THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case no**: 492/12**

Reportable

In the matter between:

North East Finance (Pty) Ltd **Appellant**

and

Standard Bank of South Africa Ltd **Respondent**

Neutral citation: **North East Finance v Standard Bank (492/2012) [2013] ZASCA 76 (20 May 2013)**

Coram: **Lewis, Ponnan, Shongwe and Saldulker JJA and Zondi AJA**

Heard: **20 May 2013**

Delivered: **29 May 2013**

Summary: **A clause in a contract requiring parties to refer their disputes to arbitration is not as a rule enforceable if the contract itself is invalid. Whether the clause is separable from the contract such that it too is not invalid depends on an interpretation of the contract as a whole, and the context in which it was concluded.**

ORDER

On appeal from South Gauteng High Court, Johannesburg (Hodes AJ sitting as court of first instance)

The appeal is dismissed with costs including those of two counsel.

JUDGMENT

Lewis JA (Ponnan, Shongwe and Saldulker JJA and Zondi AJA concurring)

[1] If there are substantive reasons to believe that a contract has been induced by fraud, does a clause in the contract requiring the parties to submit any dispute between them to arbitration bind the aggrieved party? This appeal turns on that question and on a construction of the arbitration clause itself. The South Gauteng High Court (Hodes AJ) found that allegations of fraud (inducing the contract between the parties) made by the respondent, Standard Bank of South Africa Ltd (the bank), against the appellant, North East Finance (Pty) Ltd (North East), did not appear unfounded, and constituted sufficient grounds for it not to compel the bank to submit to arbitration. The high court thus declined the application by North East to compel such a reference. The appeal is with leave of the high court.

The factual matrix

[2] The questions to be determined must be considered against the factual matrix or context of the contract, termed a ‘settlement agreement’ by the parties. In summary, this was that North East conducted business by financing the acquisition of goods by concluding rental agreements with end-users. North East discounted the debts owed to it by end-users with the bank in terms of an agreement of cession. The business between the parties commenced in 1999, and the operative cession agreement was concluded in 2001. In terms of the cession North East ceded its rights under various rental agreements to the bank, and agreed to ‘offer contracts’ to

the bank from time to time. The bank was entitled to accept such offers in its absolute discretion.

[3] The cession agreement was amended from time to time. In particular an addendum (the collection addendum) was added in 2003, and it entitled North East to collect payments directly from debtors (end-users). The bank would in turn claim payment from North East. That agreement was in turn amended in May 2007. Disputes about the collection of rentals, and the debiting of North East's bank account with the bank, arose in 2008.

[4] In September 2008, following negotiations and meetings to resolve the disputes, the parties entered into a 'settlement agreement', the purpose of which was to phase out and then terminate North East's collection function. The agreement was drafted by Mr Nimrod van Zyl, North East's attorney, and the brother of the deponent to the founding and replying affidavits in the application, Mr Hermanus van Zyl. The latter was a director of North East. The arbitration clause in issue in this matter was in the settlement agreement, clause 19.1 of which provided:

'In the event of any dispute of whatsoever nature arising between the parties (*including any question as to the enforceability of this contract* but excluding the failure to pay any amount due unless the defaulting party has, prior to the due date for such payment, by notice in writing to the other party disputed liability for such payment), such dispute will be referred to arbitration in the manner set out below.' (My emphasis.)

[5] Prior to the conclusion of the settlement agreement the bank's head of technology finance, Mr Mark Peters, became involved in the attempts to resolve the disputes. Although he did not sign the agreement for the bank, he was conversant with the nature of the disputes that had arisen, and he deposed to the answering affidavit for the bank. He was also instrumental in implementing the agreement, primarily in collecting the debts owed, estimated in 2008 to be worth some R660 million.

[6] The process of collection proved more difficult than anticipated. Peters and his team found it hard to get access to information and to understand the systems and processes used by North East prior to the conclusion of the settlement agreement. It is not necessary to examine the details of the investigation, or its outcome, described by Peters. Suffice to say that after some time Peters concluded that the settlement agreement was induced by fraudulent misrepresentations and non-disclosures: by 2010, he said, he had discovered that procedures had been flouted by North East; transactions had been disguised, funds embezzled and other serious breaches of the fiduciary duty owed by North East to the bank had occurred. Peters concluded that these irregularities must have been known to Hermanus van Zyl at the time when the settlement agreement was concluded. By deliberately failing to make disclosure of all the irregularities, the bank claimed, North East induced the bank to conclude the contract.

