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CONSTRUCTION LAW BULLETIN

SIDESTEPPING AN ARBITRATION AGREEMENT

INTRODUCTION

Arbitration is an alternative private dispute resolution process which is governed by the Arbitration Act, 42 of 1965 ("the Act").

If a party to a contract, which includes an agreement to arbitrate disputes, institutes legal proceedings, the Act provides that the other party may apply to court for the legal proceedings to be stayed so that the dispute can be dealt with by way of arbitration.[1]

The other party may also choose simply to defend the legal proceedings and raise the arbitration agreement as a special defence to the legal action.

The Act and our courts recognise the primacy of arbitration where parties have agreed to arbitrate as opposed to litigate their disputes.

However, an agreement to arbitrate disputes does not entirely oust the jurisdiction of our courts.

The Act makes provision for the court, on good cause shown, to:

- set aside the arbitration agreement[2]; or
- direct that any particular dispute not be dealt with by arbitration.

[1] Section 6 of the Act
[2] Section 3 of the Act

The question is what will a court see as “good cause” to allow a party to bypass its agreement to arbitrate and to resort to court action.

THE GENERAL APPROACH

The default position of our courts has been to uphold arbitration agreements and stay legal action which has been taken vis-à-vis an arbitration agreement or alternatively uphold a defence to the action based on the existence of the arbitration agreement.

The principles that emerge from our case law on the subject are:

- there must be very strong grounds for avoiding the arbitration agreement;
- the party seeking to avoid the agreement has the onus of persuading the court, which will not be easily discharged;
- arbitration has the advantage of finality and a party should not be readily deprived of that benefit; and
- only where there is something intrinsically unfair about arbitration proceedings should a court allow a party to avoid the arbitration agreement.

Some of the factors which courts have taken into account in determining whether good cause exists to avoid the arbitration agreement are:

- In cases where fraud is alleged, a court will be inclined to direct that such a case be heard in open court as opposed to by way of arbitration. However, a distinction is drawn between who seeks the referral to court. If it is the person against whom fraud has been alleged, the court will more readily uphold an application to avoid the arbitration agreement. If it is the person alleging fraud, the court may be less inclined to set aside the arbitration agreement.
- Where two different tribunals will have to adjudicate the same facts and may come to conflicting decisions.[3]
- The avoidance of the wastefulness involved in having issues investigated and decided in two different tribunals.
- Where a claim lies against more than one party and only one of the parties is bound by the arbitration agreement, which creates the possibility of conflicting findings of fact and law in the arbitration and in separate court proceedings.

Some case studies follow.

[3] Metallurgical and Commercial Consultants v Metal Sales Co 1971(2) SA 388 (W) at 393

METALLURIGICAL AND COMMERCIAL CONSULTANTS CASE

This case involved a contract in terms of which Metallurgical and Commercial Consultants ("MCC") was appointed for a five year period as a business adviser and public relations consultant to Metal Sales Co.

The contract contained a clause stipulating that any difference or dispute arising between the parties had to be submitted for determination by arbitration before a single arbitrator agreed between the parties and failing agreement appointed in accordance with the Act.

Metal Sales Co failed to make payment of fees claimed by MCC in terms of the contract and disputed that it was liable to do so.

MCC wished to have the dispute between the parties resolved by arbitration and sought Metal Sales Co's agreement to the appointment of an arbitrator. Metal Sales Co declined to cooperate and, as provided for in the Act, MCC applied to court to have an arbitrator appointed.

Metal Sales Co opposed the application on the grounds that the contract did not embody a valid transaction between the parties but was a mere pretence and was not intended to have any legal efficacy or validity.

The court observed that, if the contract embodying the arbitration agreement was invalid and without legal force, that would apply equally to the arbitration clause in the contract.

It bears noting however that, if an arbitration clause is worded in such a way that it is intended to cover disputes about the validity of the agreement itself, the arbitration clause will be treated as a separate agreement clothing the arbitrator with the power to adjudicate the issue of the validity of the agreement.

In opposing the application for the appointment of an arbitrator, Metal Sales Co argued that the court should exercise its discretion in terms of the Act and order that the dispute be dealt with in court as opposed to by way of arbitration.

