THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

Case No. 172/97

In the matter between:

DORBYL MARINE (PTY) LIMITED **Appellant**

and

DEPARTMENT OF TRADE AND INDUSTRY **Respondent**

Coram:	VAN HEERDEN DCJ, SMALBERGER, SCHUTZ, STREICHER JJA and MELUNSKY AJA
Heard:	18 MAY 1999
Delivered:	31 MAY 1999

JUDGMENT

STREICHER JA/

STREICHER JA:

[1] The issue to be decided in this appeal is whether certain statements by an arbitrator in his award are binding on the respondent.

With the necessary leave the appellant appeals against the decision of the court *a quo* that they were not.

[2] At the relevant time the appellant was primarily involved in ship building and ship repair activities. In October 1989 the Government announced that with effect from 1 April 1990 it would introduce the General Export Incentive Scheme ("GEIS"). GEIS was conceived as a subsidy scheme aimed at promoting the export of processed products. The greater the degree of processing, and the greater the local content by cost, the greater the potential GEIS subsidy. The subsidy was to be calculated according to the formula Z = U x (M $^{+}$/- E) x P where Z was the subsidy; U was the FOB value of export sales; M was the degree of processing to which the product had been subjected in South Africa; E was the exchange rate factor through which M was adjusted for inflation and exchange rate fluctuation; and P was the local content factor. At all material times (M $^{+}$/- E) was 19,5% in the case of ship building.

[3] The local content factor P was the difference between the FOB value of the export minus the CIF value of imported inputs incorporated in the product expressed as a percentage of the FOB

value. If that percentage was 75% or more P was deemed to be 100%. The effect of the aforegoing was that if the local content factor was 74% the GEIS subsidy was 14,43% of the FOB value of the export and if the local content factor was 75% or more the GEIS subsidy was 19,5% of the FOB value of the export.

[4] The appellant constructed three vessels and exported them in February 1992, September 1992 and March 1993 respectively. The GEIS guidelines provided that imported goods which had undergone a substantial "transformation" process within the Southern African Customs Union could, in certain circumstances and subject to specific approval by the respondent, qualify as locally manufactured inputs for the purpose of determining the local content thereof. Without approval of some transformations by respondent the appellant was unable to achieve a P factor of 75%. During the period February to June 1993 the appellant applied for the respondent's approval of certain transformations. The respondent refused the application. At a subsequent meeting between the appellant and the respondent in July 1993 the respondent told the appellant that, based on the oral information supplied, it would consider the transformation

applications but that some of them had no chance of success. The respondent requested the appellant to submit a full and comprehensive application in writing and to motivate fully why the transformations claimed were in compliance with the GEIS requirements. As a result of the meeting the appellant resubmitted an application for the approval of transformations. This application was also refused by the respondent.

[5] Subsequent to the meeting in July 1993 the appellant contended that the respondent had indicated at the meeting that a rejection of its transformation application would not be disastrous for the appellant because the appellant could always omit any particular imported item such as the engine, i.e. the appellant could, for example, deduct the value of the engine from the FOB value of the exported vessel as well as from the CIF value of imported inputs in order to qualify for the full GEIS subsidy on the lower FOB value. The suggested process was referred to as "omissions".

[6] After the rejection of its transformation claims the appellant submitted GEIS claims to the respondent. The claims did not include transformations but did include omissions. The

respondent took the view that the three GEIS claims had been overstated by a total amount of R25 697 072. Notwithstanding negotiations the parties could not come to an agreement as to the amount of the subsidy to which the appellant was entitled. As a result the parties agreed to submit the matter to arbitration.

[7] On 1 and 2 August 1995 the parties entered into a written arbitration agreement in terms of which they agreed to submit their "dispute regarding the payment of GEIS" to an arbitrator. In terms of the agreement the parties also agreed that the arbitrator was to issue directions as to:

i) The need for any pleadings or statements;

ii) The need for the discovery of any documents;

iii) The need for the filing of expert notices; and

iv) Any other procedure which the arbitrator in his discretion considered necessary.

[8] The appellant's statement of case, the comments of the respondent on the statement and further responses by the parties (hereinafter collectively referred to as "the written submissions") were submitted to the arbitrator. The appellant stated in its statement of

case that there were four areas of dispute between the parties, namely:

"4.3.1 The FOB issue;
4.3.2 The imported inputs issue;
4.3.3 The design costs issue;
4.3.4 The Hermes issue."