[7] Having discovered the fraud, the bank elected to resile from the agreement and to regard it as void ab initio. It refused to submit the question as to whether there had been fraud inducing the contract to arbitration, maintaining that the arbitration clause fell with the contract (and indeed asserting that the clause had been included in the agreement as part of the fraudulent strategy of the Van Zyls). North East, on the other hand, contended that any dispute between the parties had to be submitted to arbitration, including one as to the enforceability of the contract. North East, after calling for various pre-arbitration meetings (in terms of clause 19.2 of the agreement) which the bank refused to attend, launched an application in the high court for an order that a dispute existed as to whether the settlement agreement was void ab initio; that the dispute was arbitrable in terms of clause 19.1 of the agreement; and that a dispute between the parties regarding the quantum of a payment to be made under the settlement agreement was also arbitrable.

The findings of the high court

[8] The high court made several findings: that there were numerous disputes of fact relating to the fraudulent conduct of North East, and the conclusion of the settlement agreement, that could not be resolved on the papers before it; that the arbitration clause was part of the agreement and had no separate existence; that the allegations of fraud were 'not wholly unfounded' on the bank's version; that the arbitration clause did not refer to fraudulent misrepresentations inducing the contract specifically, such that this was not an issue to be determined by arbitration; that the agreement to arbitrate was not severable form the rest of the settlement agreement; and that accordingly, the court would not compel the bank to comply with the clause.

The legal issues

[9] On appeal, North East contended that the arbitration clause conferred jurisdiction on an arbitrator despite the allegations of fraud inducing the settlement agreement, and that in any event the allegations of fraud were denied, or were based on 'hearsay evidence' or 'secondary facts'. The finding of the high court that, on the bank's version, the allegations of fraud were not wholly unfounded could lead, it was argued, to a party escaping an arbitration clause, when it was no longer considered desirable, by simply alleging fraud.

[10] The bank argued that there were three issues for determination on appeal: whether the arbitration clause could survive the demise of the agreement in which it was included; whether it was divisible from the remainder of the contract and would govern the determination of the question whether there was fraud that induced the agreement including the clause itself; and whether the bank had laid a basis sufficient to persuade the court not to refer the question of fraud to arbitration.

[11] As I see it, there are really only two issues for determination. First, whether the particular arbitration clause should be construed so as to compel submission to arbitration on whether the bank was induced by North East's fraud to conclude the

settlement agreement; and if so whether the allegations of fraud do not appear to be 'wholly unfounded'.

The effect of fraud on an arbitration clause in general

[12] The first principle that the bank argued required consideration is really not in question. If a contract is void from the outset then all of its clauses, including exemption and reference to arbitration clauses, fall with it. The principle was most recently enunciated by this court in *North West Provincial Government & another v Tswaing Consulting & others*[1] where Cameron JA said that an arbitration clause 'embedded in a fraud-tainted agreement' could not stand. The court referred in this regard to *Wayland v Everite Group Ltd*[2] which in turn relied on *Allied Mineral Development Corporation (Pty) Ltd v Gemsbok Vlei Kwartsiet (Edms) Bpk*.[3] That decision referred to *Heyman & another v Darwins Ltd*[4] where Viscount Simon LC said:

'An arbitration clause is a written submission, agreed to by the parties to the contract, and, like other written submissions to arbitration, must be construed according to its language and in the light of the circumstances in which it is made. If the dispute is as to whether the contract which contains the clause has ever been entered into at all, that issue cannot go to arbitration under the clause, for the party who denies that he has ever entered into the contract is thereby denying that he has ever joined in the submission. Similarly, if one party to the alleged contract is contending that it is void *ab initio* (because, for example, the making of such a contract is illegal), the arbitration clause cannot operate, for on this view the clause itself is also void.'

