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Refusal to pay: An act of repudiation of arbitration agreement

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Refusal to pay: An act of repudiation of arbitration agreement

Tan Sri Dato' Cecil W M Abraham, **Aniz Ahmad Amirudin** and **Shabana Farhaana Amirudin**

Cecil Abraham & Partners

Summary

IN SUMMARY

This article examines the present stance adopted by Malaysian courts in dealing with recalcitrant respondents attempting to stifle determination of disputes by seeking a stay of court proceedings and refusing to pay arbitral institution deposits. Specifically, the article explores the implications for the enforceability of arbitration agreements in such circumstances.

DISCUSSION POINTS

- Effect of refusing to pay one's share of the arbitral institution's fees on the enforceability of the arbitration agreement
- Is praying for both striking out and, alternatively, stay of proceedings pending arbitration a fail-safe mechanism?

REFERENCED IN THIS ARTICLE

- Sections 10, 19(1), 19(2)(e), 21(3)(d) and 21(3)(i) of the Arbitration Act 2005
- Order 18 Rule 19(1)(a), (b), (c) and (d) of the Rules of Court 2012
- *JSB v ACSB*
- *Kebabangan Petroleum Operating Co Sdn Bhd v Mikuni (M) Sdn Bhd & Ors*
- *Press Metal Sarawak Sdn Bhd v Etiqa Takaful Bhd*
- *Lion Pacific Sdn Bhd v Pestech Technology Sdn Bhd*
- *BDMS Ltd v Rafael Advanced Defence Systems*
- *PP Persero Sdn Bhd v Bimacom Property & Development Sdn Bhd*
- *Sotella Fund Pte Ltd v Lextrend Sdn Bhd & Ors*
- *Perunding Kinakota Sdn Bhd v Kinta Samudra Sdn Bhd & Ors (Kinta Samudra Sdn Bhd & Anor, third parties)*

A conundrum often faced in arbitral proceedings is when a respondent refuses to pay its share of the fees and the associated costs thereto to the respective arbitral institution without any valid reason. While the claimant may attempt to refer the dispute before a court of law rather than electing to solely fund the arbitration, such attempt is easily frustrated by the recalcitrant respondent by seeking a stay of the court proceedings pending arbitration under section 10 of the Arbitration Act 2005.

The claimant is thus placed in a difficult situation where the only possible way to have the dispute determined is by bearing the entire costs or fees, or both, of the arbitration and to claim the same at the end of the proceedings if the claims succeeds. Factors such as the significance of the claim amount, the presence of a counterclaim and whether the counterclaim includes inflated claims only serves to compound the issue, as the fees and costs are calculated based on the total value of the claims referred to the arbitral tribunal for determination.

This is notwithstanding the fact that a successful enforcement of an arbitral award and claiming the costs awarded therein comes with its own share of issues, especially when dealing with a recalcitrant respondent.

However, all hope is not lost for the claimants, as recent decisions of the Court of Appeal appear to be the light at the end of the tunnel for this conundrum. In ***JSB v ACSB***,[1] the court echoed its earlier finding in ***Kebabangan Petroleum Operating Co Sdn Bhd v Mikuni (M) Sdn Bhd & Ors***[2] that deliberate non-payment of deposits due to an arbitral institution renders an arbitration agreement inoperative.

JSB V ACSB

A dispute arose from a construction contract wherein ACSB was appointed by JSB as the main contractor for a project. In accordance with the arbitration agreement therein, JSB commenced arbitration against ACSB, which was administered by the Asian International Arbitration Centre (AIAC). The arbitration was still at the preliminary stage of settling pleadings when a second tranche of further deposits was required by the AIAC. However, ACSB refused to pay the further deposits which left JSB with two options, namely, to make the payment on ACSB's behalf or to continue with its claim without paying ACSB's share of the deposit. The latter of which would only allow ACSB to defend the claim without being allowed to proceed with its counterclaim and indemnity claims against a third party.

