

Effect of fraud on dispute resolution clauses

By [Kyle Bowles](#) and [Caley Hil](#)

16 Jul 2020

In the current struggling economic climate and due to the shortage of infrastructure projects plaguing the South African construction industry, it comes as no surprise that there is fierce competition among contractors to be awarded the little work that remains. As a result, it is common for contractors to up the ante of their tender submissions by submitting incorrect or misleading information in an effort to make their tender proposals appear more favourable, and ultimately gain some form of advantage over their competitors.



© szefei – [123RF.com](#)

The effect that a fraudulent misrepresentation committed during the tender process has on a contract, which is concluded as a result of such misrepresentation, has recently been addressed by the Supreme Court of Appeal (SCA) in *Namasthethu Electrical (Pty) Ltd v City of Cape Town and Another* [2020]. In addition, the SCA considered whether a dispute resolution clause included in a contract survives the termination of the contract on the grounds of fraudulent misrepresentations made during the tender process.

Namasthethu Electrical was awarded a contract in 2014 by the City of Cape Town for the supply, retrofit, and installation of energy efficient luminaries at the Cape Town Civic Centre, following the required tender process. A written agreement was then concluded between the City and Namasthethu.

Fraud conviction

In September 2014, an unsuccessful competing bidder appealed the awarding of the tender to Namasthethu and requested that the tender be set aside on the basis that the winning bidder and its directors had been convicted of fraud and corruption in 2013 and sentenced to a fine of R200,000 coupled with a wholly suspended sentence of 5 years' imprisonment. This conviction was particularly significant since Namasthethu had expressly declared in its tender submission that neither it, nor any of its directors, had been convicted of fraud in the last five years. The competitor's allegations were denied by Namasthethu.

Following confirmation by the Construction Industry Development Board and a further investigation by the City's Forensics, Ethics, and Integrity Department (FEID), it was verified that Namasthethu and its directors had in fact been convicted of

fraud and corruption less than a year prior to its tender submission, and that the negative declaration regarding fraud convictions in the tender application was a *prima facie* misrepresentation. In addition, the report identified that Namasthethu had provided a false business address in its tender submission, in order to bolster its application by giving the impression that the company had a local office.

Cancelled contract

The City, acting on the recommendation made by FEID, cancelled the contract with immediate effect due to Namasthethu's fraudulent acts committed during the tender process which had led to the conclusion of the contract. In disputing the cancellation, Namasthethu referred the dispute to adjudication as per the dispute resolution procedure in the contract. The appointed adjudicator granted Namasthethu's claim for damages based only on a Statement of Claim, and without hearing any evidence. The City then sought and was granted relief from the High Court to have the contract rescinded and the adjudicator's award set aside; a decision which was taken on appeal by Namasthethu.

Dispute resolution

On appeal, Namasthethu contended that disputes of any kind, including those regarding cancellation due to allegations of fraud during the tender process, were subject to the dispute resolution process set out in the contract, and further that there was no basis in law for the judicial review of the adjudicator's decision. Namasthethu once again disputed that it had previously been charged and convicted of fraud and corruption.

The SCA reaffirmed the position held by the High Court - that all the requirements for fraudulent misrepresentation on the part of Namasthethu had been met, and further emphasised the principle that *"fraud is conduct which vitiates every transaction known to the law"*.

“ Therefore, any contract induced by fraudulent misrepresentation renders the contract voidable by the innocent party, and grants that party the power to elect whether to abide by the contract and potentially claim damages, or to resile from the contract and regard it as void from inception. ”

The SCA then dealt with the question of whether, in light of the fraudulent and corrupt conduct of Namasthethu, the City could still be compelled to submit to a dispute resolution process in accordance with the contract after validly cancelling it. The court applied the reasoning in *North West Provincial Government and Another v Tswaing Consulting CC and Others [2006]* that once an agreement has been rescinded by an aggrieved party, the dispute resolution clause in such contract simply cannot stand, because to enforce the arbitration agreement, which is the tainted product of fraud, would be offensive to justice. Thus, disputes regarding the validity or enforceability of contracts that were induced by fraudulent misrepresentation and non-disclosures were not generally intended to be arbitrable.

Possible exception

A possible exception to this principle was identified, where the parties specifically make provision in the contract for this form of dispute to be referred to adjudication or arbitration. This would be the case where it may confidently be inferred that, at the conclusion of the contract, the parties contemplated the possibility of a dispute arising in regard to a fraud, misrepresentation, or concealment in the negotiations or tender, and provided very clear directions that such a dispute is to be referred to dispute resolution. The well-established principles of contractual interpretation are to be relied upon to arrive at this inference by having regard to the context in which the agreement was concluded.

The SCA found that the contract at hand unquestionably did not provide for a dispute over termination due to fraud to be determined by means of the dispute resolution mechanism in the contract, and it therefore upheld the High Court's decision to set aside the adjudicator's award on the basis that the referral to adjudication was invalid and unlawful and that the adjudicator lacked the jurisdiction to make such determination. Namasthethu's appeal was accordingly dismissed and a punitive cost order was made in recognition of the corrosive effect that fraud and corruption have on society.

Warning

This case should serve as a warning to contractors to be aware that their actions and information which they provide during a tender process may have far-reaching consequences should it be discovered that they were tainted by dishonesty or fraud. While innocent misstatements on tender documents may be excusable, deliberate misrepresentations, no matter how immaterial they may seem, could amount to fraud and will be a sufficient basis on which to terminate a contract. Fraudulent misrepresentation and the resultant cancellation of the contract may also be relied upon at a later stage by an employer as a defence to invalidate any dispute resolution process and will leave a contractor with few legal remedies.

ABOUT THE AUTHOR

Kyle Bowles and Caley Hill - attorneys at Lawtons Africa

For more, visit: <https://www.bizcommunity.com>