Malaysian-German Chamber of Commerce and Industry
Deutsch-Malaysische Industrie- und Handelskammer

Arbitration in Malaysia (as of March 2020)

1. What is Arbitration?

Arbitration is an alternative form of dispute resolution. It distinguishes from mediation in that there is an ultimate decision-maker - which boasts much of the competencies a presiding judge would have in a lawsuit before a proper court of law. In arbitration however, the decision-maker is not a government appointed officer of state, assigned to the disputants by the statutory rules of procedure. Rather, the parties have to agree on the persons that are tasked to resolve their dispute. In contrast to judges, arbitrators act in a private capacity. Arbitration is a private endeavour.

Many legal orders, the Malaysian and German among them, acknowledge rulings by arbitrators – also referred to as award – and even enforce them as if they were judgements rendered by a court.

2. Why Choose Arbitration in Malaysian-German Business Settings?

a. Disadvantages of Litigation

Even though the judiciary and the legal systems of Malaysia and Germany are well established, trustworthy and reliable, courts of law, in international settings, may not always be the best forum to have a legal dispute resolved.

One obvious reason is that one of the parties will always run the risk of being burdened to navigate an unfamiliar legal order and to conduct proceedings in a foreign language. Thus, one of the parties will always be initially disadvantaged.

Enforcement of judgements in a foreign country can also be time consuming and ambiguous. For example, enforcing German judgments in Malaysia is not straight forward as Germany and Malaysia have not entered into a treaty, according to which they would recognise and enforce each other's judgements. Germany is not listed in the Reciprocal Enforcement of Judgments Act 1958 (REJA) and thus, German judgements can only be introduced as cause of action for a separate and new trial, and be enforced only indirectly. Note that that will only be the case if the German judgement is a monetary judgement that amounts to a specified sum. Filing a new suit is not only time-consuming and generates expenses – it is always associated with the risk of losing. Enforcement itself might rarely be necessary; however, it is important to note that it is the enforceability that makes the debtor compliant, making this property essential.

In comparison to litigations, they are governed and conducted by the rules of procedure. This results in little flexibility as to how, when and where the proceedings will take place. Given that

court trials are principally held in public, this kind of exposure might be unfavourable to public companies or individuals as it could cause them negative publicity. Thus, it can be seen that arbitration would be a much better choice for companies.

b. Advantages of Arbitration

Arbitration is founded on the principle of party autonomy, which is carried by the rationale that the parties themselves know best what suits their needs. Parties are able to choose and define the rules and the language by which the arbitration is to be conducted, which provides a level playing ground. Proceedings can be held however the parties see fit and they do not even have to be held in Malaysia or Germany (assuming that the parties are Malaysian and German). Hence, the obvious advantage is that the entire dispute remains confidential between the parties as arbitration is of private nature.

Further, enforcing arbitral awards in Malaysia is less onerous and limited than enforcing German judgement. As a signatory to the New York Convention[1] (NYC) and an adaptor of the UNCITRAL Model Law[2] (ML), Malaysia is a very arbitration friendly nation which fully recognizes and enforces arbitral awards principally, be they foreign or local.

As there is no appeal or review in arbitration, obtaining a final decision through arbitration is much faster as compared to litigation because arbitrations are single procedures. Summing all up, it can be concluded that the advantages far outweigh the disadvantages.

3. Private vs Institutionalised Arbitration

As arbitration is a private matter, it is the parties' responsibility to organize everything that is needed to conduct the arbitration. Examples are organising the facilities of arbitration and everything that is associated with it, and providing a set of rules by which the arbitration is conducted – basically, the nuts and bolts of arbitration.

While parties are free to organize their arbitration on their own, there exists arbitration institutions which offer services in assisting the parties. These services range from providing basic facilities (such as rooms and amenities for the arbitral hearings) to fully-managed arbitration, which is ultimately known as the institutionalized arbitration. Note that the most important service is that these institutions provide rules of procedure which have stood the test of time and they have been proven to be effective and reliable – which use is strongly recommended. Find the institution that serves your interest well.

The biggest and most renowned arbitration institution in Malaysia is the Asian International Arbitration Centre (AIAC), which is formerly known as Kuala Lumpur Regional Centre for Arbitration (KLRCA). Its German counterpart is the Deutsche Institution für Schiedsgerichtsbarkeit (DIS).

