability. Equity which is a substantive concept relates to the implementation of BBBEE which is also advanced in relational procurement law and construction procurement law prescripts which require the advancement of developing contractors or SMMEs. Transparency as a cornerstone of a relational procurement law will naturally further this objective. Competition will be encouraged in the elements of mutuality, reciprocity and restraint of power and all these factors will promote the attainment of cost-effectiveness in section 217 of the Constitution. Therefore, relational procurement law will not only further but give meaning to these constitutional principles.

Along with these would be the norms the parties agree to such as those prescribed by the CIDB Code of Conduct. Any values or norms prescribed by the relevant professional associations will form the external norms to the agreement.

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<sup>619</sup> See Bolton *The Law of Government Procurement* 45-47.

The Constitutional Court acknowledged in *Barkhuizen v Napier*<sup>620</sup> that a more principled approach to contracts is needed in terms of which objective criteria are used with a sensitivity to the way in which economic power in the public sector should be appropriately regulated in order to ensure a fair society. Further to this, the court noted that parties should contract on a basis that acknowledges the public interest. The element of public interest has been thwarted by the private law of contract in that only parties to the contract are privy to its contents. However, in the case of public procurement this simply cannot be the case. Public procurement is exercised with large amounts of public funds and for this reason alone public interest in such matters is justified. The court's reference to the public interest in contracts which affect the public is thus commendable and an indication of acknowledging a relational contract law.

Furthermore, in the judgment *South African Forestry Company Limited v York Timbers Limited*,<sup>621</sup> the Supreme Court of Appeal held that where the express terms of a contract were ambiguous, it was entitled to impose clearly expressed intentions of the parties. All contracts should thus be based on good faith, and the intention of parties should be interpreted based on the assumption that they negotiated and agreed in good faith. The high courts of the country therefore acknowledge the need for a relational approach to contracts.

Although a relational procurement law is advocated, the classical contract law cannot be completely ignored. In the event of a breakdown in any of the relationships or a dispute, express terms can and should be provided for in a written agreement as a safety net. Therefore, a hybrid system (a combination of relational and classical contract law) will be

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<sup>620</sup> 2007 5 SA 323 (CC).

<sup>621</sup> 2004 4 All SA 168 (SCA).

best employed in ensuring an efficient relational procurement law. This will ensure legal certainty to those parties who prefer this.

Relational procurement law is underpinned by the South African Constitution which in itself is a relational document. Section 39 enjoins our courts to develop the common law (in this case the classical contract law) in line with the Bill of Rights of which the section 9 right to equality forms part. Contracts executed in terms of relational procurement law will allow for the support and development of small construction contractors who are not able to enforce their rights by way of litigation. This is since relational procurement law provides a more amicable basis on which to resolve disputes. The section 33 right to just administrative action requires that the construction procurement process be reasonable. Therefore, a balance must be struck between the adverse and beneficial effects of the values of the contracts which give meaning to the contract norm of restraint of power. Furthermore section 195 places an obligation on government entities to act ethically and a corresponding obligation on courts to develop the common law by considering foreign law such as the American relational contract theory when adjudicating South African matters. Relational contract theory or rather, relational procurement law may therefore promote transformative constitutionalism.

To this end, relational procurement law may even form the basis on which public law matters in general are dealt with. The South African Constitution, as noted, is a relational document since it is meant to govern the country over a long period of time. It binds all parties in the public and private spheres. The Bill of Rights describes the progressive realisation of rights which must be achieved based on the values of the Constitution which are akin to that of relational procurement law.

As of late there has been a call for the development of contract law in that it should be “constitutionalised”.<sup>622</sup> In other words, constitutional values such as openness, fairness and reasonableness should apply to private contracts. This will gradually blur the lines between private and public law which may prove to be a positive development for the law of public procurement since the entire procurement process and resultant contract will be concluded and managed in terms of public law values which align with those of a proposed relational procurement law.

## 5 Public-Private Partnerships (PPPs) in Construction Contracts

### 5.1 The nature, regulation and definition of PPPs in South Africa

PPPs are loosely considered to be long-term contracts concluded between the government and a private party in terms of which the private party delivers a service to the public on behalf of the government and receives payment either from the government or from the public who use the service. PPPs are normally used in the case of large scale construction projects and involve a great number of role players. Currently in South Africa, PPPs constitute 1,7% of the country’s total infrastructure budget. They therefore play a large role not only in the construction industry but in the South African economy as whole.

