ARBITRATION

A TALE OF TWO FORUMS – CAN AN ARBITRATION AGREEMENT BE SUBORDINATED TO A JUDGMENT IN DEFAULT OBTAINED IN COURT PROCEEDINGS?

Imagine waking up one day in receipt of a judgment in default while having an ongoing dispute concerning the performance of a contract. Imagine further that the contract contains a valid arbitration agreement which was never resorted to. Should the Judgment in Default be upheld as no appearance was ever entered? Should the Judgment in Default be set aside as it should have been referred to arbitration in accordance to the contract?

INTRODUCTION The Federal Court in *Tindak Murni Sdn Bhd v Juang Setia Sdn Bhd [2020] MLJU 232* grappled with the issue of whether a judgment in default obtained in court proceedings should be set aside on the basis of the existence of the arbitration agreement.

THE ISSUES The issues before the Federal Court were the following questions of law:

a) Can a judgment in default in court be sustained when the plaintiff who obtained the judgment in default is bound by a valid arbitration agreement/clause and the defendant has raised disputes to be ventilated *via* arbitration pursuant to the arbitration clause?

b) Should the court in hearing an application to set aside the judgment in default where a valid arbitration clause is binding on parties consider the "*merits*" or "*existence*" of the disputes raised by the defendant?"

The Federal Court answered both questions in the negative.

BRIEF FACTS Tindak Murni Sdn Bhd, the employer ('**Tindak Murni**') entered into a Building Construction Contract with Juang Setia Sdn Bhd, the contractor ('**Juang Setia**').

The contract was in relation to a project for the construction of the remaining portions of a main access road, earthworks and infrastructure works in relation to 428 condominium units in Dengkil, Selangor. The contract was in the standard format as per the *Pertubuhan Akitek Malaysia* ('PAM') contract. Subsequently, disputes arose between the parties resulting in the Respondent initiating a civil suit ("**Suit**"). The Suit was initiated notwithstanding the clear and unambiguous provision requiring parties to refer any dispute or difference arising between them in relation to any matter in connection with the contract to arbitration.

No appearance was filed within the requisite time period and as a consequence thereof, the Juang Setia obtained a judgment in default against Tindak Murni.

Tindak Murni proceeded to file an application to set aside the judgment in default and for a stay of the Suit pending arbitration. The High Court allowed the application to set aside the judgment in default and for a stay of the Suit pending arbitration.

Juang Setia appealed to the Court of Appeal against both decisions of the High Court. The Court of Appeal allowed Juang Setia's appeals and reinstated the judgment in default and dismissed the application for stay. In doing so the Court of Appeal focused solely on the merits of the application to set aside the judgment in default without considering the application for stay of the Suit or the arbitration agreement between the parties.

Tindak Murni being dissatisfied, sought leave to appeal and thereafter appealed to the Federal Court in respect of the decisions of the Court of Appeal.

DECISION OF THE FEDERAL COURT

The Federal Court in reaching a decision canvassed the issues below.

Was there is a valid agreement to arbitrate?

The Federal Court firstly considered the issue of whether there was a valid agreement to arbitrate between the parties. Section 10 of the Arbitration Act 2005 ("AA 2005"), sets out the role of the Court when confronted with an application for stay pending arbitration which reads as follows:

> *"A court before which proceedings are brought in respect of a matter which is the subject of an arbitration agreement shall, where a party makes an application before taking any other steps in the proceedings, stay those proceedings and refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed."*

The Federal Court made a finding that there was a valid arbitration agreement pursuant to clause 34 of the underlying contract entered between the parties. As such, Juang Setia in light of the arbitration clause should have referred the disputes to arbitration from the very outset.

Would the position be any different if a party had already obtained a judgment in default in court proceedings, notwithstanding the arbitration clause?

The answer given by the Federal Court was simply no, for the following reasons:

a) Section 10 of the AA 2005 applies notwithstanding the judgment in default. When analysed, section 10 only allows consideration of the following matters:

   i. That there subsists an agreement to arbitrate;
   ii. That no step has been taken in court proceedings; and
   iii. That the arbitration agreement is not null, void, inoperative or incapable of being performed.

   In short, the Federal Court is of the view that even when a judgment in default has been procured, section 10 of the AA 2005 remains applicable. This in turn means that the Court is bound to consider the matters set out in (i), (ii) and (iii) above **notwithstanding the existence of a judgment in default**. This is particularly so when there are active efforts being made to set aside the judgment in default of appearance such that the matters in dispute can be ventilated fully by way of arbitration as is the case here.

b) Tindak Murni by conduct clearly demonstrated an intention to be bound by the contract, namely to have the dispute referred to arbitration. As such, Juang Setia acted in clear breach of the arbitration agreement by initiating the Suit and cannot rely on its own breach to seek to impugn or subordinate the agreement to arbitrate. Neither does the agreement to arbitrate stand voided or inoperative or incapable of being performed because of the existence of the judgment in default.

c) If the commencement of litigation by Juang Setia in the instant case in breach of the agreement to arbitrate as agreed in Clause 34 of the underlying contract is condoned, it would "*effectively render that agreement nugatory*" and "*the intention of the parties at the point in time when the contract was concluded would be effectively undermined.*"

d) The Federal Court further noted that while both the application to set aside the judgment in default and the stay application were separate applications, it was crystal clear that the applications were inextricably intertwined and should have been considered in totality by the Court of Appeal.

The Federal Court allowed both appeals and restored the decision of the High Court.

CONCLUSION Interestingly, Malaysian courts appear to no longer consider the issue of whether a '*dispute*' exists in an application for a stay of court proceedings pending arbitration. This approach accurately echoes Section 10(1) of the AA 2005 post-2011 amendments.

The Federal Court's decision above is consistent with other appellate court decisions on Section 10 of the AA 2005 post-2011 amendments (see ***TNB Fuel Services Sdn Bhd v China National Coal Group Corp [2013] 4 MLJ 857*** and ***Press Metal Sarawak Sdn Bhd v Etiqa Takaful Bhd [2016] 5 MLJ 417***).

Moving forward, commercial entities should be well advised and fully informed of the benefits and pitfalls of arbitration before agreeing to resort to arbitration as a dispute resolution mechanism in their contracts. It will be the only method in which parties can resolve their disputes moving forward unless the requirements in section 10 of the AA 2005 are not fulfilled.

For more information, kindly contact the undersigned.

Authors

Idza Hajar Ahmad Idzam
idza.hajar@zulrafique.com.my

Nan Muhammad Ridhwan Rosnan
ridhwan.rosnan@zulrafique.com.my

Zul Rafique & Partners
15 June 2020