Of course, there are many more arbitration institutions to choose from. Choosing an arbitration institution depends on many factors and require an assessment of the specific situation. Yet,

[1] United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958).
[2] UNCITRAL Model Law on International Commercial Arbitration.

as a general guidance, the AIAC seems suitable for German companies conducting business in Malaysia for various reasons, one of them being that the Malaysian courts are very familiar with AIAC and their rules.

4. The Applicable Laws and their Application in Malaysian Courts

As arbitration is of private nature and that arbitrators lack governmental authority, court assistance will be required, for example, when summoning witnesses. The key to arbitration is that courts intervene into the arbitration as little as possible and only if necessary.

Arbitrations that are seated in Malaysia are governed by the Arbitration Act 2005 (AA), which is a very faithful adoption of the ML. Whereas, arbitrations seated outside of Malaysia are governed by the NYC. Courts must apply the AA and NYC accordingly and be true to the spirit of the ML and the Convention. It is therefore safe to say that Malaysia can be regarded as an arbitration friendly nation.

Procedural rules which the parties have chosen will be applicable to the arbitration. For example, when the AIAC is selected to govern the arbitration, the AIAC Arbitration Rules (AIAC-Rules), which incorporate UNCITRAL Arbitration Rules (UNCITRAL-Rules), apply.

5. The Arbitration Agreement

The most fundamental part of an arbitration is the arbitration agreement. The jurisdiction of the courts is ousted and the jurisdiction of the arbitrators is established – only if the agreement is valid. Arbitration agreements are typically included in the parties' business contracts or their other agreements.

The arbitration clauses must govern all disputes (if possible) which arise out of or are related to the respective contract(s). Although it is possible that parties agree to arbitrate after the dispute has arisen (known as ad-hoc arbitration), the chances of obtaining consent from the other party will usually be low and it would be difficult to pass through this stage. Therefore, it cannot be emphasized enough that arbitration clauses must be drafted, and carefully drafted as ill-drafted clauses would result in the courts retaining jurisdiction.

A model arbitration clause provided by the AIAC:
"Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof shall be settled by arbitration in accordance with the AIAC Arbitration Rules."

An arbitration clause must also state if the parties desire to arbitrate under the governance of an arbitration institution. The parties must also agree on the seat of arbitration as this allows the parties to attach the arbitration to a specific legal order. For example, the AIAC-Rules determine the seat to be Kuala Lumpur.

Note that the seat is not to be confused with venue or place of arbitration. The seat of arbitration is a mere virtual concept while the venue of arbitration refers to the physical location where the arbitration will be held. Choosing the venue of arbitration is a matter of practicality and it

should be considered based on the circumstances of the time; hence, the venue of arbitration must not be necessarily determined in the arbitration agreement.

If the seat of arbitration is to be in Kuala Lumpur, it is strongly recommended to add a clause which sets English to be the language of communication as English is the international language.

6. Conduct of an Arbitration

a. Initiation

In the unfortunate event of a dispute, the party that seeks to initiate an arbitration must submit a request to arbitrate to the AIAC, similarly as one would file a suit with the court. For more details on the documents that need to be submitted, please refer to Rule 2 of AIAC-Rules. It is noteworthy that the claimant must up pay the arbitration fees. This is unlike the litigation in German law suits, which the claimant himself must serve a notice of a request to arbitrate to the opposing party.

b. Appointment of the Arbitrator

The next step is to appoint the arbitral tribunal. The tribunal can be of a single arbitrator, a panel of three, or even more if parties choose to do so. If the parties have not agreed on the number of arbitrators, Rule 4 of AIAC-Rules and Sec. 12 (2) AA state that, if an international arbitration involves at least one foreign party, the matter is to be arbitrated by a panel of three arbitrators. In cases of a domestic arbitration, where both parties are Malaysian, a single arbitrator presides.

Parties must agree on an arbitrator. This will then lead to an arbitrator who will then, be appointed by the AIAC accordingly. It is to note that the AIAC also provides a list of recommended arbitrators; it is just that AIAC gives the freedom to parties to choose their arbitrator, who is selected by both parties. However, in the case that the parties fail to agree on an arbitrator within 30 days of notice, each party may request the AIAC to appoint an arbitrator at its own discretion.

