When challenging an arbitral award becomes a challenge

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Introduction

Quite often when a decision is issued in an arbitration, the final outcome may “surprise” parties in that neither party’s arguments had been accepted fully; rather a decision lying somewhere between the two sides of the dispute was the final outcome.

This has sometimes tempted the dissatisfied party or parties to challenge the decision on grounds that they had not been given an opportunity to argue the point or that there was no evidence to substantiate the decision or that the tribunal had exceeded its jurisdiction (by reaching a decision that neither party had contended for).

In *AUF v AGF* [2015] SGHC 305, Justice Belinda Ang examined one such case and issued a judgment which did not encourage parties to freely avail themselves of this course of action. The fact that a decision is not based squarely on the submissions or interpretation of the evidence championed by any of the parties is not by that mere fact alone sufficient to impugn or disturb the decision. While this decision arose out of now comparatively rare domestic construction arbitration, the principles stated and applied are similar in nature to the now more common international arbitration cases and should provide useful guidance to practitioners and parties.

Background

In an arbitration that started in 2000 and ended only in 2014, the owner of a building sued the main contractor for defects in the external wall façade system. Apparently, there were numerous defects which resulted in water leaks. The external wall façade system had been designed and installed by a specialist subcontractor who had initially been joined as a party to the arbitration. However, the subsequent liquidation of the specialist subcontractor left the main contractor as the lone party facing the owner’s complaint.

In the initial case submitted, the owner claimed for the costs of total replacement of the external wall façade system plus other ancillary damages suffered. Much later in the arbitration, the owner abandoned the claim for costs of total replacement and claimed for loss and damage arising from the defective external wall façade system. This amended claim was put forward as a claim for the costs of repairing the defects and evidence for the costs was submitted in the form of two tender submissions which the owner had obtained to ascertain the potential cost of repairs. In the course of hearings, the arbitrator raised the possibility of an alternative basis for damages namely, diminution in value. The owner indicated its willingness to make submissions on this and directions were given to deal with this issue.

The controversy in the case was due to evidence. The owner had submitted evidence of the costs of rectification (in the form of the two tenders it had obtained) but no evidence of diminution in value (usually, this would be evidence from property valuers). The owner argued that the arbitrator could use evidence of the costs of rectification to

determine diminution in value since such costs would be a relevant factor in determining the value of diminished building (basically, the value of the building would be what the market would be prepared to pay for the building and the market would reduce the price to take into account the costs which the buyer would have to incur to carry out the repairs after the purchase). The contractor maintained vehemently that diminution in value must be based on actual evidence of diminished value of the building and clearly, no evidence had been produced by the owner. Furthermore, the owner had not framed its case on the basis of a claim for diminution in value (and in fact its counsel admitted that it had made a decision to pursue the claim for costs of rectification only). Therefore, the arbitrator would be acting beyond his jurisdiction or acting in excess of his authority if he proceeded to award damages on the basis of diminution in value.

In the course of the final round of the submissions (of which there were numerous), the owner (according to the contractor) caused further controversy by introducing allegedly new grounds for its claim. In its final submission of 29 May 2014, the owner submitted that based on the *Multiplex case* [2006] EWHC 1313 (TCC) and extracts from *Keating on Construction Contracts*,its claim could also be cast as an abatement claim. To briefly explain, another way of looking at the claim was to consider that the contractor had not delivered an external wall façade system which the owner had contracted for. In fact, what was delivered was less in value since it was defective. Therefore, having paid in full for the external wall façade system, the owner could claim a refund for what he had overpaid; the overpayment being the difference between the amount the owner had paid and the actual value of the defective product.

The contractor strongly objected to this argument and asked for the right to reply. The arbitrator, perhaps considering himself fully informed of all the issues or perhaps (one suspects) weary of the voluminous submissions which had been tendered, replied that he would not give leave to reply in the following words:

“Both parties have rendered adequate assistance to the Tribunal on the issue of diminished value. The Tribunal does not require further submissions unless it is by mutual consent.”

