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CONSTRUCTION LAW BULLETIN

AGREEMENT TO ARBITRATE

INTRODUCTION

The resolution of disputes by means of arbitration requires that there be an agreement between the disputing parties to that effect. Absent agreement, the default mechanism for resolving disputes is by means of legal proceedings.

What happens if there is a dispute about the existence of the arbitration agreement that one of the disputing parties wishes to rely on for purposes of the determination of a dispute?

The Supreme Court of Appeal ("SCA") recently delivered a judgment which provides useful insight into this question.[1]

BACKGROUND FACTS

In 2013 the Qwaha Trust ("the Trust") requested Canton Trading 17 (Pty) Ltd which traded under the name Cube Architects ("Cube Architects") to accept appointment as Principal Agent for a contract relating to the expansion of a mill owned by the Trust in Bloemfontein.

In March 2014, a month after Cube Architects had orally accepted appointment to act as Principal Agent for the mill project, its attorneys produced a draft professional services contract incorporating a clause providing for the resolution of disputes by arbitration. Neither party signed the contract.

[1] Canton Trading 17 (Pty) Ltd t/a Cube Architects v Fanti Bekker Hattingh NO [2021] ZASCA 163 (1 December 2021)

In August 2014 the Trust terminated its contract with Cube Architects because of defective work performed by the Contractor, which the Trust blamed Cube Architects for not preventing.

The Trust declared an intention to pursue a claim against Cube Architects and, in conformity with the dispute resolution clause in the draft contract, invited Cube Architects to agree on the appointment of a mediator, alternatively an arbitrator.

The Trust invited Cube Architects to agree on the appointment of a retired judge to act as arbitrator, namely Judge Hancke.

Cube Architects rejected mediation but advised that it was in principle prepared to arbitrate before Judge Hancke as the arbitrator. It requested the Trust's attorneys to prepare a draft arbitration agreement for consideration.

Shortly thereafter, the Trust's attorneys submitted a draft arbitration agreement to Cube Architects' attorneys.

A pre-arbitration meeting was convened between the parties at which the arbitration agreement was discussed. Cube Architects requested that a clause be inserted in the agreement that its terms would be subject to acceptance by its insurers.

Not long after that, Cube Architects had a change of heart and conveyed to the Trust that it did not feel bound to proceed with the arbitration in that the draft professional services contract, which provided for arbitration, had never been signed. It in short denied that there was any agreement between the parties obliging it to arbitrate.

HIGH COURT PROCEEDINGS

The Trust applied to the High Court for an order compelling Cube Architects to submit to arbitration in relation to the disputes between the parties by virtue of the arbitration clause contained in the unsigned professional services contract.

The High Court judge decided to adopt a robust approach and cut through the denial by Cube Architects that it was bound by the unsigned professional services contract which contained the obligation to arbitrate. The court said its denial of the contract was untenable and palpably implausible and ordered it to submit to arbitration.

The High Court's approach was contrary to the normal practice of a court faced with a dispute of fact on affidavit where the court will usually decline to try and resolve the dispute on paper and require that the dispute be referred to a court hearing at which the necessary witnesses can testify and be cross-examined.

PROVINCIAL APPEAL COURT

Cube Architects appealed this decision to the Free State Provincial Appeal Court.

In its appeal to the Provincial Appeal Court Cube Architects complained that the High Court had ignored the normal rule that, in application proceedings where there is a dispute of fact, the respondent's version, in this case Cube Architects, should be accepted as correct at face value and as such the robust approach adopted by the court was not justified.

The Appeal Court was unpersuaded and, in dismissing the appeal, held that firstly a signed agreement to arbitrate was not a prerequisite for a party to be bound to arbitrate, and secondly that its denial of the existence of the professional services contract was palpably untrue.

SCA

Undeterred, Cube Architects continued the fight and appealed to the SCA.

The key issue before the SCA was whether, in the face of a dispute of fact that an agreement exists to refer disputes to arbitration, there is any basis to find that the parties had agreed to refer the dispute as to the existence of an agreement to arbitrate to arbitration ("Existence Dispute"). If not, was it then the competency of the High Court to decide the Existence Dispute?

