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# Judicial approach to application and construction of Arbitration Act 2005 in Malaysia: section 37

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Over the past few decades, Malaysia has sought to develop a refined and efficient system for alternative dispute resolution. Today, Malaysia has a relatively robust arbitration ecosystem. This article is part of a series that considers how the courts in Malaysia have construed and interpreted sections 8, 37 and 42 of the Arbitration Act 2005 (the 2005 Act) and, in particular, focuses on challenges to arbitral awards pursuant to section 37.[1]

**Background**

Section 37(1) reads as follows:

> *(1) An award may be set aside by the High Court only if -*
>
> *(a) the party making the application provides proof that –*
>
> *(i) a party to the arbitration agreement was under any incapacity;*
>
> *(ii) the arbitration agreement is not valid under the law to which the parties have subjected if, or, failing any indication thereon, under the laws of Malaysia;*
>
> *(iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present that party's case;*
>
> *(iv) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration;*
>
> *(v) subject to subsection (3), the award contains decisions on matters beyond the scope of the submission to arbitration; or*
>
> *(vi) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Act from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Act; or*
>
> *(b) the High Court finds that –*
>
> *(i) the subject-matter of the dispute is not capable of settlement by arbitration under the laws of Malaysia; or*
>
> *(ii) the award is in conflict with the public policy of Malaysia.*

As a general rule the courts in Malaysia do not interfere with an award of an arbitrator unless the award is tainted with infirmities that are identified pursuant to section 37(1)(a)(i) to (vi) and 37(1)(b) of the 2005 Act. Clear, definitive and specific allegations must be spelt out for the application to succeed. Section 37 of the 2005 Act vests discretionary powers in the court regarding whether to accede to an application to set aside the award.

**Interpretation**

Notwithstanding the general rule in effect, the Federal Court appears to have taken what some may argue as diametrically opposite approaches in *Master Mulia Sdn Bhd v Sigur Rus Sdn Bhd*[2] and *Pancaran Prima Sdn Bhd v Iswarabena Sdn Bhd and another appeal*[3] in interpretating and applying section 37 of the 2005 Act.

***Master Mulia***

The dispute in *Master Mulia* concerned whether the alleged negligence by a charterer had caused damage to an owner's vessel. This issue turned on how the damage had been caused. Extraneous evidence was therefore the central issue of causation. The Federal Court, having heard the arguments, set aside the award on the principal premise that the arbitrator relied on extraneous evidence without according parties a right to be heard.

The Federal Court held that the High Court retains a residual discretion not to set aside an arbitral award, notwithstanding the fact that a ground for setting aside the arbitral award is made out. The Federal Court set out the following guiding principles on the exercise of residual discretion:

> *Subsection 37(1) clearly provides that the High Court retains a residual discretion not to set aside an award even though a ground for setting aside may be made out. What is important is to ascertain the principles applicable to the exercise of such discretion in cases where an application is grounded on breach of the rules of natural justice . . . .*
>
> *[T]he guiding principles on the exercise of residual discretion when an application for setting aside an award is grounded on breach of natural justice may be stated as follows:*
>
> *first, the court must consider: (a) which rule of natural justice was breached; (b) how it was breached; and (c) in what way the breach was connected to the making of the award;*

*second, the court must consider the seriousness of the breach in the sense of whether the breach was material to the outcome of the arbitral proceeding;*

*third, if the breach is relatively immaterial or was not likely to have affected the outcome, discretion will be refused;*

*fourth, even if the court finds that there is a serious breach, if the fact of the breach would not have any real impact on the result and that the arbitral tribunal would not have reached a different conclusion the court may refuse to set aside the award;*

*fifth, where the breach is significant and might have affected the outcome, the award may be set aside;*

*sixth, in some instances, the significance of the breach may be so great that the setting aside of the award is practically automatic, regardless of the effect on the outcome of the award;*

*seventh, the discretion given the court was intended to confer a wide discretion dependent on the nature of the breach and its impact. Therefore, the materiality of the breach and the possible effect on the outcome are relevant factors for consideration by the court; and*

*eighth, whilst materiality and causative factors are necessary to be established, prejudice is not a pre-requisite or requirement to set aside an award for breach of the rules of natural justice.*

With regard to the case in question, the Federal Court stated:

*The Court of Appeal set aside the award on the ground that once a breach of natural justice has been established, the whole award must be set aside; reading sub-ss 37(1)(b)(ii) with (2) of the AA 2005. The Court of Appeal held that the terms of s 37 do not appear to allow for severance, especially in view of the terms of sub-s 37(3) read with sub-s 37(1)(a)(v).*

The Federal Court also held that section 37 of the 2005 Act "should be interpreted in a manner consistent with the underlying policies and objectives" of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and the United Nations Commission of International Trade Law (UNCITRAL) Model Law (the Model Law). However, according to the Federal Court, the courts must be mindful against "importing principles advocated by foreign jurisdictions without careful consideration of the foreign law in question and [the 2005 Act]".