The arbitrator then issued his Award. He found that the contractor was in breach of contract for installing an external wall façade system which had defects and awarded damages to the owner on the basis of diminution in value which he determined to be 40% of the final sub-contract sum paid for the external wall façade system.

The contractor took steps to challenge the Award. Two steps were taken.

The first was to apply to set aside that part of the Award which dealt with the award of damages for diminution in value on the basis that the arbitrator had misconducted the arbitration. The arbitrator had made a decision which was not advanced by either party and had surprised the contractor. There was no evidence to support the decision. He had therefore committed a breach of natural justice or acted in excess of jurisdiction.

The second was an appeal on a question of law; the point being that the arbitrator had erred in law in coming to his decision on damages for diminution in value because there was no evidence to support the quantum of damages awarded nor was it right to award interest on damages in the form of diminution in value.

The judgment

Justice Belinda Ang devoted a significant part of her judgment to stating the principles to be applied in setting aside arbitration awards. These were:

1. The application to set aside the award was made under Section 17(2) of the 1985 Arbitration Act. Section 17(2) is about due process, not whether the arbitrator reached the right conclusions. Section 17(2) is only to be available in cases where the tribunal had gone so far wrong in its conduct of the arbitration that the court would be expected to

take action to correct the injustice.

2. What is required is a finding of “misconduct of the arbitration” which meant “a mishandling of the arbitration which may lead to some substantial miscarriage of justice”. Errors of fact or law do not qualify as “misconduct”.

3. It has been accepted that arbitrators should not come to decisions which surprise the parties. However, there is no misconduct constituting a breach of natural justice if an arbitrator comes to a conclusion which is not argued by either party as long as that conclusion, on an objective assessment, reasonably flows from or may be foreseen from parties’ arguments.

4. The contractor invited the court to add a “third pillar” of natural justice, ie the “no evidence rule”. The established pillars of natural justice were the rule against bias (*nemo iudex in causa sua*) and the right to a fair hearing (*audi alteram partem*). The “third pillar” supposedly was that any decision must be based on evidence (material which tends logically to show that the existence or non-existence of facts relevant to the issue to be determined, or to show the likelihood or unlikelihood of the occurrence of some future event the occurrence of which would be relevant). The proposed “no evidence rule” had been left open in two earlier High Court decisions. The court here also decided to keep the question open because there was no reason to consider the issue in the present case. The outcome of the setting aside application would turn on other grounds (as will be explained further below). There was no compelling need to recognise the “no evidence” rule as a separate free standing rule of natural justice. The absence of evidence to support any decision of an arbitrator could simply be attacked on the ground that by deciding contrary to obvious facts, he had taken the parties by surprise and hence had been guilty of misconduct. In other words, the “no evidence rule” could be subsumed within the right to a fair hearing.

5. Another aspect of fairness in proceedings is the need for the arbitral tribunal to give reasons for its decision. However, whether a given decision is sufficiently reasoned is a matter of degree and must be considered in the circumstance of each case. Even if no reason was given in an arbitral award, this would not invariably cause the award to be set aside for breach of natural justice.

6. For misconduct to constitute a breach of natural justice, and in order to succeed in challenging the award as having been made in contravention of the rules of natural justice, the Contractor must establish:

    1. which rule of natural justice was breached;
    2. how it was breached;
    3. in what way the breach was connected to the making of the award; and
    4. how the breach prejudiced its rights.

7. As to the threshold of prejudice that must be crossed, the issue is whether the material could reasonably have made a difference to the arbitrator; rather than whether it would *necessarily* have done so. Where it is evident that there is no prospect whatsoever that the material if presented would have made any difference because it wholly lacked any legal or factual weight, then it could not seriously be said that the complainant has suffered actual or real prejudice in not having had the opportunity to present this to the arbitrator.

The court then proceeded to determine the issues in contention.