The grounds relied upon by Metal Sales Co in advancing this case were that it had claims against the majority shareholder of MCC and other parties which it intended to pursue in court proceedings connected with alleged fraudulent conduct on the part of the shareholder concerned. It contended that the shareholder's fraudulent conduct would feature not only in the intended court litigation but in the arbitration proceedings as well.

Metal Sales Co relied on authority which is to the effect that, although questions relating to fraud can be settled by arbitration, it is usually better that they be settled in court.

It also argued that it would be wasteful to have to deal with the investigation of the shareholder's fraud both in the court proceedings and the arbitration, which it said also gave rise to the possibility that the two tribunals might reach different conclusions on the same issues.

It relied strongly on the English case of Halifax Overseas Freighters[4] where this consideration had weighed heavily in favour of not upholding the arbitration agreement.

Reasoning as below, the judge took the view that the grounds relied upon by Metal Sales Co were not sufficient to show good cause to avoid the arbitration agreement and that the Halifax Overseas Freighters case was distinguishable.

[4] Halifax Overseas Freighters Ltd v Rasno Export Technoprominport and Polskie Linie Oceaniczne PPW (the "Pine Hill") [1958] 2 Lloyd's List Law Reports 146, McNair J

Firstly, the principle that issues of fraud should be dealt with in court rather than arbitration applied in cases where the person accused of fraud wished to bypass an arbitration agreement and have the issue adjudicated in court.

Secondly, the Metal Sales Co claims did not lie against MCC but a third party, namely the major shareholder, and the risk of a decision on liability in one tribunal being different to the decision in another tribunal involving the same parties did not arise.

Thirdly, the facts in the Halifax Freighters case were distinguishable because in that case there was the danger of the plaintiff falling between two stools. The same facts and law had to be adjudicated in arbitration and court which, if there were conflicting findings, would end up with the plaintiff being unsuccessful in both forums whereas, if the various defendants were all in one forum, the plaintiff had to succeed against one of them.

The upshot of the application was that the court referred the dispute as to the validity of the agreement containing the arbitration clause for the hearing of evidence in court on the basis that, if the agreement was held to be valid, the arbitration would then proceed.

HALIFAX OVERSEAS FREIGHTERS CASE

This was a case involving an equivalent provision in the English Arbitration Act where a party applied to court to stop arbitration proceedings.

The matter was a shipping case involving a charter party, namely a ship lease, which contained an arbitration clause and bills of lading which did not.

The plaintiff elected to sue the party implicated in the charter party and two other defendants implicated in the bills of lading in court so that all protagonists were in the same forum.

The charter party defendant applied to court to stay the proceedings on the grounds that the claim against it had to be dealt with by arbitration.

The position was that the decision in relation to the plaintiff's claim against the charterer and its alternative claim against the bills of lading defendants depended on decisions on the self-same issues.

The court said that it was apparent that the matter was one which, if possible, consistently with the contractual obligations which the parties had assumed, should be determined in one set of proceedings.

The court took into account three relevant factors:

- firstly, that, if the claim of the plaintiffs against the bills of lading holders and the plaintiffs' claim against the charterer were allowed to proceed before different tribunals, there was a substantial risk that one would get from those two tribunals inconsistent findings of fact, resulting in the plaintiffs losing in both forums when, if all parties were in the same forum, it had to succeed against one of the defendants;

- secondly, the case involved complicated and difficult questions of law which two different tribunals could come to different conclusions on, with the same adverse consequences for the plaintiff;

- thirdly, having the matter dealt with in one forum would have the benefit of a very substantial saving in time and costs.

The judge observed that, whilst each consideration might not individually justify avoiding the arbitration agreement, collectively he considered that they did.

In the circumstances, the court dismissed the charterer's application to stay the legal proceedings and held that the legal action should be allowed to continue.

SERA VS DE WET[5]

In this case De Wet appointed Sera to carry out certain building works at his house in Pretoria.

De Wet cancelled the contract in circumstances which Sera contended gave rise to him having a damages claim against De Wet.

Sera did not wish to pursue his damages claim in terms of the arbitration clause in the building contract and applied to court for an order that the arbitration agreement should not apply to his claim.

