ARBITRATION

IN SEARCH OF THE GOLDILOCKS THRESHOLD FOR SETTING ASIDE AN ARBITRATION AWARD

This article discusses the facts, issues and judgment of the case.

INTRODUCTION The Federal Court in *Pancaran Prima Sdn Bhd v Iswarabena Sdn Bhd [2020] MLJU 1273* engaged with the issue of *inter alia* whether the threshold under section 37 of the Arbitration Act 2005 ("**AA 2005**") is very low and whether the arbitrator who applies his own knowledge and expertise in the construction industry to a fact in issue can be in breach of the rules of natural justice.

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

a) Whether the threshold requirement stipulated by section 37 of the AA 2005 to set aside an award as 'very low' as set out in the cases of *Petronas Penapisan (Melaka) Sdn Bhd v Ahmani Sdn Bhd [2016] 2 MLJ 697* and *Sigur Ros Sdn Bhd v Master Mulia Sdn Bhd [2018] 3 MLJ 608* is indeed the correct test in the light of the various other provisions of the AA 2005;

b) Whether the arbitrator who is an engineer who relies on his own knowledge of the construction industry in arriving at a decision on the quantum of 'loss of profit' pursuant to a provision recognised by section 21(3)(b) of the AA 2005 for an arbitrator to be able to draw its own knowledge and expertise, can then be said to be in breach of the rules of natural justice within the meaning of section 37(1)(b)(ii) read together with subsection 2(b) of the Act;

c) Whether the act of an arbitrator relying on his own knowledge and expertise on matters of 'evidence' relating to an industry in which he is well acquainted will amount to a breach of natural justice within the meaning of section 37(1)(b)(ii) read together with subsection 2(b) of the AA 2005;

d) Whether the precept of a breach of the rules of natural justice extends to the arbitrator applying his own knowledge and expertise on an issue where the parties have led evidence on and which forms one of the very issues which the arbitral tribunal has to deal with, especially when the knowledge of the arbitrator has an impact on the quality of evidence required for evaluation by the tribunal; and

e) Whether the decision of the arbitrator in making an award on what constitutes the value of completed works, and the basis on which such an assessment is to be made, can constitute a 'question of law arising out of the award'.

BRIEF FACTS By Letter of Appointment dated 18.7.2011 Iswarabena Sdn Bhd ("**Iswarabena**") appointed Pancaran Prima Sdn Bhd ("**Pancaran Prima**") as its subcontractor for the construction and completion of vehicular box culverts and drainage works which formed part of the proposed Sungai Buaya Interchange and Toll Plaza which were contracted out to Iswarabena. The subcontract was for a lump sum price of RM9.5 million for preliminaries and drainage works and a provisional sum of RM3.8 million for another two works.

Iswarabena purported to terminate the subcontract, which led to a dispute between the parties which in turn gave rise to claims for compensation and damages by Pancaran Prima and to counterclaims by Iswarabena. The termination was allegedly due to the delay of more than 20% financially as stipulated by clause 12 of the subcontract. One of Pancaran Prima's claims was that the subcontract had been unlawfully terminated by Iswarabena. Its case was that it was prevented by Iswarabena from progressing with the works due to lack of site possession.

Pancaran Prima subsequently referred the dispute to arbitration. On 11.1.2016, the learned arbitrator made and published his Final Award. There are three parts to the award:

a) A finding that the subcontract had been unlawfully terminated by Iswarabena;

b) A finding that works to the value of RM1,409,154.75 had been completed by Pancaran Prima; and

c) A finding that Pancaran Prima had incurred a loss of profit of RM942,109.52 resulting from the unlawful termination of the subcontract.

Pancaran Prima applied to the High Court for enforcement of the award pursuant to section 38 of the Act whilst Iswarabena filed for setting aside or variation of the award pursuant to sections 37 and 42. The learned High Court Judge delivered his decision on 22.11.2016 favouring Iswarabena. The arbitration award was varied pursuant to section 42 of the Act and Pancaran Prima's application to enforce the award under section 38 was dismissed. In a complete reversal of the learned arbitrator's finding, the learned Judge found that the subcontract had been lawfully terminated by Iswarabena.

Pancaran Prima filed two appeals to the Court of Appeal against the decision, one against the variation of the arbitration award and the other against the dismissal of its application to enforce the award. Iswarabena on its part filed a cross-appeal, asking for a variation of the High Court Order.

It was unanimously decided in the Court of Appeal as follows:

a) that the findings of the High Court pursuant to section 42 of the Act were completely reversed;

b) Pancaran Prima's appeal against the High Court order varying the award was dismissed in its entirety; and

c) Iswarabena's cross-appeal for a variation of the High Court order was allowed.

