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When Rome is Only Half-Built: Construction Contracts and Special Damages

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1. Introduction

Disputes between employers and contractors have had a long history in construction projects. To borrow from the metaphor in the title, imagine if the builders of the Colosseum had used mudbrick instead of rock, delayed the completion of the arena, and the Romans had to pay thousands of gold coins to rent an amphitheatre because of the delay. While a steel warehouse in Midrand is not precisely the Colosseum, similar circumstances were at the centre of a recent dispute between a steel structure manufacturer – Quandomanzi Investments (trading as SM Structures) and its client – Grid Electronics. The case in question is *Grid Electronics vs Quandomanzi Investments (Pty) Limited t/a SM Structures* [2024], referenced as ZAGPJHC 633 in the South Gauteng High Court, South Africa.

Using the *Grid Electronics* case as a backdrop, this paper examines the distinction between general and special damages in construction contracts. Set in a South African Contract Law context, the paper provides an analysis of contractor defaults that may result in costs that constitute general damages, *as oppos*ed to those that are categorised as special damages and are not ordinarily imputed against contractors. Furthermore, the paper examines instances in which a contractor may be held liable for special damages. In *Grid Electronics*, the court had to rule on whether the employer was entitled to special damages after a delay by the contractor in completing the structure resulted in the former having to rent alternative premises. The defendant, Quandomanzi Investments (trading as SM Structures), failed to fulfil all its obligations under a contract for the construction of a structure for Grid Electronics. As a result, the latter incurred costs of over half a million Rand, comprising additional rental paid to its landlord due to the delay, and the costs of procuring additional building material. In its application, Grid Electronics sought to hold SM Structures liable for both amounts as general damages. Ultimately, the court ruled in favour of Grid Electronics and awarded general damages in respect of the costs incurred in procuring additional building materials. However, it dismissed the claim in respect of the rental amount, holding that this constituted special damages.

This case note adopts a doctrinal approach to investigating the conceptual and practical differences between general and special damages. Using a combination of case law and contract standards that apply locally in South Africa and to international construction, and persuasive academic texts, this case note analyses of the court's approach to determining: (i) the quantum in claims for general damages, (ii) whether a loss resulting from a breach in a construction contract amounts to general or special damages, and (iii) when, in the event that special damages are proven, the defaulting party is deemed liable.

2. Background

In October 2019, Grid Electronics entered into a contract with SM Structures, in terms of which SM Structures would construct a portal frame steel structure on Grid Electronics' premises. Grid Electronics intended to use the premises to operate its automotive sound and accessories business. Of significance to the case is the fact that this was intended to be a move from the premises that Grid Electronics had been renting.
The parties agreed that the structure would be completed by 1 December 2020, and that SM Structures would be paid a total contract price of R435,500 for the work, staggered as follows:

i. 30% of the contract price upon placement of the order;

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ii. 60% on delivery of the structure on site, no later than 31 October 2019;
iii. 5% on completion of the frame, no later than 29 June 2020; and
iv. 5% on completion of installation and erection of the frame.

According to the contract, SM Structures was required to roof the structure with a special type of high-quality galvanised roof sheeting, specifically 0.5mm thick IBR Chromadek. This would later become a key issue in the dispute between the parties.

The first payment, an amount of R115,000, had already been paid to SM Structures prior to the conclusion of the agreement. SM Structures met the next milestone, which was the delivery of the structure, and Grid Electronics paid the second tranche, an amount of R276,150, at the end of October 2019. Upon completion of the frame, Grid Electronics paid R21,775, being the first of the two 5% tranches, at the end of June 2020. A balance of R21,775 remained, which was to be paid upon the installation and erection of the frame. Grid Electronics refused to make the last payment, alleging that SM Structures had breached the contract, as the latter had failed to complete the installation of the structure and had not supplied enough of the Chromadek roof sheets.

