The effect of an arbitration agreement law commercial essay

Law

by Arunachalam KasiIt is well known that the general effect of an arbitration agreement is that the parties are bound by it just like any other agreement and hence should submit their disputes, if any arise, to arbitration for resolution. If a party institutes a legal action in breach of the agreement, then the aggrieved party may apply for stay of the court proceedings and in such event a stay is generally mandatory by virtue of the Arbitration Act 2005. Though the mandatory stay under the Arbitration Act is the most popular relief, this is not the only relief available for breach of an arbitration agreement. Relief may be available under other heads of the law, namely, Contracts Act 1950, Specific Relief Act 1950, Courts of Judicature Act 1964. There might be cases where such alternative relief becomes particularly significant because the popular mandatory stay is not available for some reason. This article purports to explore such alternative reliefs as well as relief by popular mandatory stay. 1. 1. IntroductionThe effect of an arbitration agreement is generally that the parties are bound to submit their disputes for resolution by arbitration rather than court, provided that any party insists on this right at the right stage of the proceedings pursuant to the applicable civil procedure1. It is interesting to note that an arbitration agreement does not preclude a party from instituting an action in the court. However, in such action, if any party insists on its right of arbitration at the right stage of the proceedings pursuant to applicable civil procedure then the court proceedings will generally be stayed pending resolution of the dispute by arbitral tribunal2. This is the effect of Arbitration Act 2005. It should be mentioned here that a stay does not mean in any way that the jurisdiction of the court is impugned, but it means that the court has

exercised its jurisdiction to enforce the arbitration agreement. At this point, it is interesting to note that the Singaporean legislature has explicitly endorsed this concept in the title to section 6 of their International Arbitration Act3 that provides for mandatory grant of stay in favour of arbitration agreement, which reads as "Enforcement of International Arbitration Agreement"4. The court performs supervisory role over the arbitral proceedings5, and is charged with the responsibility of recognising and enforcing the arbitral award unless there is reason not to do so, and is empowered to vary or set aside the arbitral award in appropriate cases6. Naturally, an application for stay needs to be made in the same court where the action has been instituted. If the proceedings are instituted in a foreign court, the party intending to insist on its right of arbitration would face an added difficulty in that it has to take the trouble of applying for the stay in the court of that country pursuant to the laws and procedure applicable in that country. The party intending to insist on its right of arbitration further faces the risk that the laws of that country might place him in a more disadvantageous position in procuring the stay than that in Malaysia. An alternative option that is available to the party intending to insist on its right of arbitration is to institute a separate legal action in any court of competent jurisdiction7 against party breaching or threatening to breach the arbitration agreement in order to obtain an anti-suit injunction to order in personam the defaulting party not to institute the threatened proceedings8 or to discontinue the proceedings if one was already instituted9. Having said that there are primarily two types of reliefs available in the case of beach of an arbitration agreement, namely a stay of court proceedings under the

Arbitration Act 2005 and an anti-suit injunction, it is important to appreciate that an arbitration agreement is an agreement that is subject to law of contract as much as any other agreement. It is merely that in the case of an arbitration agreement there is an additional set of arbitration laws regulating it10. This additional set of laws is supplementary to the general rules of the contract law. Accordingly, the reliefs available in the case of breach of an arbitration agreement could be found in the general rules of the contract law as well as in the supplementary laws relating to arbitration. The reliefs ordinarily available in the general contract law may be qualified by the specific laws relating to arbitration. In this article, an attempt will be made to introduce the different reliefs available in the case of an arbitration agreement by virtue of the general rules of the contract law as well as the specific rules of the arbitration law. The general rules of the contract law have been codified in two primary legislations in Malaysia, namely Contracts Act 1950 and Specific Relief Act 195011. The specific rules applicable to arbitration are found in the Arbitration Act 200512. Apart from these three statutes, another statute that has relevance in the current context is Courts of Judicature Act 1964, which inter alia preserves the inherent jurisdiction of the courts. While generally the relief by stay of court proceedings is granted by virtue of the Arbitration Act 2005, exceptionally a court may grant a stay by exercise of its inherent jurisdiction13. 1. 2. Contracts Act 1950Contracts Act 1950 is the statute providing the general contract law. It applies to all agreements including arbitration agreements. There is nothing in the Arbitration Act 2005 (or its predecessor, Arbitration Act 1952) to exclude the application of the Contracts Acts to cases of arbitration agreement. Nor is