The Federal Court was also of the view that:

*Although the court's discretion to set aside an award under [section 37(1) of the 2005 Act] is unfettered, it must nevertheless be exercised with regard to the policies and objectives underpinning the 2005 Act. In particular, due cognisance must be taken of the purposes of encouraging arbitration as a method of dispute resolution and facilitating the recognition and enforcement of arbitral awards.*

The Federal Court held that the dispute concerned, among other things, whether the damage had been caused by the negligent acts of the respondent. The arbitrator, in coming to a determination, relied on extraneous evidence in concluding that the damage had been sustained due to the respondent continuing to operate the stinger and the vessel in severe weather conditions. The Federal Court held that the arbitrator's reliance on extraneous evidence without affording the parties the opportunity to address such evidence was a breach of natural justice as the arbitrator would not have reached that conclusion without such extraneous evidence:

*The Court of Appeal found that the two pieces of extraneous evidence were relevant and material to the issue of causation of the damage to the stinger hitch, and the evidence in question were considered by the arbitrator without informing the parties until the award was rendered, by which time it was too late. As such, the case which had been submitted for arbitration had been redefined by the arbitrator without giving the parties the opportunity to present their responses. We are therefore in agreement with the views expressed by the Court of Appeal in paras [90]–[92] of the written judgment: that without these two pieces of extraneous evidence which were never put to the parties, the arbitration would also have reached a different outcome. As such, the Court of Appeal was correct in setting aside the entire award on the basis that the breach had materiality and causative effect on the outcome of the arbitration . . . .*

*As stated, a mere finding of a breach of the rules of natural justice is in itself insufficient. It must be shown that the breach was significant or serious such as to have an impact on the outcome of the arbitration. Prejudice, though, a relevant consideration, is not a requirement.*

***Pancaran***

In *Pancaran*, the dispute concerned a subcontractor who sought damages for loss of profit at a margin of 25%. The main contractor contended that nominal damages should be awarded because the subcontractor had not proved its alleged profit margin of 25%. The arbitrator awarded 10% and 7.5% profit margins for different parts of the subcontract, based on the arbitrator's own experience that a 10-15% for profit and attendance to manage a nominated subcontractor was the norm in the construction industry.

The Federal Court held that this issue was reasonably foreseeable, even though both parties to the dispute had submitted only on loss of profit for an appointed subcontractor and not on profit and attendance for a nominated subcontractor.

The Federal Court in *Pancaran* held as follows:

*The principle is trite that courts do not exercise appellate jurisdiction over arbitration awards . . . .*

*In cases where an arbitrator is appointed for his or her special knowledge and skill or expertise, such arbitrator is entitled to draw those sources for the purpose of determining the dispute and need not advise the parties that he or she is doing so . . . .*

*It will not always be easy to determine when special facts relating to a special or particular case become subsumed within the general knowledge that a busy and experienced expert is bound to acquire. The best I can do to provide an acceptable test is to reformulate the question in this way: is the information upon which the arbitrator has relied information of the kind and within the range of knowledge one would reasonably expect the arbitrator to have acquired . . . .*

*Given the evidence before the arbitral tribunal, the question of the arbitrator having relied on 'extraneous evidence' which he 'invented' or 'thought up' of the 10–15% no risk profit norm for P&A in the Malaysian construction industry as alleged by the respondent does not arise at all. As such, the question of the arbitrator having breached the rules of natural justice by failing to give the parties the opportunity to submit on the norm also does not arise . . . .*

> *Even if the learned arbitrator was wrong in not giving the parties the opportunity to submit on the 10–15% no risk profit norm for P&A, we do not consider the breach to be of such gravity and materiality that the respondent can be said to have been denied due process under s 20 of the Act. It would not in our view have affected the outcome of the learned arbitrator's decision on the loss of profit award . . . .*
>
> *It is clear to us that the arbitrator's loss of profit ruling was based on evidence before him and the inferences to be drawn therefrom. Both courts below were therefore wrong in setting aside the loss of profit award, either under s 37 or under s 42 of the Act or under both ss 37 and 42.*