A dispute ensued, and Grid Electronics approached the court, claiming contractual damages of R147,756.60 as fair and reasonable compensation for the additional roof sheeting it had to purchase. This amount constitutes general damages; that is, damages that ordinarily follow from such a breach. Grid Electronics claimed a further amount of R428,506.08, being the additional rental it had to pay to its then landlord between 1 December 2020 and 31 March 2021 due to the delay in completing the structure on its new premises. This amount represents special damages; that is, damages that would not be expected to ordinarily flow from the kind of breach in question.

SM Structures conceded that Grid Electronics had indeed suffered general damages. What then remained for the court to decide, in relation to general damages, was the quantum. A more complex inquiry was required in respect of special damages. Despite initially claiming the rental paid due to the delay as special damages, counsel for Grid Electronics would later claim, in written heads of argument and the closing argument before the court, that this amount also represented a claim for general damages. The court had to determine whether the amount constituted general or special damages and whether Grid Electronics would be entitled to compensation if the amount constituted special damages.

3. Discussion

As a point of departure, it is important to note that the determination of damages resulting from defective performance need not always be a matter for a court to decide. When parties negotiate a construction contract, they may pre-agree on an amount to be paid for damages in the event of a delay or if the structure fails to meet the required performance or completion criteria. Liquidated damages are often stated as a rate or amount per day/week of delay in scheduled completion, while performance liquidated damages are stated as a fixed amount for each criterion the structure fails to meet. For present purposes, an example of delay liquidated damages would be the parties agreeing that SM Structures would pay a specified amount for each unit of time (such as weeks or months) that it fails to complete its performance. Parties seeking to include such clauses in their contracts are advised to consult the FIDIC *Conditions of Contract for Plant and Design-Build (Yellow Book)*, often used for projects of this nature, for standard-form delay and performance liquidated damages clauses. There is no indication from the ruling in the present case that the contract contained such a clause. In the absence of such a clause, the courts had to settle the parties' disputes on all matters relating to damages.

South African law distinguishes between general damages and special damages. The reason, which shall become apparent in the discussion below, is provided in *Holmdene Brick Works (Pty) Ltd v Roberts Construction Co Ltd* (173/75) [1977] ZASCA 61 as being:

"To ensure that undue hardship is not imposed on the defaulting party the defaulting party's liability is limited in terms of broad principles of causation and remoteness…"

4. 3.1 General damages

General damages are those damages that flow naturally and generally from the kind of breach that has been committed, and which the law presumes the parties contemplated would probably result from such a breach (Christie, 2024). In the event of a breach that results in general damages, the defaulting party is liable to the other party for the value of the loss incurred by the latter. McLauchlan (2019) describes the claim for general damages as a remedy intended to place the injured party in the position it would have been in had the other party performed as agreed. In the present case, general damages refer to the costs that Grid Electronics incurred to remedy the defective performance of SM Structures.

With counsel for SM Structures having conceded that Grid Electronics suffered general damages, the court did not have to decide whether Grid Electronics had incurred general damages due to SM Structures' failure to complete the installation of the roof structure. Both parties accepted that the costs of purchasing the shortfall of the galvanised roof sheeting constituted general damages. SM Structures submitted that the general damages amounted to R75,458.50, while Grid Electronics sought damages to the sum of R122,012.60. The court had to determine the amount for which SM Structures would be liable.

There are two prominent methods used in determining general damages, namely, the cost-of-completion-or-repair method and the diminution-in-value method (Haywood, 2003). The cost-of-completion-or-repair method seeks to place the injured party in a contract – in this case, the employer – in the position it would have been in had the counterparty, the contractor, fully performed its obligations under the contract. Using this method, damages are calculated by determining the cost to the employer of completing or repairing the defective work. In contrast, the damages under the diminution of value method are calculated by subtracting the market value of the object of the contract following the defective performance, from the market value it would have had if the defaulting party had fully performed its obligations. The latter method may result in complexities due to the need for expert appraisals in relation to market value, potential subjectivity associated with them, and associated cost implications (Sonnemans, 2017). As such, courts often use the comparatively simpler cost-of-completion-or-repair method when determining damages.