there anything in the Contracts Act itself to exclude its application in the case of arbitration agreements. The Arbitration Act 200514 had made some provisions to supplement the Contracts Act in the case of arbitration agreements. The Contracts Act provides rules as to formation of contract by consensus of minds15, promises supported by consideration16, certainty in terms17; rules as to when a contract is voidable for reasons such as duress, fraud, misrepresentation18, and undue influence19; rules as to when a contract becomes void ex post facto for reasons such as frustration, subsequent illegality20, and avoided voidable agreement21; and rules as to when an agreement is void ab initio for reasons such as illegality22, lack of capacity23, mutual mistake of essential fact24, and impossibility25. It also provides remedies in case of breach of contract26. These rules and remedies are applicable to all agreements including arbitration agreements. These rules and remedies are not repeated in the Arbitration Act 2005, and there is no reason to repeat them, since an arbitration agreement is subject to the law of contract just like any other agreement. Section 10(2) of the Contracts Act27 expressly makes way for other legislations to impose requirement as to form such as that imposed by section 9 of the Arbitration Act 2005 in the case of arbitration agreements, which in principle requires an arbitration agreement to be in writing. Section 29 of the Contracts Act provides that an agreement that restricts a party absolutely from enforcing his rights under or in respect of any contract by the usual legal proceedings in the ordinary tribunals is invalid. However it expressly makes exception in case of arbitration agreements in its exceptions 1 and 2. These provisions have explicitly made way for the special rules in the Arbitration Act 200528 to

supplement the regulation of arbitration agreements. Having said that the Contracts Act has application to arbitration agreements, the remedy available in it for breach of contract is due for consideration now. Section 74 of the Act provides that if a party breaches his promise, the aggrieved party is entitled to damages. There is no doubt that this provision applies to also breach of an arbitration agreement. However the question is whether this remedy will be satisfactory to the claimant. The quantum of the damages generally is the amount of loss suffered by the aggrieved party out of the breach29. When the aggrieved party does not suffer loss despite the breach, then his entitlement for damages will be limited to nominal damages30. When an arbitration agreement is breached, it is hard to justify that any loss was suffered by the aggrieved party. This is because the result of the breach is merely that the mode of dispute resolution is switched from arbitration to court. Both these modes involve cost of litigation in the respective tribunals including ordinarily engagement of lawyers. In fact in the case of arbitration, a further cost of arbitrator's fee is involved. In the case of court, the risk of appeal and the resultant time delay is present. However it is hard to justify or quantify the loss suffered by this mere possibility of appeal and resultant delay. In the case of arbitration, albeit unavailability of appeal system per se, it is possible that questions of law arising from an arbitral award are referred to the court wherein the court may vary, remit back to arbitration or even set aside the arbitral award31. Further an arbitral award may be challenged in the court by an application to set it aside32 or by objection to its recognition and enforcement33, though such issues might be raised only on exceptional grounds. Accordingly, if a claim is made for damages for breach of

arbitration agreement, only nominal damages are likely to be awarded, and hence this remedy, though available to the aggrieved party, will not be attractive to any claimant and is unlikely to be claimed by any aggrieved party. 1. 3. Specific Relief Act 1950Specific Relief Act 1950 is the statute providing for specific relief34 and preventive relief (injunction) 35 with respect to contractual matters as well as non-contractual matters. The Act classifies the cases in which specific performance of contract may be granted36 and cases in which it may not be granted37. When specific performance may be granted, the Act has made it discretionary for the court to award specific performance with the provision that the exercise of the discretion should be guided by judicial principles38. The general theme of specific performance of contracts under the Act is that the remedy may be granted where damages are not adequate remedy39 or where there is no standard for ascertaining damages40. While an arbitration agreement would fall within this general theme, however a relief of specific performance under this Act of an arbitration agreement has been ruled out in its section 20(2), which reads "[s]ave as provided by the law relating to civil procedure, no contract to refer a controversy to arbitration shall be specifically enforced."This provision has not barred specific enforcement of arbitration agreements, but has merely left the matter to be regulated by special rules relating to arbitration agreement, which are in turn, at present time, found in the Arbitration Act 2005. In fact these special rules have provided far fetching remedy in case of arbitration agreement by generally making it mandatory to grant stay of court proceedings at the application of an aggrieved party41. On passing, it should be noted that the Arbitration Act