JSB, however, declined to pay ACSB's portion of the deposit and sought to terminate the arbitration on the basis that the arbitration agreement had become inoperative. The entire arbitration proceedings were accordingly terminated by the arbitrator. Subsequently, JSB filed a claim in the High Court, but ACSB objected, contending that the arbitration agreement remained valid despite the non-payment of the latter's share of the AIAC's deposit.

ACSB proceeded to file an application pursuant to Order 18 Rule 19(1)(a), (b), (c) and (d) of the Rules of Court 2012 to strike out JSB's writ and statement of claim, or alternatively, prayed for a stay of court proceedings under section 10 of the Arbitration Act 2005. The learned High Court Judge held in favour of ACSB and distinguished the principles laid out in ***Kebabangan Petroleum***. Essentially, it was held that:

- unlike the respondent in ***Kebabangan Petroleum***, ACSB had actively participated in the arbitration proceedings and was prepared to defend the claims notwithstanding its loss of opportunity to proceed with its counterclaim. The arbitration agreement was thus not inoperative; and
- despite filing a striking out application, ACSB had not taken any steps in the court proceedings as a perusal of the prayers therein clearly indicated that the court was not invited to determine the merits of the case unlike the facts of ***Kebabangan Petroleum***-[3]

Aggrieved with the decision of the High Court, JSB appealed to the Court of Appeal. The key issues raised were:

1. whether ACSB, by applying to strike out the High Court suit, had invoked the court's jurisdiction and initiated fresh steps in the proceedings;
2. whether the arbitration agreement had become inoperative under section 10 of the Arbitration Act 2005 due to ACSB's refusal to pay its share of the AIAC's deposit; and
3.

whether staying the court proceedings would be futile given ACSB's adamant refusal to pay the deposits.

This article will primarily focus on issues (2) and (3) above.

EARLIER DECISIONS OF THE MALAYSIAN COURTS

Before delving into the issues raised in *JSB v ACSB*, it is important to have an understanding of what was the initial position in Malaysia insofar as the said conundrum is concerned.[4]

It is settled law that under section 10 of the Arbitration Act 2005, the court has no discretion but to make an order for a stay of proceedings once there is an arbitration agreement unless it is established that the agreement is null and void, inoperative or incapable of being performed. However, when it came to dealing with a party's wilful refusal to pay its share of the arbitration fees and costs, the courts were initially not inclined to hold that such actions were acts of repudiation of the arbitration agreement.

For instance, the High Court allowed a stay of proceedings in *Lion Pacific Sdn Bhd v Pestech Technology Sdn Bhd*[5] and refused to impose any conditions to the effect of forcing the respondent to make the necessary deposits to the arbitral institution. It was held that the risk of an arbitration being stalled could be avoided by making the payment on behalf of the respondent, which could then be recouped in the arbitral award subsequently if the claim is eventually decided in favour of the claimant.

While the English case of *BDMS Ltd v Rafael Advanced Defence Systems*[6] was not referred to in *Lion Pacific Sdn Bhd*, the principle that non-payment of deposits does not render an arbitration agreement inoperative and that a stay ought to be granted in such circumstances appeared to be somewhat maintained.

CURRENT POSITION IN MALAYSIA

The first decision to clarify this conundrum to some extent was *Kebabangan Petroleum*. The facts of this case were similar in that the respondent had unreasonably delayed its portion of deposits due to the arbitral institution and failed to respond to the letters issued to this end. Such conduct on the part of the respondent was taken to connote that the respondent was disinterested and had unequivocally abandoned its rights under the arbitration agreement. The Court of Appeal thus held that the arbitration agreement was inoperative.

Turning to the case of *JSB v ACSB*, two issues arose for determination in this respect namely: whether the arbitration agreement had become inoperative under section 10 of the Arbitration Act 2005 due to ACSB's refusal to pay its share of the AIAC's deposit; and whether staying the court proceedings would be futile given ACSB's adamant refusal to pay the deposits.

