

Stay Pending Arbitration : Too late for Stay after Judgment in Default is entered?

**TINDAK MURNI SDN BHD v JUANG SETIA SDN BHD
03-2-11/2018(B) AND 02(i)-104-11/2018(B)]**

ISSUES

There is an arbitration clause in the contract. A dispute arose between parties concerning the performance of contract. But for one reason or another, the counterparty entered judgment in default when you failed to enter appearance in the civil suit commenced against you. What now?

Would it be too late to stay the civil suit and refer the dispute to arbitration now that a judgment in default had been entered? How do you show defence on merit when the Court ought not to consider the merit of the dispute in light of the arbitration agreement?

These are some of the issues considered by the Federal Court in **Tindak Murni Sdn Bhd v Juang Setia Sdn Bhd [03-2-11/2018(B) & 02(i)-104-11/2018(B)]**.

BRIEF FACTS

The brief facts of the appeals are as follows:-

- (a) The Appellant is the employer and the Respondent is the contractor in a construction contract dated 01.06.2015 (“**Contract**”). The Contract is based on the PAM standard form of contract. There is an arbitration clause in the Contract.
- (b) On 29.01.2016, the architect issued a Certificate of Practical Completion (“**CPC**”) certifying that the works were satisfactorily completed.
- (c) The Respondent contended that the Appellant failed to make payment of RM1,702,870.37 due to it. Parties subsequently entered into negotiation but this dispute was not resolved. As a result, the Respondent issued a Notice of Determination on 29.08.2016 and gave the Appellant 7 days notice to remedy the alleged breach.
- (d) The Appellant did not respond to the Notice of Determination and the Respondent terminated the Contract pursuant to Clause 26.1(i) of the Contract.
- (e) The Respondent then commenced a civil suit and claimed payment for allegedly for work done and owing under 3 interim certificates amounting to RM2,684,924.55 (“**Civil Suit**”).
- (f) The Appellant paid the Respondent the sum of RM1,143,149.65 but maintained its disputes, amongst others, relating to material defects that warrant a set-off or complete defence to the Respondent’s claim.



- (g) However, the Appellant did not enter appearance within the prescribed time and consequently, the Respondent obtained a judgment in default against the Appellant on 01.03.2017 (“**Judgment in Default**”).
- (h) The Appellant filed a Notice of Application dated 10.04.2017 to set aside the Judgment in Default (“**JID Setting Aside Application**”) on the following grounds:-
 - (i) The Appellant has valid disputes against the Respondent’s claims; and
 - (ii) There is an arbitration clause in the Contract.
- (i) The High Court Registrar allowed the JID Setting Aside Application and set aside the Judgment in Default. Dissatisfied, the Respondent appealed to the Judge in Chambers.
- (j) Meanwhile, the Appellant filed an application for stay pending arbitration on 10.08.2017 (“**Stay Pending Arbitration Application**”).
- (k) On 14.11.2017, the Judge dismissed the appeal against the JID Setting Aside Application and allowed the Stay Pending Arbitration Application.
- (l) The High Court Judge found that there was a defence on merits as there are issues / disputes of facts that require determination at trial and that there is a valid arbitration clause to warrant a stay pending reference to arbitration.
- (m) Dissatisfied, the Respondent appealed to the Court of Appeal against both the decisions. The Court of Appeal approached the appeals by starting with the appeal on the JID Setting Aside Application. Only after that, the appeal on the Stay Pending Arbitration Application was considered.
- (n) On 03.05.2018, the Court of Appeal allowed both appeals and in effect:-
 - (i) Granted judgment in favour of the Respondent on the ground that there was no defence on merits;
 - (ii) Refused to stay the Civil Suit pending arbitration.
- (o) The Appellant then obtained leave to appeal to the Federal Court.

FEDERAL COURT

The Federal Court heard both appeals on the JID Setting Aside Application and Stay Pending Arbitration Application on the following questions of law:-

- “1) *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?*
- 2) *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, allowed both appeals and restored the decisions of the High Court.



STARTING POINT

The Federal Court noted that the “*starting point*” in approaching the appeals is to ascertain if there is a valid arbitration agreement. When confronted with an application for a stay pending arbitration under section 10 of the Arbitration Act 2005 (“**AA 2005**”), “*the first step is to ascertain whether there is in fact an agreement to arbitrate in respect of the dispute in question.*”

Factually, the Federal Court finds that there is a valid arbitration agreement under clause 34 of the Contract.