[13] North East accepted the general principle expressed in the passage in *Heyman*. But it argued that the arbitration clause itself provided that a dispute as to the enforceability of the settlement agreement had to be determined by arbitration

[1] *North West Provincial Government & another v Tswaing Consulting & others* 2007 (4) SA 452 (SCA) para 13.
[2] *Wayland v Everite Group Ltd* 1993 (3) SA 946 (W) at 951H-I
[3] *Allied Mineral Development Corporation (Pty) Ltd v Gemsbok Vlei Kwartsiet (Edms) Bpk* 1968 (1) SA 7 (C) at 14B.
[4] *Heyman & another v Darwins Ltd* [1942] 1 All ER 337 (HL) at 343.

given the phrase in parentheses: 'including any question as to the enforceability of this contract'. It contended that there is authority that if an arbitration clause 'specifically says so' the validity of the whole agreement must also be determined by a reference to arbitration. This will, of course, depend on a construction of the clause in the contract to see if it does 'specifically say so'.[5]

The interpretation of the arbitration clause

[14] North East argued that the arbitration clause in this case specifically said that the validity of the settlement agreement was to be determined by arbitration: that was the effect of the inclusion of the phrase concerning the enforceability of the agreement. The bank argued that 'enforceability' was not co-extensive with 'validity' and that the question whether the contract was void as a result of the fraudulent misrepresentations or non-disclosures was not one that could be determined by an arbitrator. I do not think that this argument is helpful. The effect of fraud that induces a contract is, in general, that the contract is regarded as voidable: the aggrieved party may elect whether to abide by the contract and claim damages (if it can prove loss) or to resile – to regard the contract as void from inception, and to demand restitution of any performance it may have made, tendering return of the fraudulent party's performance.

[15] The bank chose to treat the settlement agreement as void from inception, and when it made that election the contract effectively ceased to exist. It did not have to be cancelled or rescinded: it was void. The terms are often used loosely and confusingly. See *Christie's The law of contract in South Africa*[6] where the authors write of rescission of a contract induced by fraud (if a contract is void there is nothing to rescind), but point out that where the fraud results in a fundamental mistake, it cannot be anything but void from inception. That principle was expressed clearly by

[5] *Sentrale Kunsmis Korporasie (Edms) Bpk v Van Heerden & others* 1972 (2) SA 729 (W), referring to *Heyman*, which was approved also in this court on appeal: *Van Heerden en andere v Sentrale Kunsmis Korporasie (Edms) Bpk* 1973 (1) SA 17 (A) at 27G-H.
[6] Sixth ed by R H Christie and G B Bradfield (2012) 296-297.

this court in *Brink v Humphries & Jewell (Pty) Ltd*.[7] It is not, however, necessary (indeed it is not possible, given the disputes of fact in respect of the alleged fraud) for this court to determine whether the settlement agreement was void from inception or voidable until the bank had elected to resile. I consider that the term 'enforceability' refers to both a void and a voidable contract: if the parties had intended that the question whether fraud inducing the contract should be determined by an arbitrator then he or she would determine whether the contract was valid and enforceable, or voidable or void.

[16] It is in principle possible for the parties to agree that the question of the validity of their agreement may be determined by arbitration even though the reference to arbitration is part of the agreement being questioned. That is suggested in *Heyman*. Lord Porter said:[8]

' . . . 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 a 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 have been made, but I do not see why it should not be done.' (My emphasis.)

[17] North East contended that the principle set out in *Heyman* was approved and applied by this court in *Van Heerden* (above), a matter decided on exception. This particular passage was not, however, referred to. (I shall return to the passage

[7] *Brink v Humphries & Jewell (Pty) Ltd* 2005 (2) SA 419 (SCA) para 2.
[8] At 357.

shortly.) And in *Van Heerden* this court held that the question whether misrepresentations (included as warranties in the contract) had induced the contract should be referred to arbitration on the basis that the plaintiff relied on breach of warranties. As the bank contended, that case is distinguishable and turned on the nature of the dispute.

[18] North East relied also on the House of Lord's decision in *Fiona Trust & Holding Corporation & others v Privalov & others*[9] where Lord Hoffman endorsed the approach of Longmore LJ in the Court of Appeal in that matter, that a fresh start should be made in determining whether an arbitration clause in an agreement covered a particular dispute, including whether the contract was valid. The approach set out is instructive, but in my view says not much more than was said in *Heyman* by the same court: the question must be determined by interpreting or construing the clause itself and the contract generally.

[19] The fresh start was needed in part to avoid the very fine distinctions drawn by the English courts on the basis of the use of different prepositions – as was the case in *Heyman* where Lord Porter drew a distinction between 'arising under' and 'arising out of' an agreement. More importantly, it was required because s 7 of the Arbitration Act 1996 introduced a completely new principle in England. It provides:

'Separability of arbitration agreement

Unless otherwise agreed by the parties, an arbitration agreement which forms or was intended to form part of another agreement (whether or not in writing) shall not be regarded as invalid, non-existent or ineffective because that other agreement is invalid, or did not come into existence or has become ineffective, and it shall for the purpose be treated as a distinct agreement.'