The arbitration clause in the draft professional services contract incorporated the Rules of the Arbitration Foundation of South Africa Ltd ("AFSA") which contain a provision to the effect that an arbitrator is taken to have the power to rule on his own jurisdiction.

The SCA acknowledged that parties may agree that a dispute pertaining to the validity of the agreement which contains an arbitration clause is to be itself determined by arbitration even though the arbitration clause forms part of the agreement that is subject to the validity challenge.

Such an arbitration clause may be embodied in the disputed agreement or may be something agreed upon by the parties on an ad hoc basis. Where this type of agreement is not readily discernible, the problem becomes who decides the Existence Dispute, the courts or the arbitrators?

The issue regarding an Existence Dispute can crystallise for the first time before the "appointed arbitrators" or, as in this case, can be the subject matter of prior litigation.

In the former case, if arbitrators decide the Existence Dispute and uphold the arbitration agreement and proceed with an arbitration, ultimately that decision will be subject to scrutiny by the courts when there is an attempt to enforce the arbitration award.

SCA ANALYSIS

The SCA explained that there are two approaches that can be followed in resolving the Existence Dispute conundrum:

- the first is based on separability; and
- the second is based on the principle of competence-competence.[2]

In relation to separability, although it might seem logical that if the agreement embodying the arbitration clause is invalid the Existence Dispute cannot be determined in terms of that clause, that is not inevitably so.

There have been cases where the court has found that the arbitration clause in an agreement is a self-standing agreement distinct from the main contract of which it forms a part.[3] In such cases the court will leave it to the arbitrators to decide the controversy.

[2] Known as Kompetenz-Kompetenz which has its origins in German law.

In some cases arbitration clauses are framed so as to allow the question of the validity, enforceability or indeed the very existence of the contract of which they form a part to be decided by arbitration.

In such cases courts will defer to that interpretation and leave the decision to the arbitrators.

The principle of competence-competence means that:

- arbitrators enjoy the competence to rule on their own jurisdiction and need not stay the proceedings pending a court decision on the subject; and
- where arbitrators have been seized of the question, a court will not try and rule on the issue.

The SCA noted that the principle has not been applied in our courts but that there is no reason why in appropriate cases our courts should not uphold the principle of competence-competence.

SCA DECISION

The SCA decided that the separability principle found no application in the case despite the fact that the AFSA Rules, incorporated into the arbitration clause, allowed for arbitrators to determine their own jurisdiction. This because the very existence of the agreement incorporating the AFSA Rules was hotly disputed by Cube Architects. Leave aside that the AFSA Rules do not expressly purport to confer on an arbitrator the power to determine the very existence of the main contract.

The SCA concluded that, where submission to the AFSA Rules is disputed, then it could not countenance a referral of the Existence Dispute to an AFSA arbitrator.

In the opinion of the SCA the High Court had fallen into error in undertaking an assessment of the probabilities as to whether the professional services contract existed. It should have decided simply whether to dismiss the application or to refer it for the hearing of oral evidence so that the factual dispute could be properly decided.

Accordingly, the SCA upheld the appeal and referred the matter back to the High Court to decide whether the application should be dismissed because of the dispute of fact which was not soluble on the papers or whether to refer the application for the hearing of oral evidence.

The final score in the result was four judges for the Trust and five against.

CONCLUSION

Arbitrators faced with a challenge as to their jurisdiction on the basis that the underlying arbitration agreement is invalid or never came into being should apply their minds to the issue and make up their own minds as to the validity of the challenge. They should not simply without more abdicate to a court to rule on the issue.

They may decide that the separability principle applies or that invoking the competence-competence principle is justified.

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[3] Zhongji Development Construction Engineering Co Ltd v Kamato Copper Co SARL [2014] ZASCA 160.

If an arbitrator proceeds on the basis that the arbitration agreement is valid, there is always a risk that a court might, when the successful party applies to have the award made an order of court, refuse the application on the grounds that the arbitration agreement relied on was not binding. However, the SCA having opened the door to the competence-competence principle being accepted into our law hopefully makes this scenario less likely.

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