Issue 1: Whether The Arbitration Agreement Became Inoperative By Reason Of Non-payment

It was provided in the construction contract that the arbitration shall be by an arbitrator appointed by the Director of the AIAC and that it shall be conducted in accordance with the rules for arbitration of the AIAC using the facilities and system available therein. Therefore, the Court of Appeal held that compliance with an arbitration agreement would also include compliance with the applicable arbitral institution rules that the parties have agreed to abide by therein.

The Court of Appeal further condemned the contumelious conduct of a non-paying party by stating, inter alia, that:

> "The defendant cannot in all honesty say and indeed it would be hollow, for it to say that it is committed to having the dispute that has arisen between the parties to be resolved through arbitration and yet not be willing to abide by the Rules governing the arbitration to pay its share of the AIAC's Deposit which includes the arbitrator's fees.
>
> It becomes more disturbing when the argument for not paying the AIAC's Deposit is justified on the ground that it has a choice not to and that there can be no adverse consequences that would befall it as its commitment to the arbitration proceedings has always been firm and remains unchanged.
>
> …
>
> For as long as the arbitration proceedings continue under the financing of the paying party, the refusing party would just have to ride on the goodwill of the paying party. We can think of no more belligerent action on the part of the refusing party to inflict suffering and punishment on the paying party and to expose it to greater risk of inability to recover the fees paid on its behalf in the award of costs.
>
> To say that such an action on the part of the refusing party is a perfectly proper strategy to adopt in an arbitration with no fear of adverse consequences would be to give applause and approval to such an unsavoury act.
>
> …
>
> We can think of no better strategy to adopt to bring the Arbitral process and proceedings into disrepute. The refusing party's action in not wanting to pay its share of the AIAC's Deposit simply by saying it is not keen to and that it has a choice not to, must be exposed and excoriated for what it truly is: a subtle but sly strategy to scuttle the arbitration with impunity for the other party would have no choice but to pay the refusing party's share of the AIAC's Deposit if it has more to lose by not continuing with the arbitration.
>
> …
>
> Little wonder that the expression 'breach of the arbitration agreement' is not used in s 10 of the AA 2005 or for that matter anywhere in the AA 2005 but rather the arbitration agreement is 'null and void, inoperative or incapable of being performed.' It would be fair for us to surmise that the test to be applied for the arbitrator to decide on whether to stay or terminate the arbitral proceedings would be whether the arbitration agreement has become inoperative through the refusal of one party to pay its share of the arbitrator's fees and that it has waived its right to arbitration when it refuses to comply with the applicable AIAC Arbitration Rules which has been incorporated as a term of the arbitration agreement under Clause 66.3 of the PWD 203A Contract.
>
> …

> There is no clearer means of rendering an arbitration agreement inoperative than a simple but stubborn refusal of a party to pay its share of the administrative body's deposit for no other reason than it does not want to, though couched euphemistically as a commercial decision[7]
>
> ...
>
> As the other party is prepared to proceed with litigation seeing that the defendant is stalling arbitration by its stoic stand not to pay its share of the arbitrator's fees, it has no cause for complaint if it no longer enjoys party autonomy and confidentiality of the arbitral process and finality of the arbitral award. That is a detriment which the other party is prepared to accept and so those living in glass houses must be careful not to throw stones.[8]"

The first issue was thus answered in the affirmative and the Court of Appeal reiterated the position taken in ***Kebabangan Petroleum***. It was further clarified that offering an opportunity to the other party to pay the refusing party's share of the deposit does not convert the option into an obligation. Non-defaulting parties were also reminded that apart from seeking a termination of the arbitration proceedings, an application may be made under sections 19(1) and 19(2)(e) of the Arbitration Act 2005 to seek an adequate amount as security for costs. Failure to comply with the ordered amount for security for costs, if any, could result in the arbitral tribunal prohibiting the refusing party from pursuing or defending the claim or counterclaim in accordance with the powers given to the arbitral tribunal under sections 21(3)(d) and (i) of the Arbitration Act 2005.