The statement of case concluded as follows:

"14.1 Overall it is Dorbyl Marine's case that:

14.1.1 The actual audited FOB value should be used in the calculation of the GEIS subsidy;
14.1.2 It should be allowed to take imported inputs out of both sides of the equation in order to reach a 75% P factor;
14.1.3 The design costs do not form part of the calculation of the P factor;
14.1.4 The Hermes insurance costs do not form part of the calculation of the P factor."

[9] In its comments on the appellant's statement of case the respondent stated that its determination of the FOB value should be accepted; that it would be acting *ultra vires* if it were to allow the appellant to take imported inputs out of both sides of the equation in order to reach a 75% P factor; that the design costs formed part of the calculation of the P factor; and that the Hermes costs formed part of the calculation of the P factor. Those were the four issues between the parties. Transformation was not an issue.

[10] On 5 September 1995 the arbitrator issued his written directions in which he stated *inter alia*:

> "6.1 There is, in my view, no need for any pleadings or statements. I should, however, indicate at this stage that, as I understand the nature of the arbitration agreement, it is agreed that I should state in my award what, in my view, should properly have been payable in respect of GEIS for the three vessels here in issue, namely Nos 105, 106 and 107. I understand, therefore, that I am at large to form a view as to the proper application of GEIS which may be different from that advanced by either party."

It is clear, and not disputed, that the arbitrator did not consider pleadings to be necessary in that the written submissions, in which the issues between the parties were clearly defined, could serve as pleadings. The parties accepted the arbitrator's written directions and certain documents required by him were made available to him.

[11] The arbitration took place on 26, 27 and 28 September 1995. During the arbitration and in the documentation submitted to the arbitrator reference was made to transformation claims. It is, however, apparent from the record of the arbitration proceedings that, at least insofar as the parties were concerned, the transformation claims were only considered to be relevant in order to show how the dispute about the omission of imported inputs came about. This

appears from the following:

(a) In his opening address appellant's counsel emphasized that there were four areas of dispute, namely, the four mentioned in appellant's statement of case. The arbitrator assured him that he had studied "the memoranda and what serve as pleadings". He was obviously referring to the written submissions.

(b) When the appellant called its second witness, Mr Dawe, its counsel said:

> "He will be talking of the second claim which has to do with the omission of items from the input part of the formula. There will be some discussion about what's known as transformations and in, I think, the statement of claim and the defence there are references to transformations. I think as matters have turned out, there is no need for you to worry yourself as to what precisely constituted a transformation, what would be an acceptable transformation, because all that has fallen by the wayside ..."

Mr Dawe stated in his evidence that because the respondent had led the appellant to believe that the option of taking out imported items was available to it the appellant had not pursued the other options open to it.

(c) During the evidence in chief of Mr Bullough, who at the

relevant time was the managing director of the appellant,

appellant's counsel asked the following question:

> "Mr Bullough, we now move on to the second area of dispute between Dorbyl Marine and the Department of Trade and Industries. Perhaps as well what we can do is before we go to the correspondence, Mr Dawe did testify to some extent on it, could you explain to Mr Arbitrator the basis of your claim to be entitled to omit certain imported items from the formula? And in asking you that question generally, could you also generally and broadly just refer to how it came about, namely I want you to talk about the transformation idea as it developed."

(d) In his argument to the arbitrator after all the evidence had been presented, appellant's counsel stated that the appellant, at the meeting in July 1993, had abandoned the transformation application and decided to go for the option of elimination and omission.

(e) The appellant led no evidence in support of a transformation claim.

[12] In his award the arbitrator referred to what he had said in paragraph 6.1 of his directions. In paragraph 55 of the award he stated that "on the issues as stated to me, therefore, I reach the following conclusions". They were that the correct export sales value was

R333 775 707; that permission had been given to the appellant to omit certain identifiable imported items for the purpose of increasing the P factor to 75% but that the permission was invalid; and that many of the transformation claims set out with regard to Vessel No 107 should have been allowed. In the latter regard he added:

> "56.2 The net effect of the inclusion of these items would, as I understand it, be to raise the P factor to over 75%. I have not been given information as to the precise nature of some of the operations. They would appear, however, to be sufficiently described. As I understand it, the description of the operations was accepted, but it was felt that there was no sufficient transformation. This is a view with which I do not agree."

[13] In paragraph 57 the arbitrator dealt specifically with the four claims set out in the written submissions of the parties and stated:

> "On these claims my award is as follows."

