

## The impact of fraud on dispute resolution clauses<sup>1</sup>

### ***Namasthethu Electrical (Pty) Ltd v City of Cape Town and Another*** (201/19) [2020] ZASCA 74 (29 June 2020)

In the recent judgment of ***Namasthethu Electrical (Pty) Ltd v City of Cape Town and Another***<sup>2</sup> (***Namasthethu***), the Supreme Court of Appeal (SCA) confirmed a judgment of the Western Cape Division (WCC) of the High Court. The WCC, as the court of first instance, set aside the referral by the Association of Arbitrators (Southern Africa) NPC (**the Association**) of a dispute to an adjudicator for determination<sup>3</sup> (**WCC's judgment**). The SCA also confirmed the setting aside of the adjudicator's determination. The referral and determination were set aside on the account of fraud committed by one of the parties to an agreement.

1. In ***Namasthethu*** the SCA held that an arbitration or adjudication clause contained in an agreement, which was found to have been induced by fraud, cannot stand.<sup>4</sup> In doing so, it followed its own earlier judgments in ***North West Provincial Government and Another v Tswaing Consulting CC and Others***<sup>5</sup> (North West) and ***North East Finance (Pty) Ltd v Standard Bank of South Africa Ltd***<sup>6</sup> (North East).

2. In ***North East*** the SCA (*per* Lewis, JA) held:<sup>7</sup>

*'If a contract is void from the outset, then all of its clauses, including exemption and reference to arbitration clauses, fall with it.'*

3. In ***North West*** the SCA (*per* Cameron, JA) found that:<sup>8</sup>

*'... the arbitration clause was embedded in a fraud-tainted agreement the province elected to rescind. The clause cannot survive the rescission, and the agreement purporting to give effect to it is stillborn.'*

4. In the ***North West*** and ***North East*** cases, the dispute resolution proceedings were not proceeded with because recourse was sought from the courts prior to the commencement thereof.<sup>9</sup> However, what distinguishes the ***Namasthethu*** case from the other two cases referred to is that the alternative dispute resolution proceedings in ***Namasthethu*** ran its course: An adjudicator was appointed, the adjudication process was concluded and the adjudicator made a determination. Only after the adjudication proceedings had been

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<sup>1</sup> [By Adv K Bailey, SC, FAarb.](#)

<sup>2</sup> Case no. (201/19) [2020] ZASCA 74 (29 June 2020).

<sup>3</sup> ***City of Cape Town v Namasthethu Electrical (Pty) Ltd and Another*** [2019] 1 All SA 634 (WCC).

<sup>4</sup> Paras [30] and [31].

<sup>5</sup> 2007 (4) SA 452 (SCA) at para [13].

<sup>6</sup> 2013 (5) SA 1 (SCA) at para [30].

<sup>7</sup> Para [12].

<sup>8</sup> Para [13].

<sup>9</sup> ***North West***, para [3]; and ***North East***, para [7].

completed, the innocent party to the fraudulent agreement approached the WCC for relief, which, in turn, led to the latter court's judgment and, ultimately, that of the SCA.

5. In the first instance, the facts in the *Namasthethu* case are analysed succinctly. For this purpose, I will refer to and use the WCC's judgment in *Namasthethu* because it contains a comprehensive account of the salient facts:

5.1. On 7 March 2014, the City of Cape Town (**the City**) advertised a tender for the supply and installation of energy efficient luminaries at the Cape Town Civic Centre. Namasthethu Electrical (Pty) Ltd (**the contractor**) was awarded the tender on 19 August 2014. The estimated value of the tender was some R33 million;<sup>10</sup>

5.2. The City and the contractor concluded a written JBCC Series 2000 Principal Building Agreement (**JBCC-PBA**)<sup>11</sup> on 25 November 2014, which was to endure for a period of 18 months;<sup>12</sup>

5.3. On the same day that the JBCC-PBA was concluded, allegations that the contractor had committed fraud in the tender process came to light. The City wrote to the contractor in this regard. The contractor responded and denied the allegations of fraud;<sup>13</sup>

5.4. On 18 December 2014, the City handed over the site, and the work commenced as agreed;<sup>14</sup>

5.5. In the meanwhile, and on 9 December 2014, the City requested a forensic investigation into the contractor. The City received the forensic report during early 2016. According to the report, the contractor made misrepresentations in the tender documents.<sup>15</sup> It was recommended that the JBCC-PBA be terminated and that criminal charges be lodged against the contractor and certain individuals;<sup>16</sup>

5.6. As a result of the forensic report, the City wrote to the contractor on 15 March 2016, informing it of the cancellation of the JBCC-PBA with immediate effect on the basis that the contractor had '*committed fraudulent acts during the tender process*';<sup>17</sup>

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<sup>10</sup> Para [3].

<sup>11</sup> The principal building agreement of the Joint Building Contracts Committee (**JBCC**).

<sup>12</sup> Paras [4] and [20].

<sup>13</sup> Paras [5] and [6].

<sup>14</sup> Para [12].

<sup>15</sup> Para [13].