Issue 2: Whether A Stay Of The Court Proceedings Would Be Futile In Light Of The Respondent's Refusal To Pay The Deposits

In its decision, the Court of Appeal refused to grant a stay of proceedings pending arbitration having duly considered the following:

- the respondent's failure to challenge the arbitrator's order to terminate the arbitration suggests an acceptance of this outcome;
- what initially began as a mutual obligation to contribute equally to the arbitration deposit morphed into a situation where the respondent adamantly asserted its right to refrain from paying the deposit required for the AIAC's arbitration process;
- it was therefore foreseeable that if the court were to grant a stay in favour of arbitration, the respondent would likely continue to refuse payment, leading to the termination of the arbitration proceedings by the newly appointed arbitrator;
- consequently, the claimant may elect to reinstate the court proceedings or file a fresh suit, to which the respondent might object or seek another stay;
- granting a stay under such circumstances would be futile, as it would perpetuate the impasse and allow the respondent to hold the claimant to ransom, compelling payment of its share of the AIAC's deposit to proceed with arbitration;
- moreover, the doctrine of estoppel applies to parties' conduct before an arbitral tribunal, where non-compliance with rules may affect the continuation of proceedings. The refusal of the respondent to pay its share of the AIAC's deposits would unjustly burden the claimant with all expenses, contrary to the parties' agreement in the arbitration agreement; and

- in such instances, pursuing litigation in court, rather than arbitration, becomes a viable option. Despite the advantages of arbitration, such as party autonomy and confidentiality, these considerations diminish when one party obstructs the arbitration process.

Ultimately, the Court held that granting a stay would only prolong the impasse and undermine the claimant's efforts to resolve the dispute expeditiously. Therefore, the Court of Appeal concluded that a stay of proceedings would be futile and would not serve the interests of justice.

SEEKING TO STRIKE OUT OR STAY A CIVIL SUIT: A FAIL-SAFE MECHANISM?

The decision of *JSB v ACSB* is further instructive in terms of providing clarity on whether a party ought to pray for striking out a civil suit in addition to seeking a stay in the alternative.

For completeness, section 10(1) of the Arbitration Act 2005 provides:

> "A 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."

The Court of Appeal reminded that this issue was not new as it had been considered since 1999 under the previous section 6 of the Arbitration Act 1952 in *PP Persero Sdn Bhd v Bimacom Property & Development Sdn Bhd*.[9] Abdul Malik Ishak J (later JCA) upheld the senior assistant registrar's decision to strike out the defendant's application for including a prayer for striking out the plaintiff's writ in the defendant's stay application. Further, the recent decision in *Kebabangan Petroleum* in holding that the applicant therein was blowing hot and cold when it failed to make an election as to whether to challenge the jurisdiction or invoke the court's jurisdiction to hear the merits of the case, was cited with approval.

The decision of the court at first instance was overruled as invoking the jurisdiction of the court to strike out the claim on the ground that it was scandalous, frivolous and vexatious would certainly require the court to determine the merits of the case. The Court of Appeal further endorsed the approach taken by the full bench in the Singaporean Court of Appeal in the case of *L Capital Jones Ltd and another v Maniach Pte Ltd*, wherein the following was held:

> "In this case, given the several steps that JtGGH took to advance its striking out application on the merits, it cannot be said that JtGGH did not take a step in the proceedings just because it decided not to pursue its striking-out application at the last moment. But even assuming that JtGGH had not yet filed any affidavits or submissions in support of its striking out application, we would have been inclined to hold that the very act of filing an application to strike out the suit on its merits would have constituted a step in the proceedings because, as we have noted at [78] above, this was an invocation of the court's jurisdiction. Once such a step is taken, it will generally be irrevocable. Even if the application is subsequently withdrawn, or the party indicates that it no longer wishes to

> prosecute the application, that cannot change the fact that a step has been taken under s 6(1) of the IAA.[10]"

The Court of Appeal thus held that by including a prayer for striking out the claimant's claim, the respondent was inviting and invoking the jurisdiction of the Court to hear the claim on its merits. By 'having submitted and surrendered to the court's jurisdiction, it has succumbed to it under its spell; it can no longer escape from it but swim or sink within its system. It is unlike a fail-safe mechanism where in the event of a specific failure in striking out, there is the alternative route of little impact in a stay of the proceedings'.[11] The respondent was thus held to have waived its right to arbitration and could no longer switch to arbitration to resolve the dispute.