2005 is a law relating to civil procedure, since it does not provide a party's substantive rights, but it merely provides the alternative procedure and mechanism of dispute resolution and of ascertainment of parties' rights. An analogy could be made to section 14(2) of the Indian Specific Relief Act 1963, which reads '[s]ave as provided by the Arbitration Act, 1940 (10 of 1940), no contract to refer present or future differences to arbitration shall be specifically enforced ...' It is understood that such specific reference to an Arbitration Act could not have been made in our Specific Relief Act 1950, because our first Arbitration Act was only enacted two year later in 1952. Apart from specific enforcement of contracts (which is not available in the Specific Relief Act 1950 in the case of arbitration agreements), the Act also provides for preventive relief (injunction). Unlike specific performance, there is nothing to prevent an injunction being granted under the Act in support of an arbitration agreement. Accordingly, this relief is due for consideration now. The Act provides two types of preventive injunctions42 that may be granted43. The first type is a temporary one and the second is perpetual. Temporary injunction is an interlocutory order to preserve the status quo pending determination of some issue by the court. Temporary injunction does not determine the rights and obligations of the parties, and is not a remedy44. Perpetual injunction is a permanent injunction granted after hearing the merits of the case and determines the rights and obligations of the parties, and accordingly is a remedy45. Hence what is of interest in the context herein is only perpetual injunction. Section 52(1) allows the court to grant a perpetual injunction, at its discretion, to prevent breach of an obligation. An obligation may be contractual or non-contractual. Prevention

of a breach comprises prevention of a breach that that has already taken place and is continuing46 as well prevention of an anticipatory breach47. Section 53 further permits the court to grant a mandatory injunction when it is necessary to prevent a breach of an obligation. In the context of arbitration agreement, when a breaching party threatens to institute legal action, the aggrieved party may apply to the court for a preventive injunction under section 52(1), and where the breaching party has already instituted legal action, the aggrieved party may apply to the court for a mandatory injunction directing the breaching party to take due steps to discontinue or halt the action by virtue of section 53. The injunction48 is commonly known as "anti-suit injunction". The injunction operates in personam against the party whom it is issued against, and not in rem, that is, not against the foreign court49. In this context, it should be noted that section 54(b) provides "[a]n injunction cannot be granted to " (b) to stay proceedings in a court not subordinate to that from which the injunction is sought." Typically such an injunction will be sought when a party institutes or threatens to institute legal action in a country other than that where the injunction is sought50. Accordingly when such an injunction is sought in a Malaysian High Court to prevent an action being instituted or continued in another country, section 54(b) will not be applicable since there is no question of whether the foreign court is subordinate to our High Court, each being situated in different jurisdictions. The remedy of preventive injunction is granted at the discretion of the court. Apart from the considerations of all relevant matters as between the parties, some special considerations become relevant in the case of an anti-suit injunction. When action has

already been instituted in a foreign court, the injunction might offend international comity and cause interference into proceedings at a foreign. The court will also have to take into consideration the current stage of the proceedings at the foreign court. A further issue with any anti-suit injunction (whether the action is instituted already or merely threatened to be instituted) is the question of whether the defendant is amenable to the jurisdiction of the court that grants the injunction in personam against the defendant51. Yet another important consideration is whether there is sufficient justification why the applicant opts to apply for the injunction rather than apply for stay of proceedings in the court in which the legal action is instituted or threatened to be instituted. As with any injunction, a balancing exercise would be undertaken between the hardship caused by grant of the injunction and the hardship caused by refusal to grant the injunction. The fact that the foreign proceedings are oppressive and vexatious would afford a strong reason to support an application for the injunction. In totality, the court would have to act with great caution in granting the injunction. Generally a court would grant the injunction only when the ends of justice require the same52. 1. 4. Arbitration Act 2005Section 10 of Arbitration Act 2005 provides for grant of stay of court proceedings at the application of an aggrieved party. Section 10(1) of the Arbitration Act 2005 readsA 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. Section 10(1) has generally made it mandatory53 for the court to grant stay of court proceedings at the application of a party. However this is subject to satisfaction of the requisites for application of section 10(1). The first requisite is as to the seat of arbitration. The arbitration must be a domestic one where the seat of arbitration is in Malaysia54 or an international one irrespective of where the seat of arbitration is55. At the outset one might think that a domestic arbitration is one where the seat of arbitration is in Malaysia and an international arbitration is one where the seat is not in Malaysia. However it is not so, but it is quite a complex matter. The effective result of classification of arbitration in section 3 is that arbitration is generally a domestic one where all the parties to the arbitration agreement have their places of business in Malaysia, quite irrespective of where the seat of arbitration is. It is generally an international one where any party has its place of business in any country other than Malaysia, again quite irrespective of where the seat of arbitration is. All non-commercial arbitrations are generally considered domestic. The second requisite is that the subject matter is arbitrable, that is, the arbitration agreement is not contrary to public policy56. The third requisite is that the party applying for the stay has not taken any other step in the legal proceedings57. The forth requisite is that there is a valid and operative arbitration agreement that is capable of performance58. Section 10(1) of the Arbitration Act 2005, as originally enacted, explicitly contained a fifth requisite namely that there should be a dispute59 between the parties for reference to arbitration. However the explicit words requiring this requisite in section 10(1) was removed through the amendment to Arbitration Act 2005