The grounds advanced by Sera in support of his application were:

- there were serious allegations regarding the honesty and integrity of the architect who had administered the contract;
- the arbitration agreement made provision for the appointment of an architect as arbitrator;
- the architect appointed as arbitrator would be in an embarrassing and difficult position to rule on the honesty and integrity of a colleague;
- courts of law are better equipped to decide upon matters of credibility; and
- the main issue in the case was a legal one involving whether a certificate issued by the architect entitled Sera to payment, which was a matter best decided upon by a court.

The judge somewhat surprisingly upheld the application and ruled that Sera was entitled to pursue his claim in litigation as opposed to by way of arbitration.

The judge may have been influenced in this decision in no small way by his finding that De Wet had acted in an arrogant and dictatorial manner, had completely taken matters into his own hands, manipulated them as he wished and in the process, not only absolutely usurped the powers of the architect, but also, as the judge described it, rendered him a servile instrument for his purposes.

YORIGAMI MARITIME CONSTRUCTION VS NISSHO-IWAI CO LTD[6]

In this case Nissho-Iwai Co ("Nissho") concluded a towage charter with Yorigami Maritime Construction ("Yorigami"), a tug owner, for purposes of towing two vessels owned by Nissho from Piraeus in Greece to Pusan in Korea.

[5] Sera v De Wet 1974 (2) SA 645 (T)
[6] Yorigami Maritime Construction v Nissho-Iwai Co Ltd 1977(4) SA 682 (C) at 694

While towing the two vessels, the tow broke, with the result that the two vessels were wrecked off Camps Bay and Llandudno in the vicinity of Cape Town.

Nissho attached the tug in Cape Town to provide jurisdiction to pursue a damages claim against Yorigami in the Cape Town High Court.

Yorigami applied to the court to uplift the attachment of its tug and relied *inter alia* on the fact that there was an arbitration clause in the towage charter requiring disputes between the parties to be decided by arbitration in Japan.

The court made the point that in our law an arbitration clause does not oust the jurisdiction of the court.

In rejecting Yorigami's application to stop Nissho pursuing a damages claim against it in the Cape Town High Court, the court relied on the following factors:

- the vessels connected with the damages claim were within the jurisdiction of the Cape Town High Court;
- many of the witnesses who would have to testify in the proceedings required to determine the liability of the master of the tug were resident in Cape Town;
- investigations would have to be carried out in Cape Town by experts who could not be compelled to give evidence in an arbitration in Japan;
- Nissho's claim also lay against the South African Railways and Harbours;
- the claim might also lie against another defendant, Trade Traffic, based in Cape Town; and
- if arbitration proceedings against Yorigami were held in Japan and legal proceedings against the Railways and Trade Traffic in Cape Town, there would be a multiplicity of actions and a high likelihood of resultant conflicting decisions.

RAWSTORNE VS HODGEN[7]

In this matter the Rawstornes sold their members' interests in a close corporation which owned a residential property in Fourways together with certain movable assets to Mr Hodgen.

The agreement contained an arbitration clause.

Mr Hodgen instituted arbitration proceedings against the Rawstornes for the value of certain of the movable assets that had not, in breach of contract, been delivered and also in respect of latent defects in the residential property which he contended the Rawstornes had fraudulently failed to disclose.

The Rawstornes applied to court to stop the arbitration proceedings on the grounds that, in light of the allegations of fraud against them, the case ought properly to be dealt with in court proceedings.

The court observed that the discretion of a court to not uphold an arbitration agreement is a limited one and the onus of satisfying a court that it should exercise its discretion to do so is on the party who wishes to bypass the arbitration agreement. It is a discretion that must be exercised judicially.

[7] Rawstorne and Another v Hodgen and Another 2002(3) SA 433 (W) at 438

In this case, as the Rawstornes were the parties who had been accused of fraud and, as they wished the allegations of fraud to be dealt with in open court, the court considered it appropriate to grant the application and direct that the arbitration agreement would not apply to Mr Hodgen's claims.

WELIHOCKYJ VS ADVTECH[8]

This case related to a sale of business agreement which incorporated a dispute resolution clause providing for resolution of disputes by an independent person acting as an expert and not as an arbitrator.