The Federal Court then dealt with the threshold requirements for setting aside awards pursuant to section 37 and section 42 of the 2005 Act in the following manner:

> *[T]he threshold requirement stipulated by s 37 of the Act 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 s 42 . . . .*
>
> *[However,] whether the threshold is 'very low' or 'very high', a wide discretion is vested in the court by s 37 of the Act and the decision to set aside an award is not 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 the applicant's favour in all the circumstances of the case . . . .*
>
> *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. The authorities are clear that in considering whether the discretion should be exercised, the court must undertake an evaluation of relevant factors such as those identified in Kyburn, amongst which would be the seriousness, magnitude or materiality of the breach, its nature and its impact, whether the breach would have any effect on the outcome of the arbitration and leaving room for 'casual breach or occasional error' . . . .*
>
> *The 'very low' threshold for s 37 as decided in Petronas Penapisan and Sigur Ros must be understood in the context it was made, ie that compared to s 42, the threshold under s 37 is 'very low'. In other words, it is 'very low' relative to the threshold under s 42. It must be remembered that the grounds enumerated in s 37 are exhaustive and as such the court cannot set aside an award for reasons other than those that are listed.*
>
> *The grounds enumerated in s 37 need to be construed narrowly as they represent exceptions to the finality of arbitration awards (s 36). This is to avoid devaluing the arbitration agreement that arbitral awards are final and binding and also to preserve the autonomy of the forum selected by the parties by minimising judicial interference in arbitral awards: Jan De Nul.*

The decision in *Pancaran* raises the following issues of concern:

- The arbitrator had not been appointed in the arbitration due to his special knowledge, skill or expertise. Therefore, the arbitrator was not entitled to draw on his own resources to determine the dispute. The arbitration clause did not provide for a specialist arbitrator to be appointed. For instance, in commodity arbitrations, such as Palm Oil Refiners Association of Malaysia (PORAM) arbitrations, the arbitrator must be someone who is familiar with the palm oil trade. This is specifically provided for in section 1-11-2 of the PORAM Rules, which reads as follows:

  > *Persons approved to serve as Arbitrators shall be an employee of a member of PORAM who is known to have relevant experience in the trade or those who are directly connected with the trade of those who are known to have had considerable experience and background of the trade or in the related matters.*[(4)]

- The arbitrator had failed to give the parties an opportunity to submit on the "10-15 no risk profit norm P & A in the Malaysian construction industry", which gave rise to the notion of a breach of the rules of natural justice.

The decision in *Pancaran* also had to deal with the question of whether the threshold requirement stipulated by section 37 of the 2005 Act to set aside an award as "very low" – as set out in the cases of *Petronas Penapisan (Melaka) Sdn Bhd v Ahmani Sdn Bhd*[(5)] and *Sigur Ros Sdn Bhd v Master Mulia Sdn Bhd*[(6)] – was indeed the correct test in light of the various other provisions of the 2005 Act.

*Petronas Penapisan*

The Federal Court in *Pancaran* relied on the decision in *Petronas Penapisan* – in particular, the separate judgment of Mr Justice Sultan Hamid Sultan JCA:

> *The threshold to satisfy under s 37 is very low (though the courts are slow in setting aside the award) and upon proof if successful, the court has an option to send back the matter to the arbitral tribunal to eliminate the grounds for setting aside, as set out in s 37(6). This was not done in this case. To put it in another way when a party to the arbitration complains of breach related to s 37(1)(a)(iv) and/or (v) etc, he must invite the courts attention to s 37(6) and cannot rely on s 42 as it will be an abuse of process, as he is relying on omission or excess of jurisdiction which is covered under s 37 and not s 42 of the AA 2005.*

No authority was cited in support of the contention that the threshold to satisfy an application under section 37(1) is very low. In contrast, Mr Justice Prasad Abraham (as he then was) delivered the judgment of the court, with which the other member of the Court of Appeal (namely, Madam Justice Rohana Yusof JCA (as she then was)) agreed. Mr Justice Prasad Abraham (as he then was) made no reference to the threshold being "very low".