<sup>16</sup> Para [13].

<sup>17</sup> Para [16].

- 5.7. The contractor disputed the cancellation, and correspondence in this regard was exchanged between it and the City. The City persisted with its contention that the JBCC-PBA had been validly terminated;<sup>18</sup>
- 5.8. The contractor insisted that the dispute concerning the cancellation of the JBCC-PBA be adjudicated upon in terms of the dispute resolution provisions contained therein.<sup>19</sup> It applied to the Association for the appointment of an adjudicator. The late Mr James Garner, a Fellow of the Association, was appointed as the adjudicator<sup>20</sup> (**the adjudicator**);
- 5.9. The City, in a letter to the contractor dated 19 May 2016, reiterated its position that the JBCC-PBA had been validly terminated. It stated that the contractor must approach the High Court for relief, and informed it that it would not participate in the adjudication process. It added that should the adjudication proceed; the City would take any such decision to the High Court to be set aside;<sup>21</sup>
- 5.10. On 22 May 2016, the adjudicator wrote to the parties and stated that, in the absence of any amendment to the adjudication provisions of the JBCC-PBA, either party is entitled to refer a dispute to adjudication in terms of Clause 40.0, and that Clause 40.9 thereof provides that the provisions of Clause 40.0 survive the termination of the JBCC agreement;<sup>22</sup>
- 5.11. The provisions of Clause 40.0 of the JBCC agreement are pertinent. In particular, Clause 40.1 reads as follows:<sup>23</sup>

*'Should any disagreement arise between the **employer** or his **principal agent** or **agents**, and the contractor arising out of or concerning this agreement or its termination, either **party** may give notice to the other to resolve such disagreement.'*

(Own underlining. The words rendered in bold are per the JBCC's conventions.)

- 5.12. Clause 40.9 is also relevant. It reads as follows:<sup>24</sup>

*'The termination of this **agreement** shall not affect the validity of this Clause 40.0.'*

(Own underlining).

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<sup>18</sup> Paras [18] to [23].

<sup>19</sup> Para [24].

<sup>20</sup> Para [25].

<sup>21</sup> Para [26].

<sup>22</sup> Para [27].

<sup>23</sup> Para [61].

<sup>24</sup> *Ibid.*

- 5.13. The contractor submitted its statement of claim and other papers to the adjudicator. The City, on 10 August 2016, informed the adjudicator that it would not participate in the adjudication process but told him about a written '*plea of guilty*' allegedly made by the contractor. The City sent this to the adjudicator at his request;<sup>25</sup>
- 5.14. The contractor's statement of claim was premised on the basis that the termination asserted by the City was in fact incorrect and did not exist. It thereafter also pursued claims for payment in terms of the JBCC-PBA;<sup>26</sup>
- 5.15. No oral evidence was led before the adjudicator. He prepared his determination on the basis of the statement of claim and further papers submitted to him. The determination was delivered on 24 August 2016, upholding various of the contractor's claims, while dismissing its other claims;<sup>27</sup>
- 5.16. In his determination, the adjudicator observed that the City maintained that the termination of the JBCC-PBA was lawful and that the City had the *onus* to prove that. The City submitted no such proof. In the circumstances, he found, among other things, that the contractor's claims were valid;<sup>28</sup>
- 5.17. It is of interest to note that by the time the City cancelled the JBCC-PBA on 15 March 2016, the work had been 92% complete and the City already had paid, as at that stage, the contractor an amount of R24 721 740.44;<sup>29</sup> and
- 5.18. The WCC set aside the adjudicator's determination and declared that the JBCC-PBA was validly rescinded by the City on 15 March 2016.<sup>30</sup>
6. I now turn to consider the established legal principles applicable to the invocation of alternative dispute resolution clauses contained in agreements where a party to such an agreement asserts that the agreement is tainted by fraud.
7. Our courts have confirmed the following principles:
- 7.1. Adjudication and/or arbitration clauses cannot survive the rescission of an agreement that is found to have been tainted by fraud, as this would be offensive to justice;<sup>31</sup>
- 7.2. Parties may, however, agree that the question of the validity of their agreement in circumstances of fraud may be decided in adjudication or arbitral proceedings,

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<sup>25</sup> Para [29].

<sup>26</sup> Paras [30] and [36].

<sup>27</sup> Para [30].

<sup>28</sup> Para [34].

<sup>29</sup> Para [40].

<sup>30</sup> Para [121].