Disputes arose which were referred for determination in accordance with the dispute resolution clause.

The first thing the court found was that, although the clause referred to the party acting as an expert and not as an arbitrator, because the clause made it clear that the person was expected to exercise a quasi-judicial function, in truth he was an arbitrator.

The clause clearly contemplated the person making decisions based on evidence provided rather than simply relying on his own experience and skill. The fact that the clause made reference to an expert acting did not mean that the proceedings contemplated were not to be regarded as arbitration proceedings.

Allegations of fraud had been levelled at Mr Welihockyj and his co-applicants which prompted them to apply to court to stay the arbitration proceedings so that the disputes, including the allegations of fraud, could be determined in court proceedings.

The court upheld the application in light of the following considerations:

- serious allegations of fraud had been made against the applicants which justified a public hearing in court with a right of appeal;
- the disputes involved in the arbitration were interwoven with legal proceedings which were already under way and which, if allowed to continue independently of each other, would result in a costly duplication in the resolution of the disputes;
- the disputes subject to arbitration could be easily introduced into the legal proceedings and continued in the High Court;
- issues raised by Advtech in its counterclaims in the arbitration related to and affected third parties which were not subject to the sale of business agreement and the arbitration clause in respect of which an arbitrator would have no powers of investigation; and
- a court of law on the other hand would not be curtailed by such factors and would be in a position to adjudicate and conclude on all of the interwoven issues in one and the same process.

[8] Welihockyj and Others v Advtech Ltd and Others 2003(6) SA 737 (W) at 740 and 754-755

CROMPTON STREET MOTORS VS BRIGHT IDEA PROJECTS[9]

In this case the Constitutional Court upheld the refusal by the High Court to stay legal proceedings which had been instituted in relation to a matter where the parties were bound by an arbitration agreement.

In passing, the Constitutional Court confirmed that a party who wished to stop legal proceedings and insist on a dispute being dealt with in terms of an arbitration agreement had two avenues for achieving that:

- a substantive application in terms of section 6 of the Act to stay the court proceedings; or
- by way of a special plea in the action requesting a stay of the proceedings pending the determination of the dispute by arbitration.

The Constitutional Court confirmed that the discretion to refuse arbitration should be exercised judicially and only when a very strong case has been made out.

It found that the High Court had exercised its discretion appropriately in refusing to stay the legal proceedings and, as an appellate court, its role was not to decide whether the High Court was right or wrong but whether or not it had exercised its discretion judicially. In other words, the court had not taken into account irrelevant considerations and had not based the exercise of its discretion on a wrong appreciation of the facts or wrong principles of law.

The Constitutional Court interpreted section 6 of the Act to mean that the default position of a court when faced with an application to stay legal proceedings in light of the existence of an arbitration agreement was that such a stay should be granted upon request. The onus then rested on the party who had instituted the legal proceedings to persuade the court that a stay was not appropriate.

In refusing to stay the legal proceedings, the High Court had taken into account the following considerations in refusing a stay of the legal proceedings:

- a stay of the proceedings would be a waste of judicial resources as the merits of the underlying disputes had already been fully argued in court;
- Bright Idea Projects who had instituted the legal proceedings was entitled to have the matter heard without undue delay which it appeared that Crompton Street Motors was intent on orchestrating;
- the relief which Crompton Street Motors wished to seek in an arbitration, namely the extension of a lapsed franchise and lease agreement and a challenge of a refusal to conclude new agreements, was a matter that an arbitrator would not be empowered to rule on; and
- the franchise agreement which was the subject matter of the proceedings had expired through effluxion of time such that the dispute could not be said to be a dispute connected with the agreement which had to be subjected to arbitration in terms of the arbitration clause.

[9] Crompton Street Motors CC t/a Wallers Garage Service Station v Bright Idea Projects 66 (Pty) Ltd t/a All Fuels 2022(1) SA 317 (CC)

CONCLUSION

The courts will sparingly refuse to uphold arbitration agreements.

They will however allow parties to sidestep arbitration agreements where:

- a party accused of fraud wishes to do so; or
- there are a multiplicity of parties in relation to the disputes involved, some of which are bound by an arbitration agreement and others not, and where the self-same issues need to be adjudicated.

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