*Sigur Ros*

The Federal Court in *Pancaran* also referred to the decision in *Sigur Ros Sdn Bhd v Master Mulia Sdn Bhd*, in which Madam Justice Mary Lim (as she then was) held as follows:

> *In the same decision of the Court of Appeal in Petronas Panapisan (Melaka) Sdn Bhd v Ahmani Sdn Bhd, is the view expressed that the threshold to satisfy under s. 37 is "very low (though the courts are slow in setting aside the award) and upon proof if successful, the court has an option to send back the matter to the arbitral tribunal to eliminate the grounds for setting aside, as set out in s. 37(6).*

The Court of Appeal in *Sigur Ros* addressed the threshold requirements of section 37 of the 2005 Act compared with that in section 42 of the 2005 Act. However, the Court of Appeal then stated as follows:

> *Further, however "low" the threshold to be met under s. 37(1)(b)(ii) or 37(2) (see Petronas Penapisan (Melaka) Sdn Bhd v. Ahmani Sdn Bhd), it can only be on a balance of probabilities, that there has been a breach of the rules of natural justice either during the*

*arbitral proceedings or in connection with the making of the award.*

***Other case law***

In *Jan De Nul (Malaysia) Sdn Bhd & Anor v Vincent Tan Chee Yioun & Anor*,[(7)] the Federal Court held as follows:

> *[56] Even though the court finds that a breach of the Rules of Natural Justice has been established or that an arbitral award is in conflict with the public policy under s. 37 of the AA 2005, it does not necessarily mean that the award must be set aside as a matter of course. The power of the court to set aside an award under s. 37 is discretionary and will not be exercised automatically in every case where the complaints are established . . . .*
>
> *The court must evaluate the nature and impact of the particular breach in deciding whether the award should be set aside under s. 37. The court must also consider the background policy of encouraging arbitral finality and minimalist intervention approach to be adopted in line with the spirit of UNCITRAL Model law. The effect of ss. 8, 9, 37 and 42 of the AA 2005 is that the court should be slow in interfering with or setting aside an arbitral award. The court must always be reminded that constant interference of arbitral award will defeat the spirit of the AA 2005 which for all intent and purposes, is to promote on-stop adjudication in line with the international practice.*

Section 68 of the English Arbitration Act 1996 sets out the procedure to challenge an award for serious irregularity. The House of Lords in *Lesotho Highlands*[(8)] held that section 68 of the English Arbitration Act requires a "high threshold", opining that that this was necessary to drastically reduce the extent of intervention of courts in the arbitral process.

**Comment**

In view of the substantial similarities in the issues raised by reference to the application of section 37 of the 2005 Act and the breach of natural justice arguments, the fact that *Master Mulia* and *Pancaran* were heard one after the other and resulted in different outcomes is concerning. These two decisions of the Federal Court were delivered on the same day, by the same quorum. The judgment in *Master Mulia* was delivered by Mr Justice Vernon Ong, FCJ and the judgment in *Pancaran* was delivered by Mr Justice Abdul Rahman Sebli, FCJ. The Federal Court came to diametrically opposed conclusions on the issue of the arbitrator's knowledge and the test of setting aside an arbitral award under section 37 of the 2005 Act.

The two judgments are difficult to reconcile, and there is a lack of cross-reference in them to each other. The two judgments therefore give rise to a degree of concern particularly to the arbitral community. How the Malaysian courts apply these two decisions moving forward, and how the conundrum will eventually be resolved by the Federal Court, is important. As in the past, it is likely that the Federal Court will have to revisit these two decisions in seeking to clarify the law should an appropriate case come before the court in the near future.

The Malaysian courts, in dealing with setting aside arbitral awards, have generally taken an arbitration-friendly approach in line with international best practice. The recent judgments of the Malaysian courts, save for perhaps the decision in *Pancaran*, demonstrate an arbitration-friendly philosophy. It may therefore be continued to be said that Malaysia remains a relatively attractive jurisdiction for arbitration and is generally perceived as a safe seat.

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**Endnotes**

(1) For earlier articles in the series, see:

- "Judicial approach to application and construction of Arbitration Act 2005 in Malaysia: introduction"; and
- "Judicial approach to application and construction of Arbitration Act 2005 in Malaysia: section 8".

(2) [2020] 12 MLJ 198 (FC).

(3) [2021] 1 MLJ FC.

(4) *PT Permata Hijau Sawit & 2 Ors v Pacifik Inter-Link Sdn Bhd* (2011) 1 AMR 343.

(5) [2018] 8 CLJ 291.

(6) [2018] 8 CLJ 291.

(7) [2019] 1 CLJ 1.

(8) *Lesotho Highlands Development Authority v Impreglio SpA* [2006] 1 AC 221.