In this case, the court employed the cost-of-completion-or-repair method, which involved determining the costs incurred to complete the structure following the defective performance of SM Structures. The court multiplied the number of short-supplied Chromadek sheets by the unit cost and arrived at an amount of R125,393.45 as the cost of remedying the defective performance rendered by SM Structures. From this amount, the court deducted the last portion of the contract price, being the R21,775 that Grid Electronics had not paid, leaving a total of R103,618.45. It is this amount that the court deemed SM Structures to be liable for as general damages. With this finalised, the court then had to make a determination in respect of special damages.

This method aligns with the approach adopted by the Appellate Division in *Holmdene Brick Works, supra*, where a brick manufacturer supplied a construction company with defective bricks. The construction company used the bricks in the construction of walls that subsequently had to be demolished due to the crumbling bricks. Having suffered costs related to the demolition and reconstruction of the walls, the construction company sued the brick manufacturer for damages. The court held that the construction company had used the bricks for the very purpose that bricks are ordinarily used for, and that the demolition of a wall due to crumbling bricks was a natural and foreseeable consequence. As such, the costs incurred due to the manufacturer's breach amounted to general damages. In deciding the quantum of general damages, the court then had to determine the costs incurred by the construction company in demolishing and reconstructing the walls. This amount, R27,086.24, was deemed to be the amount required to place the construction company in the position it would have been in had the manufacturer fully performed its obligations.

3.2 Special damages

Special damages are losses that are not the natural result of a breach and are deemed, in law, to be too remote, unless there are exceptional circumstances (Peel, 2015). A defaulting party is deemed not liable for special damages unless exceptional circumstances exist.

With Grid Electronics having changed its claim from general to special damages in respect of the rental amount, the court had first to determine whether the additional rent paid due to a delay in completion constituted general or special damages; and if it constituted special damages, whether Grid Electronics would be entitled to claim special damages in the circumstances.

In answering the first question, the court referred to the ruling in *Shatz Investments (Pty) Ltd v Kalovyrnas Ltd* (156/74) [1976] ZASCA 4, where the Appellate Division laid out the distinction between general and special damages. The court differentiated between:

"(a) those damages that flow naturally and generally from the kind of breach of contract in question and which the law presumes that the parties contemplated would result from such a breach, and

(b) those damages that, although caused by the breach of contract, are ordinarily regarded in law as being too remote to be recoverable, unless, in the special circumstances attending the conclusion of the contract, the parties actually or presumptively contemplated that they would probably result from its breach."

While Hutchison and Pretorius (2022) define special damages as being "all damages that cannot be classified as general damages", the wording from *Shatz Investments* is instructive in the determination of special damages. Point (b) above proffers a three-step test for special damages. First, it must be determined that the plaintiff, Grid Electronics, in this case, suffered a loss. Secondly, the plaintiff's loss must be a result of the defendant's breach. The third step requires a determination of whether the loss is considered too remote to be recoverable. If a loss resulting from a breach fits the criteria above, then it is deemed to constitute special damages. There is, however, an exception applicable in special circumstances where the parties contemplated or are presumed to have contemplated that such a loss would probably result from the breach in question. This exception forms part of the test for determining whether a defaulting party will be liable for special damages, as further expounded below.

The court held that a plaintiff's obligation to pay additional rent to its landlord is not a loss that generally flows from a defendant's breach of a contract for the supply of materials and the rendering of related services. Rather, such a loss is one that incidentally or indirectly affects other business affairs of the plaintiff. As a result, the court ruled that Grid Electronics' claim in respect of the rental amount was too remote and, thus, amounted to special damages.

Having ruled that the claim was one for special damages, the court then had to establish whether the exception applied in the circumstances. South African law of contract imposes two requirements that must be satisfied for a defendant to be liable for special damages (Diamond, 2016). First, the parties must have contemplated that the damage in question would probably result from the causative breach. Secondly, the parties must have concluded the contract based on their knowledge of the probable consequences of the breach. Only if the loss satisfies the above criteria can a plaintiff be entitled to a claim for special damages.