by Arbitration (Amendment Act) 201160. However the fact that it was removed does not mean that the requisite is no longer present61. In fact this requisite is inherently present in the section 9 definition of arbitration agreement, which defines an arbitration agreement as “an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them ””62A stay is akin to, but not exactly, specific performance of the arbitration agreement. It is quasi specific-performance. This is because if the agreement was specifically enforced, then the legal action instituted pre-maturely without prior resolution by the arbitral tribunal would be struck off63 rather than stayed. In fact such position is taken in Sri Lanka64 and Thailand65, where the legal action would be struck off. The result is that the actions are struck off in those jurisdictions. Such result can lead to absurd consequences. When the matter is subsequently submitted to arbitration, the arbitral tribunal will decide on its jurisdiction. If it decides that it does not have jurisdiction, then the action would have to be re-instituted in the court. The situation will be exaggerated if the action is time-barred by the time the arbitral tribunal decides that it has no jurisdiction. In any case, the stay under the 2005 Act is a better remedy to the aggrieved party than an ordinary specific performance for reason that the stay is generally mandatory while specific performance is discretionary66. A stay operates in rem since it stays the proceedings before the court rather than merely ordering a party not to proceed with the action. 1. 5. Courts of Judicature Act 1964In the case of a domestic arbitration whose seat is in another country or whose seat is not determined yet, a stay under section 10(1) stay would not be available67. An example would be a

case where the all the parties have their places of business in Malaysia and they have entered into an arbitration agreement whereby the seat of arbitration is not determined yet or is in another country, then a stay would not be available under section 10(1)68. In such a situation if an action is instituted in a court in a Malaysia, then the court may find it prudent to exercise its inherent jurisdiction to stay the proceedings before the court69. A stay may be granted by exercise of inherent jurisdiction of the court, which is explored in the following paragraphs. This is different from the stay granted under section 10(1) of the Arbitration Act 2005. On passing, it may be noted that an anti-suit injunction would not be appropriate in such situation since it does not involve proceedings in foreign country and in fact in any case section 54(b) of the Specific Relief Act70 would bar such an injunction if the infringing action is instituted in the High Court, since the application for injunction would also be made at the High Court. The inherent jurisdiction of the court has been preserved in section 23(2) and 25(1) of the Courts of Judicature Act 1964. Sections 23(2) of the Courts of Judicature Act 1964 provides "the High Court shall have such jurisdiction as was vested in it immediately prior to Malaysia Day", which is 16th September 1963. Section 25(1) of the Act repeats a similar provision. As at the Malaysia day, which was just prior to enactment of the Act, there was no written law explicitly providing the jurisdiction of the High Court, while Part IX of the Constitution of the Federation of Malaya (1957)71 merely provided for the constitution of the judiciary and the principle jurisdiction of the Federal Court. Sections 3 and 5 of the Civil Law Act 1956 expressly provided that the English rules of equity and common law should apply where no provision has

been made in any written law in Malaysia in respect of any matter. Accordingly, the jurisdiction that the High Court in Malaysia possessed on the Malaysia day was similar to that possessed by the English High Court. At all times, the English Courts had possessed inherent jurisdiction72. The landmark case of Anton Piller KG v Manufacturing Processes Ltd73, decided by the English court in the year 1976, evidences existence at all times of inherent jurisdiction in the hands of the courts to prevent injustice or an abuse of the process of the court, beyond what was covered by the rules of court. The principle established in the Anton Piller case has been much applied in Malaysia to grant Anton Piller injunction74, evidencing exercise of inherent jurisdiction by the Malaysian court. Having asserted that the court possesses inherent jurisdiction, it is important to appreciate what is meant by "inherent jurisdiction" and its scope in some depth, so that it can be related to grant of stay by exercise of such jurisdiction. Jacob, The Inherent Jurisdiction of the Court75, describes the inherent jurisdiction of the court as including all the powers that are necessary " to fulfil itself as a Court of Law" and " to uphold, to protect, and to fulfil the judicial function of administering justice according to law in a regular, orderly and effective manner". This proposition has been cited with much support by Edgar Joseph JR J in Pacific Centre v. United Engineer76. In Asean Security Paper Mills Sdn Bhd v. Mitsui Sumitomo Insurance (Malaysia) Bhd. 77, Zaki Tun Azmi PCA in delivering the judgment of the Federal Court elaborated on the meaning of "inherent powers" and "inherent jurisdiction" as follows: What then is the meaning of inherent jurisdiction? According to the Concise Oxford Dictionary, 'inherent' means 'existing in something esp. as a permanent or characteristic