The provision in effect reverses the previous principle that a provision in a contract would have the same status as the contract itself unless the parties specifically said otherwise.

[9] *Fiona Trust & Holding Corporation & others v Privalov & others* [2007] 4 All ER 951 (HL).

[20] The House of Lords in *Fiona Trust* accordingly had to make the fresh start, and Lord Hoffmann did so in line with modern approaches to the interpretation of contracts: the court should have regard to what 'the parties, as rational businessmen, are likely to have intended'.[10]

Lord Hoffman put it this way:[11]

'Arbitration is consensual. It depends on the intention of the parties as expressed in their agreement. Only the agreement can tell you what kind of disputes they intended to submit to arbitration. But the meaning which parties intended to express by the words which they used will be affected by the commercial background and the reader's understanding of the purpose for which the agreement was made. Businessmen in particular are assumed to have entered into agreements to achieve some rational commercial purpose and an understanding of this purpose will influence the way in which one interprets their language.'

[21] It was necessary, therefore, Lord Hoffman said, to have regard to the purpose of the agreement as a whole and of the arbitration clause in particular. In doing so, the court would assume that generally parties intended to have all their disputes under an agreement determined by the same tribunal – not some disputes by an arbitrator and others by a court. If the parties intended otherwise, it was easy enough for them to say so.[12]

[22] In his speech in *Fiona Trust* Lord Hope agreed with the approach adopted by Lord Hoffmann, saying that if the parties had confidence in their chosen jurisdiction for one purpose there was no reason for them not to have such confidence for another purpose. But he did qualify this by stating that 'one should be slow to

[10] Para 13.
[11] Para 5.
[12] Para 13, referring to Longmore LJ's judgment in the Court of Appeal: [2007] 1 All ER (Comm) 891.

attribute to reasonable parties an intention that there should in any *foreseeable eventuality* be two sets of proceedings' (my emphasis).[13]

[23] Lord Hope thus echoed the principle set out by Lord Porter in *Heyman*, quoted above, that if the parties foresee the possibility of a particular dispute arising as to the validity of their contract, they may provide that it be referred to an arbitrator for resolution. Accordingly if they anticipate that the contract itself may be invalid for want of true consensus or for some other reason, they may make that arbitrable. But that can be determined only by having regard to the context in which the agreement was concluded. This is in line with the South African approach to the interpretation of contracts generally.

Interpretation of the contract in general

[24] I do not propose to recite the principles of interpretation comprehensively. They are well-settled. The court asked to construe a contract must ascertain what the parties intended their contract to mean. That requires a consideration of the words used by them and the contract as a whole, and, whether or not there is any possible ambiguity in their meaning, the court must consider the factual matrix (or context) in which the contract was concluded. See *KPMG Chartered Accountants (SA) v Securefin Ltd.*[14]

[25] In addition, a contract must be interpreted so as to give it a commercially sensible meaning: *Ekurhuleni Metropolitan Municipality v Germiston Municipal Retirement Fund*.[15] This is the approach taken to considering the ambit of an

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[13] The court referred in this regard to *Ashville Investments Ltd v Elmer Contractors Ltd* [1988] 2 All ER 577 (QB) at 599.

[14] *KPMG Chartered Accountants (SA) v Securefin Ltd* 2009 (4) SA 399 (SCA) para 39. See also *Christie* op cit 225ff and S W J van der Merwe, L F Van Huyssteen, M F B Reinecke and G F Lubbe *Contract General Principles* 4 ed (2012) 264ff.

[15] *Ekurhuleni Metropolitan Municipality v Germiston Municipal Retirement Fund* 2010 (2) SA 498 (SCA) para 13. See also *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 18.

arbitration clause adopted in *Fiona Trust*. We must thus examine what the parties intended by having regard to the purpose of their contract.

The interpretation of the arbitration clause in question

[26] North East argued that in construing the arbitration clause we must take into account the phrase 'including any question as to the enforceability of this contract'. We must, it contended, give the phrase some meaning. To do that the court is required to look at the settlement agreement as a whole, and its purpose. That we do by looking at the context in which it was concluded. As stated at the outset, the parties had a protracted dispute about the collection of debts and the amounts owed to each other respectively. The sums ran into millions of rand. The purpose of the settlement agreement was to resolve accounting issues: at the time the bank was oblivious to the malpractices it claimed were perpetrated by North East. In Peters' words, prior to concluding the settlement agreement, the bank 'was under the impression that the arrears had arisen primarily due to inadequate management and control . . . . The respondent [the bank] did not realise the full extent of the arrears and the type of transactions that had been concluded because it did not have access to the debtors' book, or the applicant's management information system.'