DECISION OF THE FEDERAL COURT

1. *Whether the threshold under section 37 of the AA 2005 is 'very low'*

The Court of Appeal analysed the cases of ***Petronas Penapisan*** (supra) and ***Sigur Ros*** (supra) where it was held that the threshold under the provision of section 37 of the AA 2005 to set aside an award is "*very low*" (although the courts are slow in setting aside the award) as opposed to a "*very high*" threshold under section 42. This inevitably leads to the conclusion that that if a party cannot succeed under section 37, an application under section 42 will be futile as section 37 relates to arbitral process whereas section 42 relates to arbitral award. The relevant portion of section 37 and 42 of AA 2005 reads as follows:

> ***37. Application for setting aside***
> *(1) An award may be set aside by the High Court only if –*
> *(b) the High Court finds that –*
> *(ii) the award is in conflict with the public policy of Malaysia.*
>
> *(2) Without limiting the generality of subparagraph (1)(b)(ii), an award is in conflict with the public policy of Malaysia where –*
> *(b) a breach of the rules of natural justice occurred –*
> *(i) during the arbitral proceedings; or*
> *(ii) in connection with the making of the award.*
>
> ***42. Reference on Questions of Law***
> *(1) Any party may refer to the High Court any question of law arising out of an award.*
>
> *Note: Section 42 of AA 2005 is deleted by Act A1569*

The Federal Court observed its own judgement in the case of ***Jan De Nul (M) & Anor v Vincent Tan Chee Yioun & Anor [2019] 2 MLJ 413*** and affirmed the low threshold test laid down in *Petronas Penapisan*. The Federal Court further stated that whether the threshold is "*very low*" or "*very high*", a wide discretion is vested in the courts under the provisions of section 37 of AA 2005 and the decision to allow for the setting aside of an award does not lead to an automatic outcome of a finding that there had been a breach of the rules of natural justice. The court will still have to evaluate whether the discretion should be exercised in all the circumstances of the case. The Federal Court further held that like any other exercise of

discretion, the discretion to set aside an award for breach of the rules of natural justice must be exercised judiciously and only when it is just to do so.

2. *Whether an arbitrator who is an engineer and has knowledge of the construction industry could be in breach of the rules of natural justice by relying on such knowledge in arriving at his decision on the quantum of 'loss of profit';*

3. *Whether an arbitrator who is well acquainted with matters of evidence relating to the construction industry could be in breach of the rules of natural justice by relying on such matters of evidence;*

4. *Whether an arbitrator who applies his own knowledge and expertise in the construction industry to a fact in issue can be in breach of the rules of natural justice*

The Federal Court held that all the three issues above were to be answered together as it is inter-related.

Firstly, the Federal Court drew a distinction between a *'lay arbitrator'* and an arbitrator with certain expertise and experience in a particular field. The Federal Court held that there is no dispute that the arbitrator in the present case was not a lay arbitrator. He was a professional engineer by profession, a chartered arbitrator and a Fellow of the Chartered Institute of Arbitrators (FCIArb).

The Federal Court referred to and relied on the provisions of section 21(3)(b) of the AA 2005 which allows an arbitral tribunal to draw on 'its own knowledge and expertise'. The Federal Court further stated that unless it can be shown that the arbitrator's knowledge and expertise on any fact in issue is plainly and unarguably wrong, courts will be slow in interfering with findings made.

Based on the above, the three questions above were answered in negative and the Federal Court held that the arbitrator had not committed a breach natural justice when the arbitrator decided based on his own knowledge and expertise.

5. **Whether the decision of the arbitrator in making an award on what constitutes the value of completed works, and the basis on which such an assessment is to be made, can constitute a 'question of law arising out of the award'**

The Federal Court agreed with Pancaran Prima's submission that the award of the value of works completed was based purely on a finding of fact by the learned arbitrator and does not involve any question of law as argued to have fallen under the provisions of section 42 of the AA 2005. The arguments were on how the value of works was to be computed in the event of termination. Pancaran Prima had to be compensated for works that it had performed and in this regard the learned arbitrator had duly made his finding on the same.

There was no compelling reason for both the High Court and the Court of Appeal to interfere with the findings of fact by the learned arbitrator. Both courts below were therefore wrong in finding that the learned arbitrator had wrongly applied the physical delay test instead of the financial delay test in deciding whether the subcontract had been lawfully terminated by Iswarabena. The Federal Court held that the arbitrator was right in finding that the subcontract had been unlawfully terminated by Iswarabena.

As such this question was also answered in the negative.

CONCLUSION The Federal Court has affirmed the different thresholds that are to be adopted in respect of applications made under the provisions of section 37 (*very low threshold*) and section 42 (*very high threshold*) of the AA 2005 as decided in the case of ***Petronas Penapisan*** (supra) and ***Sigur Ros*** (supra).

Be that as it may, the Federal Court was quick to caution that whilst courts may allow for an application to set aside an award under section 37 of the AA 2005, this cannot and should not lead to the conclusion that an automatic finding that a breach of natural justice has occurred. The court should be slow in interfering with or setting aside an arbitral award and must exercise its discretion judiciously and only when it is just to do so.

The Federal Court have also highlighted the provisions of section 21(3)(b) of the AA 2005 which allows an arbitral tribunal to draw on *'its own knowledge and expertise'* in deciding on facts in issue.

The provisions of section 21(3)(b) of the AA 2005 is not new. It is hoped that this decision will allow arbitrators to utilise and apply their own knowledge and expertise in deciding facts in issue in arbitration proceedings moving forward.

This is in line with the spirit of arbitration proceedings as an alternative dispute resolution mechanism that intends on having disputes *(which may involve niche and specialised industries)* decided by experts in the same.

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