attribute'. In the context of law, that inherent jurisdiction is deemed to be part of the court's power to do all things reasonably necessary to ensure fair administration of justice within its jurisdiction subject to valid existing laws including the Constitution. In other words, that inherent power is found within the very nature of a court of law, unlike power conferred by statute. [17] The Halsbury's Laws of England, 4th Edition in volume 37 at para 12 refers to " inherent jurisdiction" as follows: In sum, it may be said that the inherent jurisdiction of the court is a virile and viable doctrine, and has been defined as being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, in particular to ensure the observance of the due process of law, to prevent vexation or oppression, to do justice between the parties and to secure a fair trial between them. In Racecourse Betting Control Board v. Secretary of State for Air78, the court asserted that it had inherent jurisdiction at its discretion to stay proceedings brought before it in breach of an exclusive foreign jurisdiction clause79. Equally the principle can be applied in the case of an action brought before the court in breach of an alternative dispute resolution clause, as demonstrated by the House of Lords in the case of Channel Tunnel v. Balfour Beatty Construction80. In this case, such a stay was granted by exercise of inherent jurisdiction in favour of the parties' agreement to refer their disputes to a panel of experts (that was however not arbitration). In this case, the court asserted that it had at all times inherent jurisdiction to stay proceedings before it in an appropriate case and that such inherent jurisdiction was independent of the statutes such as the English Arbitration Act 1979 making provision for stay and

further that such jurisdiction was not affected by enactment of the statutes. Accordingly, it can be concluded that the Malaysian courts possess inherent jurisdiction to stay proceedings before it brought in breach of an arbitration agreement, though such need would not arise except in exceptional circumstances in view of the existence of the statutory provisions. In order to invoke the inherent jurisdiction, the applicant will have to show it is just or equitable to do so and that it is necessary to prevent vexation or oppression and to do justice between the parties81. The stay operates in rem82 since it stays the proceedings before the court rather than merely ordering a party not to proceed with the action. In an extreme case, a stay may be granted by such exercise of inherent jurisdiction though the seat of arbitration is in Malaysia and accordingly section 10(1) is applicable. This is when the other requisites in section 10(1) are not satisfied for some reason, but yet the court finds it equitable and irresistible to stay the proceedings before it. An example might be where a company spirited by a board of directors not acting in good faith had filed a defence and thereby deprived the company of the stay under section 10(1). Subsequently the board is removed and replaced by a new board. The new board of directors acting in good faith might want to apply for a stay. Alternatively, a shareholder taking conduct of the proceedings by way of derivative action83 might want to apply for the stay. In such scenario, the court might exercise its inherent jurisdiction to grant the stay. Such a sympathetic situation arose in Yayasan Melaka v. Photran Corp Sdn Bhd & Anor84, though it was not in relation to grant of stay but in relation to setting aside a default judgement obtained against the victimised defendant company eight years ago. In this case, the victimised

company's earlier board of directors not acting in good faith let go the judgment in default for a sum of RM9. 2 million. This led the company to go into liquidation, and then it took the minority shareholder eight years to obtain the necessary liquidator's approval to take action in the name of the company to set aside the default judgment. The court allowed the application to set aside despite a delay of eight years85. When the court could take cognisance of the unique facts to allow a setting-aside application after eight years, it is submitted, the same could be extended to a case as that envisaged in the preceding paragraph to grant the stay by exercise of inherent jurisdiction. The fact that a stay could not be granted under section 10(1) does not restrain a court from granting a stay by exercise of its inherent jurisdiction. In Turville Health v. Chartis Insurance86, the court refused a stay under the English Arbitration Act 1996, but granted the stay under inherent jurisdiction. In fact it is quite common practice that a claimant applying for stay would ask for the stay under the statutory provisions with alternative prayer for stay inherent jurisdiction if the former one fails87.