[27] Moreover, said Peters, the bank's investigations were frustrated by North East which gave it limited access to information. Although the bank had sent an employee to North East to examine its business viability, and the report produced did not suggest any fraud – only inadequate systems – the employee had expressly indicated in the report that an in-depth investigation was needed in order for the bank to gain some form of 'comfort/discomfort'. Had the bank known the extent of the arrears and the true facts it would not have entered into the agreement at all, it alleged.

[28] Peters alleged also that even the wording of the arbitration clause was 'improperly procured' in order 'to avoid a public scrutiny of its conduct'. The bank

argued that it had not foreseen that there might have been fraudulent conduct on the part of North East at the time of concluding the agreement. There was thus no intention that the arbitrator would be expected to resolve issues relating to fraud. It had envisaged that the arbitrator's role would be to determine disputes in respect of accounting issues.

[29] North East's counter to that argument was that the arbitration clause provided that the arbitrator would be a senior member of the Johannesburg Bar who would be able to determine questions relating to fraudulent misrepresentations inducing the agreement itself. In my view, that is not an answer. The fact that an experienced lawyer might be able to determine issues relating to fraud does not mean that the parties intended him or her to do so.

[30] I consider that, in the light of the purpose of the settlement agreement, and having regard to what the parties envisaged (because it was what they could foresee) at the time of concluding the agreement, it was not intended that the validity or enforceability of the contract induced by fraudulent misrepresentations and non-disclosures, would be arbitrable. That brings me to the next question: were the allegations made by the bank, in its answering affidavit, sufficiently substantiated such that the court should refuse to compel a reference to arbitration?[16]

Substance in the allegations of fraud?

[31] In his answering affidavit Peters catalogued in detail the results of investigations that he and his team had undertaken, and which led to the decision to resile from the settlement agreement on the ground that it had been induced by North East's fraudulent misrepresentations and non-disclosures. North East maintained that Peters' evidence was 'secondary' since he had not represented the bank when it concluded the agreement. The facts averred were also labelled secondary since they were no more than inferences drawn by Peters as to what

[16] *Allied Minerals* above at 13A-D approved in *Wayland* above at 951D-H.

Hermanus van Zyl must have known. The argument fails to appreciate that Peters had participated in discussions preceding the conclusion of the settlement agreement and had led the bank's enquiries after the agreement was concluded: that it was he who asserted that he had established fraud on the part of North East. In any event, his affidavit was confirmed by a representative of the bank who was party to the agreement and to the decision of the bank to resile.

[32] The bank argued that it need do no more than show that there was some justification for its contentions that the agreement was induced by fraud. And it maintained that its allegations had not been denied in North East's reply – merely evaded. An example of the response to allegations of fraudulent misrepresentations and non-disclosures is to be found in the introductory paragraphs of the reply, where Van Zyl asserted that the issues raised were irrelevant to the question before the court and that 'responding in detail to each and every of those allegations by the respondent will unduly burden the record and serve no purpose'. So too, the allegation by the bank that the arbitration provision was itself fraudulently induced was met with a bare denial. There was already mutual distrust, asserted North East, and the bank was not reliant on it for any disclosure. That is hardly a justification for deliberate non-disclosure.

[33] The methods described by Peters for investigating North East's systems and reconciling data, detailed comprehensively, were met with the response that 'the intricate and involved procedures set out by respondent . . . is a clear example of why the issues between the parties should be resolved by way of arbitration. The arbitrator has been vested with the authority to devise rules and procedures best suited for resolving the issues'. No purpose would be served by setting out more examples of evasion. Suffice to say that there are several.

[34] The high court correctly, in my view, held that the disputes of fact could not be resolved in the application. And it also correctly held that the allegations made by the bank were sufficient to found or to justify the conclusion that the settlement

agreement was probably induced by fraud and that the bank could not be compelled to refer the questions of fraud, and the bank's right to resile from the agreement, to arbitration.

[35] The appeal is accordingly dismissed with costs including those of two counsel.

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LEWIS JA

Judge of Appeal

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