WOULD IT MAKE A DIFFERENCE IF A JUDGMENT IN DEFAULT HAS BEEN OBTAINED?

The Federal Court then asked the following question:-

“47. In the instant appeals the more pressing question might well be whether the position is any different where one of the contracting parties, the Contractor here, had obtained judgment in default in court proceedings, notwithstanding the arbitration clause.”

The Federal Court finds that a judgment in default obtained, should not make any difference in so far as the application for a stay pending arbitration is concerned, for the following reasons:-

- (1) Section 10 of the AA 2005 applies notwithstanding the judgment in default.

*“Therefore from the statutory perspective, even when a judgment in default has been procured, **section 10** remains applicable. This in turn means that the Court is bound to consider the matters set out in (a), (b) and (c) **notwithstanding the 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.”*

- (2) The Respondent is in breach of the arbitration agreement by commencing the Civil Suit and cannot now rely on its own breach to “*impugn or subordinate the agreement to arbitrate*”, when the innocent party, i.e. the Appellant has “*by conduct clearly evinced an intention to be bound by the contract, namely to have the dispute referred to arbitration.*”
- (3) If the commencement of the Civil Suit, which is in breach of the arbitration clause / agreement is condoned, “*it would effectively render that agreement nugatory*” and “*intention of the parties at the point in time when the contract was concluded would be effectively undermined.*”
- (4) Whether the dispute ought to be dealt with by way of litigation or arbitration is an “*essential jurisdictional issue*”, which the Court is bound to consider and this “*could only have been done if the Court of Appeal had considered the form and substance of the appeals in totality and appreciated the significance of both applications*”. Notwithstanding that they are separate applications, these applications are “*inextricably intertwined.*”
- (5) The Federal Court also finds that the jurisdictional issue “*was a relevant consideration even when determining the appeal relating to the setting aside of the judgment in default because the fact of the subsistence of the arbitration agreement, a jurisdictional issue, amounted to a matter warranting further investigation. In other words it afforded a defence on the merits.*”



Following the above, the Federal Court finds that:-

“49. In all these circumstances it therefore remained incumbent upon the Court, notwithstanding the initiation of the civil suit by the Contractor, to carry out its function as set out in section 10, namely to refer the dispute to arbitration unless the arbitration agreement is null, void or inoperative. The court carries out its prescribed statutory duty by ascertaining:

- (a) whether there is an agreement to arbitrate the dispute;*
- (b) whether the arbitration agreement is valid or null, void or inoperative;*

Having done so, the following consequences ensue from section 10:

- (a) If there is a valid agreement to arbitrate then the court must refer the dispute to arbitration;*
- (b) If the agreement to arbitrate is null, void or inoperative then the matter/suit need not be referred to arbitration.”*

Having found that there is a valid arbitration agreement and that such agreement is not null, void or inoperative, the Federal Court allowed the appeals and reinstated the High Court’s decisions to set aside the Judgment in Default and stayed the proceedings pending reference to arbitration.

MOVING FORWARD

Following the decision, it is important to note that:-

- (a) The entering of a judgment in default is not a bar to stay the proceedings pending arbitration pursuant to section 10 of AA 2005 when there is a valid arbitration agreement that is not null, void or inoperable;
- (b) When there is both an application to set aside a judgment in default as well as an application for a stay pending arbitration, the application for a stay pending arbitration ought to be dealt with first before the application to set aside the judgment in default;
- (c) Even if the application to set aside the judgment in default is to be dealt with first, the existence of the arbitration agreement *“coupled with section 10 of the Arbitration Act 2005 warranted the conclusion that this amounted to a defence on the merits”* and *“the judgment in default ought to have been set aside and the matter referred to arbitration in accordance with the statutory requirements of section 10.”*

CONTACT



ANDREW HENG YENG HOE
Partner

+6012 205 8413

andrew@zainmegatmurad.com

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ZAIN MEGAT & MURAD

Advocates & Solicitors
D2-5-1 to D2-5-3A, Block D
Solaris Dutamas No.1, Jalan Dutamas 1,
50480 Kuala Lumpur, Malaysia

+6 03 6207 9331

+6 03 6207 9332

zmm@zainmegatmurad.com