[14] The appellant thereupon submitted a claim for an amount of R22 620 501 calculated on the basis that, in terms of the arbitrator's award, certain transformations qualified as locally manufactured inputs for the purpose of determining local content. In a letter to the appellant the respondent acknowledged that it was indebted to the appellant in the sum of R3 951 794 but disputed liability in respect of

the balance of the claim on the basis that the remarks made by the arbitrator in respect of transformation were considered to have been made in passing and not to be binding on the respondent. The respondent stated:

> "The transformation issue was, for purposes of the arbitration, never an issue between the parties and never formed part of the mandate of the arbitrator. Had it been an issue a full gamut of expert evidence would have been required to determine whether each and every transformation claimed had any merit. This was not done for the simple reason that it was not required. The Department noted the remarks made by the arbitrator but respectfully disagrees and does not consider itself bound by those remarks."

This dispute gave rise to an application to the Durban and Coast Local Division of the High Court by the appellant against the respondent for payment of R18 668 707. The judge in the court *a quo* held that the remarks made by the arbitrator concerning transformation claims, which according to him should have been allowed, were merely made in passing in respect of a matter which was not an issue in the arbitration; consequently, that the respondent was not bound by those remarks. The application was therefore dismissed.

[15] Before us the appellant contended that the views expressed by the arbitrator in regard to transformations were binding

on the respondent. The appellant submitted that the parties had in terms of the arbitration agreement agreed that their "dispute regarding the payment of GEIS" be submitted to arbitration; that the arbitrator understood the agreement between the parties to be that he was obliged to state what was properly payable in respect of GEIS and that he was at large to form a view as to the proper application of GEIS different from that advanced by either party; that the parties accepted the arbitrator's definition of his mandate; that as a result of the agreement in respect of omissions having been held to be *ultra vires* the transformation claims had not been novated; that once the arbitrator had found that the "omissions agreement" was *ultra vires* he could not fulfil his mandate to state in his award what was properly payable in respect of GEIS without dealing with transformations; and that he therefore dealt with the transformation issue in fulfilment of his mandate.

[16] It is common cause between the parties that the arbitrator could only have derived his authority to make a binding award from an agreement between the parties (see *McKenzie N.0. v Basha* 1951 (3) SA 783 (N) at 787F-788B). In terms of the arbitration agreement,

which was concluded on 1 and 2 August 1995, the parties agreed:

(1) To submit their dispute regarding "the payment of GEIS" to an arbitrator.

(2) That the arbitrator should issue directions as to the need for any pleadings or statements.

By that time the dispute between the parties "regarding the payment of GEIS" had been defined in the written submissions as a dispute concerning four items which did not include transformation claims. There can be no doubt that those issues constituted the matter which they had agreed to submit to arbitration. Confirmation that that was the case is to be found in the fact that the written submissions were shown to the arbitrator on 1 August 1995, that is to say at the very time that the arbitration agreement was concluded.

[17] The question then arises whether the parties, by accepting the arbitrator's written directions in which he stated his understanding of the arbitration agreement, agreed to enlarge the scope of the arbitration so as to cover matters not in dispute between the parties.

[18] In my view it cannot be found that such an agreement was concluded. My reasons are the following:

(1) It is not alleged by the appellant that by accepting the arbitrator's written directions the parties intended to amend their arbitration agreement.

(2) The written submissions served as pleadings as far as the arbitrator and the parties were concerned. The object of pleadings is to define the issues to be decided and the issues were clearly defined in those submissions.

(3) What the appellant is contending for is that, by accepting the arbitrator's understanding of the agreement, the parties agreed that the arbitrator could make an award against one of them, in respect of a matter which was not in dispute between them, without notifying them that he intended doing so and whether or not they had addressed the issue in the evidence presented or in argument. To grant such authority to the arbitrator would be so far-reaching and can lead to such unfair results that it is very unlikely that the parties could ever have intended to grant such authority to the arbitrator.

(4) All the indications are that the parties throughout the arbitration proceedings were under the impression that the issues to be

decided in the arbitration were the four issues specified in their submissions and that transformation was not one of them.

(5) In the light of the aforegoing it is probable that the parties interpreted the arbitrator's statement in his directions to be that he was at large to decide what should properly have been payable in respect of GEIS and what the proper application of GEIS was in respect of the agreed issues between the parties and not that he considered himself to be at large to decide what the proper application of GEIS was in respect of any other issues.

[19] It follows that the arbitrator had no authority to give any decision in respect of transformations and that, insofar as he purported to do so, his decision is invalid.

[20] It is therefore not necessary to decide whether the arbitrator intended to give a decision in respect of transformations or whether what he said in respect of transformations was merely said in passing and not intended to be binding on the parties.

[21] For these reasons the appeal is dismissed with costs including the costs consequent upon the employment of two counsel.

P E STREICHER
JUDGE OF APPEAL

AGREE:

VAN HEERDEN DCJ
SMALBERGER JA
SCHUTZ JA
MELUNSKY AJA