

June 2013

## CONSTRUCTION LAW BULLETIN

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### ARBITRATION FOLLY

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#### Introduction

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At the beginning of last year the Supreme Court of Appeal (SCA) was called upon to decide whether the decision of an arbitration appeal tribunal should be reviewed and set aside.<sup>1</sup>

#### The Facts

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In 2003 Gutsche Family Investments (Pty) Ltd and the other shareholder ("the Sellers") in Formex Industries (Pty) Ltd ("the Company") sold their shares to Metal Operations Ltd which subsequently assigned its rights and obligations under the agreement to Metal Equity Group (Pty) Ltd ("the Buyer").

Apparently unable to undertake a due diligence investigation of the Company, the Buyer relied on the protection of a long list of warranties, numbering 73 in all, included in the share sale agreement and relating to the Company and its business.

The Sellers indemnified the Buyer against any loss or damage suffered as a result of a breach of the warranties.

The purchase price payable for the shares was R24m, R18m payable upfront and the balance of R6m a year later.

The Buyer paid the initial R18m of the purchase price but when it came time to pay the balance of R6m, it only paid R1,4m contending that it was entitled to withhold the balance on account of damages suffered by it due to various warranties having been breached.

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<sup>1</sup> Gutsche Family Investments (Pty) Ltd and Others v Metal Equity Group (Pty) Ltd and Others (115/2011) [2012] ZASCA 4 (8 March 2011)

## The Dispute

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The breach clause in the sale agreement stipulated that if either party breached any of its obligations under the agreement, including a warranty, and failed to remedy such breach within 30 days of receipt of a written notice from the other party (the aggrieved party), the aggrieved party would have the right to cancel the agreement and/or claim damages from the party in breach.

The Sellers disputed the Buyer's right to pay a reduced purchase price on the grounds of alleged breaches of the warranties because the Buyer had never given a 30 day breach notice as provided for in the sale agreement.

The dispute was referred to arbitration.

## Arbitrator's Ruling

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The arbitrator agreed with the Sellers that before the Buyer could claim damages it was required in terms of the agreement to give a 30 day breach notice. However, the arbitrator held that the Buyer's letter explaining why it was only paying an amount of R1,4m in respect of the balance of the purchase price was sufficient to constitute the required notice.

## Arbitration Appeal

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The arbitration procedure agreed between the parties made provision for a right of appeal.

The Sellers duly appealed the decision of the arbitrator. The appeal tribunal upheld the appeal and ruled that the Buyer had no right to claim for breach of warranty because it had not given the required 30 day notice to remedy.

It was not contested by the Buyer that it was liable to the Sellers for the balance of the purchase price which it was obliged to pay absent any right to set off its damages claim once the claim was liquidated by way of an arbitration award.

Although the judgment does not deal with the issue, one might wonder why the Buyer did not simply give a 30 day notice and institute its damages claim afresh if need be in new arbitration proceedings. The answer probably lies in the fact that by that stage more than three years may have elapsed and the Buyer's damages claim would have become prescribed.

## High Court Review

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The Buyer made application to the South Gauteng High Court for the appeal tribunal's award to be reviewed and set aside on the grounds that the arbitrator's award was in fact not appealable because it was not a final award.

The application succeeded and the appeal tribunal's award was set aside. The Sellers then appealed that decision to the SCA which upheld the High Court's decision.

The net effect of all these legal skirmishes was that the matter ended up back before the arbitrator for a decision as to the quantification of the Buyer's breach of warranty claims.

Although finding that the Buyer had established various breaches on the part of the Sellers and that the Buyer had incurred losses flowing from those breaches of approximately R3m, the arbitrator held that the Buyer's claims against the Sellers could not be upheld.

The arbitrator came to this conclusion after revisiting the questions as to whether:

- the breach clause in the agreement required a 30 day breach notice before any damages claim for breach of warranty was competent; and
- the Buyer had indeed given such a notice.

The arbitrator again decided that such a notice was necessary but, on the strength of all the evidence which had been placed before him, changed his mind on the issue of whether the Buyer had given the requisite notice.

The arbitrator held that the Buyer had failed to give the notice and as such it could not enforce its claims against the Sellers.

## **Second Appeal**

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The Buyer took the arbitration award on appeal both in relation to the arbitrator's decision regarding a breach notice being a prerequisite for its claim to be enforceable and as to his ruling on the quantum of its claim.

The appeal tribunal comprising three arbitrators<sup>2</sup> came to a split decision with the majority finding that:

- the 30 day notice provision in the breach clause did not apply to claims for damages but only to claims for cancellation or specific performance<sup>3</sup>; and
- the arbitrator had erred in his assessment of the quantum of the Buyer's claims and that the Buyer had in fact suffered damages in the sum of R3,9m for which the Sellers were liable.

## **Second High Court Review**

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The Sellers applied to the South Gauteng High Court for the arbitrator's award to be set aside on review. The High Court rejected this application hence the matter finding its way back to the SCA in Bloemfontein again.

The Arbitration Act allows a court to review and set aside an arbitrator's award on specific grounds only, namely where:

- the arbitrator has misconducted himself;
- the arbitrator has committed a gross irregularity or has exceeded his powers; or

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<sup>2</sup> Eminent silks at the Johannesburg Bar.

<sup>3</sup> i.e. a claim for an award or order compelling a party to comply with its contractual obligations.

- an award has been improperly obtained.

After briefly flirting with the idea of relying on misconduct, the Sellers focused their challenge of the award on the grounds that the arbitrator had exceeded his powers.

The basis upon which the Sellers advanced this proposition was on a misconception as to the effect of the arbitration tribunal's award.

The Sellers thought that, in failing to make specific mention of the Buyer's incontrovertible obligation to pay the balance of the purchase price and having awarded the Buyer its damages claim, the net effect was that the Sellers owed the Buyer money without any right of setoff applying.

In refusing the Sellers' appeal and upholding the appeal tribunal's award, the SCA made mention of this misconception.

## Useful Principles Restated

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In its judgment the SCA repeated some of the principles relevant to a decision as to whether an arbitrator's award falls to be reviewed and set aside, namely:

- errors of law or fact committed by an arbitrator do not in themselves constitute misconduct and as such grounds for review;
- the concept of gross irregularity in the context of a review of an arbitrator's award means an irregularity of such a serious nature that it results in the aggrieved party not having his case fully and fairly determined; and
- arbitrators are bound by the pleadings or submissions exchanged between the parties. Unlike a court, an arbitrator has no inherent power to determine issues or to grant relief outside of the pleadings, and arbitrators who stray beyond the pleadings exceed their powers and render their awards liable for review and setting aside.

## Conclusion

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None of the parties to the tortuous proceedings described above are likely to come out of the exercise financially better off to any material extent once their legal bills have all been settled.

It remains exceedingly difficult to set aside an arbitrator's award.

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