In the event that three arbitrators must be appointed, each party may appoint one arbitrator, and for the presiding arbitrator, both parties have to agree to him/her. Even though each party can appoint one arbitrator without the other party's consent, the appointed arbitrators are subject to challenge. In worst case scenario, if an arbitrator gave reasons which doubt his or her impartiality during the arbitration, the resulting award may be set aside – or even not recognized. Therefore, the appointed arbitrator should be chosen carefully – he or she should refrain from impartiality.

c. Commencement of the Proceedings

How the arbitral proceedings are held from this point depends largely on what the parties, or the tribunal, finds suitable. Typically, the claimant will be asked to submit a written statement of claim to which the opposing party must respond to. There can be up to multiple rounds of exchanging statements.

If necessary, hearings will be scheduled. These hearings may be held via video conference, phone, or in person. When hearings are conducted, they are conducted in an almost similar manner as court hearings; however, with less formalities, and with much fewer provisions regarding the manner in which it is conducted. Unlike in Germany, witnesses in Malaysia are typically not questioned by the arbitrator; instead, they are questioned by the parties as Malaysia's legal system has U.K.'s common law influence.

In the case that a hearing is dispensable, the procedure will be held in writing.

7. Arbitral Award, Its Enforcement and Challenges

Once the hearings have been concluded and the arguments have been exhaustively exchanged, the tribunal will render an award with a decision on the matter, which is final and binding on the parties. In most cases, the defeated party will simply comply with the award.

In the rare circumstance that the debtor is incompliant, the creditor can apply for enforcement through the courts. Sec. 38 AA requires the applicant to produce the original award and the arbitration agreement or certified copies thereof in English.

The court may refuse recognition and enforcement according to Sec 39 AA. However, the grounds to refuse recognition are exhaustive and very narrow, and most importantly, do not concern the merits of the dispute. The courts will not review the award itself.

The grounds set out in Sec. 39(1)(a) AA are of procedural nature and are not considered *ex officio*, but must be raised by the debtor. The debtor also bears the burden of proof. So, only if the opposing party is able to proof that an error occurred in the conduct of the arbitration and that the error had an influence on the decision, recognition will be refused. Chances of successfully invoking these grounds are very slim, as arbitral tribunals are alert of such issues and they put an emphasis on an orderly conduct of the proceedings.

The only grounds the court must consider *ex officio* are set out in Sec. 39(1)(b) AA. Accordingly, the courts will refuse recognition and enforcement if the award conflicts with the public policy of Malaysia, or that the matter settled is not arbitrable under Malaysian law. Since all matters are arbitrable unless the agreement is contrary to public policy (Sec. 4(1) AA), the latter refusal ground is considered obsolete.

Public policy will be affected if the basic notions of morality and justice are violated – which is just as vague of a definition as the term public policy itself. Note that the High Court of Malaysia construes the term public policy very narrowly. An erroneous application of the law will not be sufficient itself to invoke a public policy violation.

For domestic arbitrations, the High Court has considered an incompliance of the award with mandatory laws of Malaysia as an offense to public policy. Example of Malaysian legislations that are aimed to protect the public are the Architects Act 1967, Registration of Engineers Act 1967 and the Quantity Survey Act 1967. In international arbitrations, the High Court restrains itself even more as it considers international comity. In such cases, even a violation of mandatory Malaysian provisions does not suffice; the violation must also be in conflict with the most fundamental principles of justice and morality.

In case the application for recognition and enforcement is not filed, the defeated party has the chance to have the award annulled according to the same grounds on which the award may be refused recognition.

8. Costs of Arbitration

According to Art. 42 of UNCITRAL-Rules, the cost is primarily to be borne by the unsuccessful party. In this sense, it deviates from how it would typically be in common law legal traditions and resembles a more civil law legal tradition like Germany.

Art. 40 UNCITRAL-Rules define the cost of the arbitration to comprise of the fees for the administration of the arbitration, the fees for the arbitrator, the expenses of the arbitrators, expenses in regards to the witnesses, the fees and expenses for expert witnesses, and other costs incurred in relation to the arbitration the tribunal deems reasonable.