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Not Our Facts: How Far Can an Arbitrator Look Beyond Parties' Evidence?

In a recent pair of searching judgments, the Federal Court re-examined challenges in court to arbitral awards under the perennially enigmatic ss 37 and 42 of the Arbitration Act 2005. The multi-pronged s 37 manifests itself most often as a “breach of the rules of natural justice”. The more singular s 42, currently repealed¹ but in force when the court proceedings began, concerns “questions of law”. In the three sections below, we discern only the crux of each judgment and identify their practical implications for arbitrators, counsel and arbitral parties.

Master Mulia Sdn Bhd v Sigur Rus (sic²) Sdn Bhd

The arbitrated dispute in *Master Mulia* involved a chartered vessel returned by a charterer to its owner late and damaged. The owner's claims were premised in part on its position that negligence by the charterer had caused the damage. In awarding the owner its claims, the arbitrator relied on extraneous evidence, adduced by neither party, of how the damage was caused.

The charterer applied to the High Court to set aside the award under both ss 37 and 42. Only s 37 remained as a central issue before the Federal Court. The Federal Court affirmed the Court of Appeal's judgment (which had overruled the High Court's judgment), **upholding the setting aside of the award**. The eight “guiding principles” on s 37 enumerated by the Federal Court³ can be distilled as follows:

- An applicant must first satisfy the **minimum threshold** by showing: (a) which rule of natural justice has been breached; (b) how it has been breached; and (c) in what way the breach was connected to the making of the award.

¹ Arbitration (Amendment) Act (No 2) 2018.
² Reported as *Sigur Ros* in the courts below.
³ The Federal Court's judgment in *Master Mulia*, [53].

- Once a breach is shown, “**prejudice**” is not required. The High Court was mistaken in refusing to set aside the award on the ground that although two breaches had occurred, no prejudice resulted from them.
- Rather, the High Court’s “wide” **residual discretion** under s 37 must be exercised by considering “seriousness” or “materiality”, “causation” and “significance”. Whether these are discrete considerations or simply different ways of describing the same principle is an area for judicial clarification when the opportunity next arises. Until then, the table below is our interpretation of the Federal Court’s judgment:

Seriousness of Breach	Significance of Breach	Effect of Breach on Outcome (Causation/Materiality)	Discretion to Set Aside
Immaterial	No need to investigate	Not likely to have affected	Refused
Serious	Not significant	No real impact, would have reached same conclusion	May be refused
Serious	Significant	Might have affected outcome	May be set aside
Serious	“Great”, that is, very significant	No need to investigate	Practically automatically set aside

Pancaran Prima Sdn Bhd v Iswarabena Sdn Bhd

Pancaran Prima involved claims in arbitration by an appointed subcontractor against a main contractor for: (1) the value of works done; (2) a declaration that the subcontract was unlawfully terminated; and (3) loss of profit. The three were sequentially dependent: the lawfulness of the termination depended on whether “financial progress”—relevant to the value of works done—had been delayed by at least 20%. In turn, entitlement to loss of profit would arise only if the termination had been unlawful.

The arbitrator awarded the subcontractor all its claims. The main contractor applied to the High Court to set aside the award under both ss 42 (on questions of law) and 37. Of the questions which eventually remained before the Federal Court, two merit particular attention.⁴

The first, under s 37, was the extent to which an arbitrator may rely on evidence extraneous to parties’ pleaded cases without indicating it to the parties and giving them an opportunity to respond.⁵

- In quantifying loss of profit, the arbitrator rejected both

⁴ Our summary of the five leave questions at [3] of the Federal Court’s judgment.

⁵ The Federal Court’s judgment in *Pancaran Prima*, [35], quoting the Court of Appeal’s judgment, [38].

parties' pleaded cases as unrealistic. The subcontractor sought a 25% profit margin. The main contractor suggested nominal damages because no profit had been proven.

- Instead, in ultimately awarding 10% and 7.5% profit margins for different parts of the subcontract, the arbitrator relied on his own experience that a 10%-15% margin for “*profit and attendance ... to manage a nominated subcontractor*” is “*almost a norm*” in the “*Malaysian construction industry*”.⁶
- The **Court of Appeal** viewed this finding as unsupported by evidence and uncontended by either party. Moreover, “profit and attendance”—distinct from “loss of profit”—applies to nominated subcontracts, not appointed subcontracts like the one in dispute. The arbitrator’s finding was thus a breach of the rules of natural justice, in that it was “perverse and prejudicial” to the main contractor.⁷
- Overruling the Court of Appeal’s judgment, the **Federal Court** found the **arbitrator not to have breached the rules of natural justice**. Of the numerous principles highlighted by the Federal Court, the decisive one seems to have been that an arbitrator may adopt opinions, ideas and reasoning outside parties’ pleadings and evidence unless they are not “reasonably foreseeable” to the parties,⁸ that is, they constitute a “significant surprise”.⁹