The ruling in *Shatz Investments*, although not specifically related to construction disputes, demonstrates the requirement that the parties must have contemplated the damages and acted with such knowledge. In *Shatz Investments,* a fast-food shop sued its landlord for loss of goodwill and profits resulting from the landlord's breach and subsequent cancellation of the lease between the two. The Appellate Division, in confirming an order granting special damages, held that at the time of concluding the contract, *both* parties were aware *and* acted with knowledge that cancellation of the lease would result in the store losing access to customers and a substantial amount of goodwill. The court, while acknowledging that these were not damages that naturally flowed from such a breach, held that the landlord must have contemplated that such a loss would result from his breach *and* had entered into the contract with such knowledge. Accordingly, it awarded special damages in favour of the lessee.

Similarly, the court in *Grid Electronics* had to determine whether, at the time of the contract's conclusion, there were any special circumstances indicating that both parties had contemplated that the damages in question would likely result from such a breach. If the parties contemplated that a delay in completing the structure would likely result in Grid Electronics paying additional rent, and they concluded the contract based on that knowledge, then SM Structures would be liable for the resulting special damages. The court found that no such special circumstances existed, stating that:

"…when Grid Electronics and SM Structures – especially the latter – concluded the agreement there must not only have been common knowledge that such a loss would ensue on breach of the contract, but the parties must have entered into the contract on the basis of such knowledge. In other words, the parties (especially SM Structures) must have understood that, in the event of the completion of the structure being delayed, Grid Electronics would be forced to continue renting alternative premises…"

It is unlikely that a contractor would conclude a contract based on the knowledge that, if the completion of the structure were to be delayed, the contractor would be liable for the employer's rental costs – costs possibly exceeding the actual contract price. The court held that, on a balance of probabilities, SM Structures would not have, with such knowledge, entered into the contract with Grid Electronics. Consequently, the court found that, unlike in *Shatz Investments*, there was no evidence of special circumstances in which the parties had contemplated that such damages would likely result from the breach in question. Accordingly, the court dismissed the claim for special damages and granted only general damages of R103,618.45 plus interest, as the reasonable cost of remedying the defective performance of SM Structures.

4. Conclusion

This judgment reaffirms the contract law principle that, for a claim for special damages to succeed, the parties to a contract must have had prior common knowledge of the probable result of the breach and acted based on such knowledge. Only in such circumstances will the defaulting party be deemed to have agreed to bear the consequential loss. The judgment is also instructive in relation to the approach taken by South African courts in determining the quantum in claims for general damages.

Further, the approach taken by the court in *Grid Electronics* encapsulates several contract law principles that transcend construction contracts. Among these is a reaffirmation of the *parol evidence* rule, in that, except in exceptional cases, courts will not accept extrinsic evidence when adjudicating contract disputes. In this case, as there was no express provision in the contract regulating special damages, the court sought – on a very limited basis – to determine if there was any extrinsic evidence indicating that the parties likely contemplated that special damages would likely flow from the breach in question. This is what is referred to as the ambiguity exception to the *parol evidence* rule. The very name of the exception emphasises the importance of expressly and effectively regulating the terms of a construction contract, or any contract for that matter. It is crucial that damages and any other key terms are unambiguously stated to provide clarity regarding the risk allocation between parties without requiring judicial intervention. Lastly, and linked to the above, the ruling is an enforcement of the *pacta sunct servanda* principle, or the "agreements must be kept" rule. Much like the *parol evidence* rule, this rule emphasises the importance of clearly stated contract provisions, especially those relating to risk allocation and the consequences of a breach. Parties will be held to the terms they have contracted to; and in construction contracts, where damages resulting from breaches and disputes may amount to millions, it is crucial that parties clearly define the terms they will be held to. The following section proffers a solution centred around crisp drafting of contracts, and specifically, effective risk allocation.

5. Recommendations

Special damages, by virtue of the fact that they do not ordinarily flow from a particular breach, present a clear risk of unforeseen liability for parties to any contract. The consequences of such liability may be dire for the defaulting party. The *Grid Electronics* case serves as an apt demonstration of this. Here, the contractor entered into a contract worth R435,500, but could have, if special circumstances existed, found itself losing R428,506.08 of that to a claim for special damages. The risk is even more amplified in larger construction projects. While R428,506.08 is no small change, it pales in comparison to the millions – even billions – of Rand worth of special damages that a defaulting party may find itself liable for in large-scale construction projects. It is, therefore, important for parties to construction contracts to ensure they are adequately protected from the risk of liability for special damages. An effective way to achieve this is to have a clearly defined regime for the treatment of special damages in the contract. To this end, construction contracts often include provisions that expressly exclude liability for special damages. Below is an example of such a provision.