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<sup>622</sup> See for example D Tladi “Breathing constitutional values into the law of contract: Freedom of contract and the Constitution” (2002) 35(2) *De Jure* 306-317; O Cherednychenko “The Constitutionalisation of Contract Law: Something New under the Sun?” (2004) 8(1) *Electronic Journal of Comparative Law* 1-17; B Mupangavanhu “Yet another Missed Opportunity to Develop the Common Law of Contract? An Analysis of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* [2011] ZACC 30” (2013) 1 *Speculum Juris* 148-173; M Lourens & J Frantzen “The South African Bill of Rights – public, private or both: a viewpoint on its sphere of application” (1994) 27(3) *Comparative and International Law Journal of Southern Africa* 340-356; D Moseneke “Transformative Constitutionalism: Its Implications for the Law of Contract” (2009) 1 *Stellenbosch Law Review* 3-13; M Kruger “The Role of Public Policy in the Law of Contract, Revised” (2011) *SALJ* 712-740; D Bhana & A Meerkotter “The Impact of the Constitution on the Common Law of Contract: *Botha v Rich NO (CC)*” (2015) *SALJ* 494-509; D Bhana “The Implications of the Right to Equality in Terms of the Constitution for the Common Law of Contract” (2017) 1 *SALJ* 141-161; L Hawthorne “The ‘new learning’ and transformation of contract law: reconciling the rule of law with the constitutional imperative to social transformation” (2008) 23 *SAPL* 77-99.

The pressure on government budgets and government capacity has led to increased reliance on PPPs to deliver traditionally government services by the private sector. They essentially consist of a relationship between the various parties involved based on a commitment from each of the parties to the project. All parties have equal bargaining power and the government's responsibilities relating to service delivery are lightened. Another advantage for the government in PPPs is that the initial funding for providing the infrastructure to deliver the service is provided for by the private party.

PPPs are regulated by the general public procurement legislation, along with Regulation 16 to the PFMA Act, section 120 of the MFMA and Chapter 8 of the MSA.

## 5.2 PPPs versus general public procurement

When a private party is procured to provide a service to the government in the form of a PPP, this is done as a part of the larger PPP project. In other words, the difference between a PPP and general public procurement is that the entire procurement process in a general tender forms merely one part of a PPP project. Furthermore, specifications of the service are provided by the private parties to the procuring government entity, as opposed to the general public procurement process where the government provides these requirements.

### 5.3 Advantages and challenges of PPPs

The advantage to PPPs is that the government is relieved to an extent of its responsibility to provide service delivery in that the private party in the PPPs now provides the service. It also provides the funding for the project, relieving the government of this burden. It may be cheaper to deliver certain construction projects by way of PPPs since the procurement, construction, operation and management of the service is done by one service provider, perhaps also saving time in delivering the service. The risk of an incomplete project is minimal based on the skill of the private sector and the need to replace the funds expended and to make a profit. Wasteful expenditure on the part of the government is therefore minimised.

The challenges of PPPs appear to stem from the risk of corruption. These are lack of competition, ineffective contract management, failure to monitor performance and inequitable risk allocation. These challenges present themselves when the incorrect tenderer is awarded the contract based on corruption. A further challenge posed is the risk of communication lost amongst role players since a PPP lasts for an extended period of time and parties involved in the project may as a result change. At times a lack of proper bookkeeping may lead to increased costs. Therefore, if corruption is curbed, PPPs largely have more value to add to the economy than challenges.

## 5 4 Relational PPPs

The complex workings of governments over time have led to the development of modern models of governance.<sup>623</sup> When governments collaborate with other parties, goods and services can be delivered speedily and efficiently. This is referred to as governing by network.<sup>624</sup> This type of governance is synonymous with PPPs where a collaborative relationship is established between the government in need of a supplier to deliver a service on its behalf and a private party who is able to deliver the service and make a profit. PPPs are therefore exchange relationships.

Various relationships are formed between the role players in PPPs, they are long-term, complex projects which involve an exchange in the future. PPPs are thus relational contracts. The common contract norms identified by MacNeil are inherently found in PPPs. By their very nature, relationships are formed which are based on norms decided on by the parties. Intensive planning, consent, reciprocity, mutuality, role integrity and restraint of power are amongst the norms prevalent in PPPs.

The legislation regulating PPPs are not detailed and as such provide room for a more detailed framework on which they can be based. The extended time periods of PPPs and the change in role players over time lends itself to flexible, open-term contracts which can still achieve the goals initially set out. Based on various empirical research, it has been found that a more process- rather than transactional-focussed approach to PPPs has been

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<sup>623</sup> S Goldsmith & WD Eggers *Governing by Network: The New Shape of the Public Sector* (2004) 8.

<sup>624</sup> 9.

more successful in ensuring that goals are achieved.<sup>625</sup> The formation of relationships amongst partners based on mutual trust and an adherence to the behavioural and later contract norms is imperative in PPPs.

Based on the complex nature of PPPs, conflicts are likely to arise making a written agreement favourable. This is in line with a hybrid form of relational procurement law, where contract norms are relied upon for execution of an agreement yet written provisions exist in the event of a breakdown in any of the relationships.

International instruments such as the European Commission Rules on PPPs, the World Bank Rules for PPPs, the UNCITRAL Model Legislative Provisions for Privately Financed Infrastructure Projects and the OECD Recommendations of the Council on Principles for Public Governance of PPPs all recommend that a framework for PPPs based on fairness, transparency, long-term partnerships, trust and mutual participation should be created.