While parties have historically considered, and still do, seeking both a stay and a striking out alternatively as a precautionary measure, the case of *JSB v ACSB* illustrates that these requests are mutually exclusive. One seeks to challenge the court's jurisdiction, while the other appears to invoke it. When a party chooses to invoke the jurisdiction of the court by filing a striking out application, such action shall be deemed as having taken a step in the proceedings. Consequently, the party forfeits its eligibility to seek a stay under section 10 of the Arbitration Act 2005.

It is nevertheless interesting to note that *Kebabangan Petroleum* was relied by the High Court in *Sotella Fund Pte Ltd v Lextrend Sdn Bhd & Ors*[12] in holding that the requirements under section 10 of the Arbitration Act 2005 were not fulfilled as there were steps taken by the defendant in filing a striking out application at the same time as filing the stay application. Whereas the High Court held in *Perunding Kinakota Sdn Bhd v Kinta Samudra Sdn Bhd & Ors (Kinta Samudra Sdn Bhd & Anor*, third parties)[13] that praying for the setting aside of a third-party notice as an alternative in a stay application neither amounted to taking a step in the proceedings nor an unequivocal intention to proceed with the third-party notice and abandoning the right to have the dispute referred to arbitration.

CONCLUSION

The decision in *JSB v ACSB* appears to be on par with the position in the United Kingdom as set out in *BDMS Ltd*[14] in that a party's failure to pay its portion of the deposit constitutes a breach of the arbitration agreement. However, divergence arises in interpreting whether such a breach is repudiatory. In cases such as *Kebabangan Petroleum* and *JSB v ACSB*, the breach was deemed repudiatory, whereas in BDMS Ltd, it was not. A significant factor influencing this disparity could be the existence of arbitration rules allowing one party to cover the other's share of the deposit, potentially mitigating the severity of the breach, as seen in BDMS Ltd.

Although it is now clear that a party's deliberate failure to pay its share of the advanced deposit constitutes a breach of the arbitration agreement, deeming it as repudiatory would necessitate a comprehensive investigation into the facts of the particular case. To further clarify the legal landscape surrounding repudiation of an arbitration agreement by reason of non-payment, it would be essential to examine how the principles set out in *JSB v ACSB* continue to be applied in future cases and whether a ruling is handed down to this end by the Federal Court in the interim.

Endontes

[1] [2024] 1 MLJ 195.

[2] [2021] 1 MLJ 693.

[3] [20222] MLJU 3058, see paragraphs 47 to 54.

[4] See *Press Metal Sarawak Sdn Bhd v Etiqa Takaful Bhd* [2016] 5 MLJ 417.

[5] [2022] MLJU 108.

[6] [2014] EWHC 451 (Comm).

[7] See paragraphs 42 to 54.

[8] See paragraph 80.

[9] [1999] 6 MLJ 1.

[10] See paragraph [83] of *L Capital Jones Ltd and another v Maniach Pte Ltd* [2017] SGCA 3.

[11] See paragraph [25] of *JSB v ACSB*.

[12] [2023] MLJU 2299.

[13] [2022] MLJU 3324.

[14] [2014] EWHC 451 (Comm).

Tan Sri Dato' Cecil W M Abraham cecil@cecilabraham.com
Aniz Ahmad Amirudin aniz@cecilabraham.com
Shabana Farhaana Amirudin shabana@cecilabraham.com