

# MDA PRESENTS



## FIRST AID FOR CONTRACTS



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### UNDER THE NEC 3 ECC, DOES A CONTRACTOR'S DEFECTS LIABILITY OBLIGATION SURVIVE TERMINATION OF THE CONTRACT?

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**No one enters into a contract with the intention of terminating it. As we all know only too well, terminations do occur and all modern contract forms, including the NEC contracts make provision under prescribed circumstances for termination by either of the Parties.**

The NEC3 Engineering and Construction Contract (April 2013 edition) (NEC 3), deals with termination in clause 90 and provides reasons for termination by the Contractor but allows the Employer to terminate for any reason. It then provides the procedure to be followed for termination based on the reason for termination. Lastly, it sets out the cost implications.

The question that this article seeks to answer, is what happens to the Contractor's liability for defects where the Employer terminates the contract for its convenience or termination comes about as a result of

the Employer's breach of the contract.

To answer this question, we must first consider the definition of a Defect under the NEC which is:

- “ • a part of the works which is not in accordance with the Works Information; or
- a part of the works designed by the Contractor which is not in accordance with the applicable law or the Contractor's design which the Project Manager has accepted.”

The NEC makes provision for a Defects Date which is a period of weeks after Completion of the Works where Defects must be corrected by the Contractor. It is also the period where the Contractor may be instructed to search for any Defects that may not be obvious as a result of a reasonable inspection (i.e., a latent defect).

In the normal course of events, this period would end, and the Employer would either accept the Defects or have them corrected by another party at the Contractor's cost (Clause 44 and 45 of the NEC3).

However, the above relates to liability where the Contract goes to plan and is completed. The position which exists where the contract is terminated, specifically where the termination is by the Employer and is wrongful or for convenience, is not as clear.

When a contract is terminated, it is the legal equivalent of a break-up between the contracting parties. From the acceptance of the termination, the party's contractual relationship ends and they no longer are required to perform their primary obligations under the contract or are entitled to exercise their primary rights.

Cheshire, Fifoot & Furmston's Law of Contract, Sixteenth Edition, on page 684 to 685 has the following to say regarding the effect of termination of a contract, where the repudiation/termination is accepted by the other party:

*"The effect is to terminate the contract for the future as from the moment when the acceptance is communicated to the party in default. The breach does not operate retrospectively. The previous existence of the contract is still relevant with regard to the past acts and defaults of the parties"*

Therefore, any rights and obligations that accrue prior to the termination of the contract would continue to exist after the termination of the contract. For example, where the Employer has paid the Contractor

and the Contractor has supplied defective work and/or materials, the Employer can demand that the Contractor rectify the defects at the time of the termination. Conversely, if the Employer did not pay the Contractor for work carried out, and said work turned out to be defective, and the contract is wrongfully terminated, the Employer would have no such right, nor would he be obligated to pay for this work.

In terms of the NEC, the Defects Date (and the applicable provisions) only comes into effect on Completion. Where a contract is terminated, Completion does not occur and therefore the abovementioned provisions will never come into effect. In light of this and the fact that a contract may not be resurrected after termination, in the event of a defect becoming evident after termination, an Employer will have no contractual rights to the rectification of same.

However, an Employer may be entitled to rely on the common law, which holds that where there is no contractual relationship in existence between the parties it is possible to hold a Contractor liable for such defects.

In the case of Electricity Supply Commission V Stewarts and Lloyds of SA (Pty) Ltd 1981 (3) SA 340 (A) (hereinafter the "Electricity Supply Case") where the learned judge said as follows:

*"If any defect due to the respondent's fault should develop during the currency of the contract including the maintenance period, the appellant's rights and remedies are those specified in the contract."*

*If any such defect developed afterwards, only common law rights and remedies (if any) are available. In the present case the defect developed after the expiration of the maintenance period. Hence the appellant's claim for damages was one under the common law and not under the contract. I shall assume, for it was not challenged, that despite the wording of the contract such a claim was available to the appellant."*

It was also held by the learned judge in the abovementioned case that *"it is sufficient to say that the earliest point at which prescription could begin to run, in the present case, was after the end of the period of maintenance, which was about the end of July 1972."*

The concept of prescription discussed by the learned judge in the Electricity Supply Case is governed by the Prescription Act 68 of 1969. The Prescription Act sets out a defined period during which a creditor may bring an action to recover a debt. Section 11(d) of the Prescription Act provides that the standard period is 3 years. Section 12 of the Prescription Act explains that in order for prescription to begin running, a debt must be due, and the creditor must have knowledge of the identity of the debtor and the facts from which the debt arises.

In the case of a latent defect, prescription begins to run from when the defect manifests and the Employer has a reasonable time to identify who is responsible for the defect (i.e., is it a design defect or a workmanship and material defect?)

Accordingly, where a NEC contract is terminated by the Employer for convenience or due to a breach by the Employer, the Contractor's contractual obligation to remedy the defects from that point forward would end, however, the Employer may be able to rely on the common law to hold the Contractor liable for any defects, as long as the right to do so has not prescribed.