PPPs as a form of public procurement are therefore bound by the norms of section 217 of the Constitution. The nature of PPPs as partnerships with the aim of reaching mutual goals and the provision of a service to the public indicates that PPPs are in fact inherently relational. Based on the global relationship-approach to PPPs, South Africa is in need of a relational procurement law which will ensure compliance with section 217 of the Constitution and public procurement legislation.

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<sup>625</sup> J Edelenbos & E Klijn "Project versus Process Management Public-Private Partnerships: Relational between Management Style and Outcomes" (2009) 12(3) *International Public Management Journal* 310-314.

## 6 Preferential relational procurement law in South Africa

### 6 1 Preferential procurement in South Africa

Since 1994, the use of public procurement as a policy tool has become increasingly important in South Africa. Traditionally, public procurement was used to acquire goods or services at the best possible price. However, it can be used for collateral objectives such as the promotion of environmental goals, innovation in product creation or social policies. The latter has been especially important in South Africa.

Preferential procurement was introduced in sections 217(2) and (3) of the South African Constitution. These sections permit the allocation of preference to certain individuals or groups when government contracts are awarded. This must be done in terms of the framework provided for in national legislation enacted for this specific purpose, the PPPFA. This Act provides for a points system in terms of which preference must be awarded to certain groups of contractors when government contracts are awarded. Contracts above the value of R50 million must award 90 points for price and 10 points for preference. Contracts under this value must award the same in the ratio of 80/20.

### 6 2 Preferential construction procurement

The methods employed in the construction industry for implementing preference are numerous. Some are in line with the PPPFA and others are not. Although some of these methods are contrary to current legislation, they provide for innovation and creativity in

awarding preference. It is submitted that the points system as the only method of awarding preference is rather restrictive and does not take account of sector-specific needs in awarding preference. Through having various methods, preference is more widely applied in the construction industry.

### 6.3 Relational preferential procurement

The Regulations to the Act have recently been amended<sup>626</sup> and introduced significant changes to the manner in which preference is awarded. More specifically, Regulations 9 and 12 of the 2017 PPPFA Regulations provide that where feasible to do so, 30% of the total value of a contract must be subcontracted. Regulation 12 makes provision for subcontracting after the award of a tender. Although subcontracting has been common practice in construction procurement, this provision not only makes this legally mandatory but extends the sphere of subcontracting to general public procurement. Therefore, subcontracting is becoming an important tool through which to promote preferencing in South Africa.

Based on CIDB research, subcontractors experience many challenges.<sup>627</sup> Among these are non-payment, unfair contracts, lack of labour and legal representation and little if any access to legal redress in the case of disputes or enforcing their rights. The contract that is concluded between the main and the subcontractor means that the procuring government entity is excluded from this relationship. Therefore, it cannot become involved in any dispute between the main and the subcontractor, neither can it assist the subcontractor in any of its challenges.

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<sup>626</sup> See GG 40553 of 20-01-2017.

<sup>627</sup> See CIDB Practice Note 7 "Subcontracting Arrangements" May 2007 2.

CIDB legislation and prescripts make provision for subcontractors in the Register of Contractors and in prescribing the norms they must comply with when involved in construction procurement. These norms are akin to those of relational procurement law, therefore subcontractors will effectively comply with this.

The result of enacting subcontracting provisions is that the procuring government entity becomes part of the entire contracting network. This means that a relationship is formed between the government and the subcontractor. Therefore, the main and subcontracts cannot be substantially different, and subcontractors must have access to labour and legal representation. Since a network of relationships is formed amongst the parties, the norms of relational procurement law apply.

Although Regulation 9 should be commended, it does not adequately address the needs of small contractors. When 30% of R30 million is calculated, it amounts to R9 million. This is the amount which medium capacity construction contractors tender for and not small contractors. Therefore, the amount of R30 million should be significantly decreased in order to allow for subcontracting to small or micro enterprises.

Regulation 9 refers to subcontracting if feasible to do so. There is, however, no indication as to when it would be feasible or a test for feasibility. This leaves room for some discretion to be applied which in turn is an indication of some flexibility and thus a relational approach to contracting in public procurement. However, despite this, there exists no legal framework for the implementation of this provision. Based on the open-ended terms in which the provision is written, a relational procurement law may provide an efficient framework. Relational norms such as fairness, equity, transparency, reciprocity,

harmonisation with the social matrix, mutuality, restraint of power and balancing of expectations and interests are needed to ensure effective procurement, including subcontracting arrangements. Relational procurement law therefore provides the legal framework in which it can operate.

This dissertation was aimed at investigating whether a relational perspective of construction procurement law can assist in the manner in which it is regulated in South Africa. It was found that relational contract theory can indeed provide a framework on which construction procurement is based for its legal regulation. It was established that the most effective way to do so is by way of a relational procurement law which has a layered approach to construction procurement law and constitutional principles. These aid in realising transformative constitutionalism since public procurement in South Africa is imbedded in the Constitution. Furthermore, relational procurement law can best provide for the effective implementation of public-private partnerships as a major financial contributor in the construction industry and preferential construction procurement law which ensures compliance with constitutional procurement norms.

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