"In no event shall any party be liable to the other party for any special, incidental, indirect, consequential, or punitive damages whatsoever (including, but not limited to, damages for loss of profits, business interruption, loss of information, or any other pecuniary loss) arising out of or in connection with this agreement."

The effect of the above sample clause is that, even if special damages are proven, the parties have agreed in advance to exclude liability for them. There is, of course, no one-size-fits-all solution, and parties may agree to tailor such a clause to suit their unique circumstances. The express exclusion of special damages in construction contracts is not without its drawbacks. While it is important to protect parties from risk that is considered too remote, it does not address the risk that the non-defaulting party may still suffer losses due to the breach. How, then, is the non-defaulting party's risk mitigated?

One way to mitigate the non-defaulting party's risk is by including carve-outs to the exclusion of liability for special damages. These may include – on the part of the defaulting party – gross negligence, wilful misconduct, fraud, reckless conduct, or any other conduct that the parties agree should vitiate the exclusion of liability. The ultimate intention of such carve-outs is two-fold. First, it is to incentivise the parties to conduct themselves in a manner that reduces the risk of breaching the contract, and, by extension, the likelihood of the consequential damages that may result from such breaches. Secondly, it is to provide the non-defaulting party with recourse and entitle it to special damages in the event that such damages result from the defaulting party engaging in conduct such as fraud, gross negligence, or wilful breach. In this regard, the above sample clause may be augmented as follows:

"In no event shall any party be liable to the other party for any special, incidental, indirect, consequential, or punitive damages whatsoever (including, but not limited to, damages for loss of profits, business interruption, loss of information, or any other pecuniary loss) arising out of or in connection with this agreement, other than in the case of liability arising from:

i. fraud;
ii. gross negligence;
iii. wilful breach of this agreement;
iv. reckless misconduct;
v. a breach of the National Building Regulations and Building Standards Act; or
vi. abandonment

by a party (the defaulting party)."

The above carve-outs are not an exhaustive list, and the parties may include any other acts or conduct they deem necessary, as the context requires.

In drafting exclusions of liability, parties to a construction contract – or any contract for that matter – must take caution not to include limitation clauses that are unclear, or which may be interpreted by the courts as unfairly one-sided, or limitations of liability that are precluded by law. South African courts, while reluctant to limit parties' rights to contract as they wish, have previously set aside limitation clauses in such cases. For example, in *Belet Industries CC v MTN Service Provider (Pty) Ltd* (936/2013) [2014] ZASCA 181, the Supreme Court of Appeal set aside a limitation clause on the grounds that it was ambiguous when read in the context of the agreement as a whole. While the exclusion of liability was upheld in *Barkhuizen v Napier* (CCT72/05) [2007] ZACC 5, the Constitutional Court noted that there may be circumstances in which an exclusion of liability could be set aside on the grounds that it violates public policy. To mitigate this risk, parties to construction contracts should seek guidance from local and international contract forms such as the FIDIC *Conditions of Contract for Plant and Design-Build*, the NEC 4 Engineering and Construction Contract (ECC) and the Joint Building Contracts Committee (JBCC) Agreements, and utilise or amend the damages clauses therein as applicable to their needs. For example, Clause 17 of the FIDIC *Conditions of Contract for Plant and Design-Build* contains an express exclusion of indirect damages, subject to certain caveats. In order to effectively regulate the position, parties may, as proposed in the sample clause above, amend this clause to suit their specific circumstances. Each of the aforementioned contract forms contains similar clauses.

Ultimately, it is a balancing act between protecting parties from liability that is too remote to have been contemplated, while also ensuring that non-defaulting parties are not unfairly prejudiced. Parties to construction contracts should ensure that special damages are adequately and unambiguously specified in the contract.

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