<sup>31</sup> **North West**, para [13]; **North East**, para [12]; and **Namasthethu**, para [30].

provided that the language in the alternative dispute resolution clause expressly allows for same. Such language must be clear and unequivocal,<sup>32</sup> and

- 7.3. In the case of **Heyman and Another v Darwins Ltd, Heyman v Darwins Ltd**,<sup>33</sup> (**Heyman**) Lord Porter stated the following in his speech:<sup>34</sup>

*'... I think it essential to remember that the question whether a given dispute comes within the provisions of an arbitration clause or not primarily depends upon the terms of the clause itself. If two parties purport to enter into a contract and a dispute arises as to whether they have done so or not, or as to whether the alleged contract is binding upon them, I see no reason why they should not submit that dispute to arbitration. Equally, I see no reason why, if at the time when they purport to make the contract they foresee the possibility of such a dispute arising, they should not provide in the contract itself for the submission to arbitration of a dispute as to whether the contract ever bound them or continues to do so. They might, for instance, stipulate that, if a dispute should arise as to whether there had been such fraud, misrepresentation, or concealment in the negotiations between them as to make a purported contract voidable, that dispute should be submitted to arbitration. It may require very clear language to effect this result, and it may be true to say that such a contract is really collateral to the agreement supposed to be have been made, but I do not see why it should not be done.'<sup>35</sup>*

(Own underlining).

8. In **Namasthetu** the SCA held that the referral of the dispute between the contractor and the City to the adjudicator 'was *invalid and unlawful*'.<sup>36</sup> It further held that the WCC was correct in setting aside the adjudicator's determination 'following on an *unlawful adjudication process*', and stated that the adjudicator 'was *not clothed with any authority to adjudicate the dispute*'.<sup>37</sup> The effect of these findings is that the Association acted unlawfully by appointing the adjudicator, the adjudicator had no authority to adjudicate the dispute, and the adjudication process, which led to the adjudicator's determination, was unlawful. These matters raise important questions that will be dealt with below.
9. To begin with, a dispute existed between the contractor and the City as to the validity of the termination of the JBCC-PBA by the City on the grounds of fraud. The contractor denied the allegations of fraud, as well as the validity of the City's termination of the agreement in question. It sought to have the dispute adjudicated upon in terms of the JBCC-PBA. As adumbrated above, in terms of the JBCC-PBA, any disputes arising out of it or concerning its termination is subject to adjudication. The City adopted the stance that it would afterwards, if necessary, approach the court to set aside the determination.

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<sup>32</sup> **North East**, para [16]; and **Namasthetu**, para [32].

<sup>33</sup> [1942] 1 All ER 337 (HL).

<sup>34</sup> **Heyman** at p. 357 B – D.

<sup>35</sup> **North East**, para [16]; and **Namasthetu**, para [32].

<sup>36</sup> **Namasthetu**, para [38].

<sup>37</sup> *Ibid.*

Therefore, during the entire adjudication process, the allegations of fraud had not been proven, and the termination of the JBCC-PBA remained in issue.

10. At the stage when application was made to the Association for the appointment of an adjudicator, the Association was required to act upon an agreement which had been concluded between the parties and which authorised the Association to make an appointment.
11. Having been appointed by the Association, the adjudicator was called upon to decide on the disputes placed before him by the contractor, as the claimant, in the adjudication proceedings. The City refused to participate in the proceedings, notwithstanding that there was communication between it and the adjudicator, as well as the contractor. The City was clearly content to wait for the outcome of the adjudication proceedings before approaching the Court. It was only during the court proceedings that the allegations of fraud were proved and the termination of the contract by the City was confirmed.
12. Reverting to the SCA's judgment in *Namasthetu*, and its findings that the appointment of the adjudicator and that the entire adjudication proceedings were unlawful, such findings appear, with respect, to be harsh and unjust as they presupposed that by the time the adjudicator was appointed, the allegations of fraud had been proved and that the City indeed had validly terminated the JBCC-PBA. That was not the case.
13. The position would have been entirely different had the City acted prudently by pre-emptively approaching the court for relief. It knew that the contractor had disputed the allegations of fraud and the validity of the termination of the JBCC-PBA. Instead of approaching the court for appropriate relief, such as to interdict or to apply for a stay of the adjudication proceedings, it, quite opportunistically, opted to wait. In the meantime, the contractor set in motion the adjudication process. At that stage, the Association was, in my view, within its rights to appoint the adjudicator, and the adjudicator performed his duties pursuant to his appointment. In so doing, he determined the matter on what was before him. He was in no position to decide the allegations of fraud, which formed the basis of the termination of the JBCC-PBA by the City. In any event, if at the outset it had been proved that the JBCC-PBA was tainted by fraud, then the dispute resolution clause would have fallen away, together with the JBCC-PBA, and the adjudicator would not have had any authority to determine the matter. However, it would only have been known to all concerned that that was indeed the case if the court had made such a finding beforehand.
14. The question that inevitably arises is this: In similar circumstances, should the Association appoint an adjudicator and, if appointed, should the adjudicator proceed with the dispute resolution process? In my view, the mere assertion or allegation – by one of the parties to a dispute – that the contract in question is tainted by fraud, and that, in consequence

thereof, the alternative dispute resolution provisions therein cannot be enforced, is in and of itself insufficient to prevent the implementation of the dispute resolution process. Otherwise, an abuse may arise, and the dispute resolution process may be frustrated by virtue of the mere assertion by one party to the dispute of the perpetration of a fraud by the other party. It has the potential of forcing such other party to initiate court proceedings to disprove allegations of fraud against it. Such court proceedings could be lengthy, time-consuming, and costly, as opposed to a speedy cost-effective adjudication or arbitration process.

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