The second, under **s 42**, was the extent to which an arbitrator’s reading of documentary evidence and his valuation of works done based on that reading can be challenged as errors of law.¹⁰

- The arbitrator’s valuation was based on a figure of “28%”. In court, the main contractor contended that “28%” represented physical progress; as the subcontract required works to be valued based instead on financial progress, the arbitrator had committed an error of law. The subcontractor contended that this was a finding of fact not challengeable as a question of law.
- The Federal Court agreed with the subcontractor, **dismissing the main contractor’s application**. Recalling its earlier judgment on s 42 in *Far East Holdings Bhd v Majlis Ugama Islam & Adat Resam Melayu Pahang*,¹¹ the Federal Court reiterated that arbitrators’ findings of fact cannot be questioned by the courts. The

⁶ The Federal Court’s judgment in *Pancaran Prima*, [52].

⁷ [The Court of Appeal’s judgment in *Pancaran Prima*](#), [37].

⁸ The Federal Court’s judgment in *Pancaran Prima*, [95(i)], [97].

⁹ *ibid*, [95(j)], [97].

¹⁰ *ibid*, [3].

¹¹ [2018] 1 MLJ 1.

arbitrator had indeed applied financial delay, and so had correctly applied the law to the facts.

Implications for arbitrators, counsel and arbitral parties

It will be interesting to observe precisely how the courts reconcile the two judgments—with each other and with earlier jurisprudence. That discussion is not the focus of this update and may yet become moot if the Bar Council’s proposals to amend s 37 and reincarnate s 42 come to fruition.¹² Neither will we repeat the Federal Court’s emphasis of previously established principles under the Arbitration Act 2005.

Instead, we seek below to identify the practical implications of the two judgments in the immediate term for arbitrators, counsel and arbitral parties.

- For **arbitrators**:
 - When importing into an award ideas, expertise or personal experience **outside** parties’ pleadings and evidence, an arbitrator must put them to the parties and provide an opportunity to respond, unless certain that they are **reasonably foreseeable** to the parties.
 - However, because the threshold for reasonable foreseeability would appear in practice to be **extremely low**, an arbitrator effectively retains a very wide discretion. In *Pancaran Prima*, the Federal Court seems not to have questioned the foreseeability of “profit and attendance”—a feature of nominated subcontracts on which parties neither pleaded nor led evidence—to parties disputing “loss of profit” under an appointed subcontract.¹³
 - In this way, *Pancaran Prima* might be loosely regarded as reinforcing the public policy of **arbitral finality and minimal judicial intervention**.
- For **counsel**, given the visibly low threshold for reasonable foreseeability, prudence may demand that **pleadings and evidence**—even more than they already do—**expand to cover every conceivable angle** from which an arbitrator might plausibly approach a dispute, even if merely remotely or tangentially relevant.

¹² Reported in the [Bar Council’s Circular No 248/2020 on 5 August 2020](#).

¹³ In comparison, the Federal Court did not speak of “foreseeability” and “surprise” anywhere in *Master Mulia*, read out immediately before *Pancaran Prima*. The distinction seems intricate: “foreseeability” and “surprise” determine whether a breach is established at all (*Pancaran Prima*); “seriousness”, “materiality”, “causation” and “significance” govern whether the discretion should nevertheless be exercised only *after* a breach is established (*Master Mulia*).

- For **arbitral parties**:
 - Care must be exercised in **selecting arbitrators**, especially arbitrators with **particular expertise**. In appointing such an arbitrator, parties are taken to accept what is effectively, bluntly put, a gamble that the arbitrator may rely heavily on material or ideas other than what the parties put before him, without needing first to notify the parties.
 - Likewise, the judgments are a reminder to parties that **when entering into contracts which include an arbitration agreement**, arbitral awards, once delivered, are immensely **difficult to challenge**. How parties regard this will obviously depend on whether particular awards favour them.
 - Whether counsel will in fact now seek to “cover every base” in advancing a case (as contemplated above) remains to be seen. If so, the increased case preparation can only result in **greater costs for arbitral parties**.

The Federal Court’s grounds of each judgment can be accessed below:

- [Master Mulia Sdn Bhd v Sigur Rus Sdn Bhd](#)
- [Pancaran Prima Sdn Bhd v Iswarabena Sdn Bhd](#)

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