Jurisdictional point

On the question of whether the arbitrator had acted in excess of jurisdiction, the contractor's argument was that the owner had not pleaded or pursued a case that the diminution in value of the building could be arrived at by taking the final sub-contract sum of the external façade wall system as the market value of the building, as contracted, and then applying a percentage discount to that sum. This was not a case known in law and no one was suggesting that it was permissible in law.

The court however took the view that this was not a significant argument when the award and the relevant documentary evidence were submitted to closer scrutiny. The underlying claim was the breach of the main contract in relation to the sub-contract works. In short, the arbitrator's reference was to decide on liability and quantum of damages. The owner's re-amended points of claim included a positive alternative claim based on diminution in value of the building.

The real question in argument was whether the owner had unequivocally abandoned this alternative claim in the course of the arbitration by advancing a case based on cost of cure alone, and if so, whether the arbitrator misconducted the proceedings by purporting to resolve the issue of quantum by adopting diminution in value of the building (when this had been unequivocally abandoned by the owner). The contractor submitted that the arbitrator "descended into the arena" to revive what was not or no longer the owner's case. It was contended that the articulation of the award for diminution in value was hardly the same as the pleaded alternative claim and this took the parties by surprise. While it was true that the owner's main argument on quantum of damages was based on cost of cure rather than diminution value and also true that the owner did not robustly advance the diminution in value claim because it saw evidential difficulty, the alternative claim was nonetheless left open in case the arbitrator was not minded to award damages based on cost of cure. The court agreed with the owner's submissions that it had not abandoned unequivocally diminution in value of the Building as an alternative basis of claim. This was left open while the owner advanced its primary case based on cost of rectification. Even though the contractor had submitted in the arbitration that there was never any claim made by the owner for diminution in market rental and that there was no evidence of diminution in value of the building either, the arbitrator was clearly told in the contractor's submissions that *"in many cases, diminution in value of the work may be equal to diminution in value of the building"*. That same proposition was made by the owner. It was therefore beyond doubt that the arbitrator accepted this simple proposition in his award and his decision stemmed from his acceptance and finding on that point. As the arbitrator saw it, despite the evidential difficulty highlighted, he did not think that on the available evidence damages based on diminution in value was impossible to quantify. In the circumstances, it was thus reasonable, and entirely within the arbitrator's remit, to seek submissions on diminution in value; the owner had not unequivocally abandoned its alternative pleaded claim for diminution in value of the building (unlike its express withdrawal of its claim for recladding).

As for the contractor's criticism that it was not permissible in law that the diminution in value of the building could be arrived at by taking the final sub-contract sum of the external façade wall system as the market value of the building, as contracted, and then applying a percentage discount to that sum, this type of error (assuming there was an error) was plainly not misconduct that would go the arbitrator's jurisdiction. It was a criticism of the substance of the award, ie a submission that there was an error of law. The arbitrator did not act outside his jurisdiction if the award was erroneous on the basis of legal principle.

Two further points were dealt with on this issue of acting in excess of jurisdiction.

1. The first point was the arbitrator's use of the final sub-contract sum which nobody had raised and was said to be a wholly unexpected outcome. This contention lacked credence seeing that the final sub-contract sum was raised by the contractor itself in its submissions, in response to the arbitrator's directions, and in the context of the final sub-contract sum being used as the value of the works contracted for.

2. The second point was the percentage figure of 40% in the award. It was true that the arbitrator did not spell out how and where he derived the percentage figure of 40%. However, this did not mean that the arbitrator had "applied a 60% discount plucked from thin air" if the award was examined in light of the legal principles the arbitrator took pains to reproduce in the award. Reading the award, the arbitrator applied the stated legal principles and came to the view that the sub-contract works were only worth 60% of what the owner had actually paid for it (and hence, found the diminished value of the building to be 40% of that). He arrived at the view that the sub-contract works were worth only 60% of the final sub-contract sum by taking into account the rectification costs of the 31 defects which he found to have existed. The arbitrator had worked out the diminution in value adopting the approach set out in *Watts v Morrow and Philips v Ward* and made use of the rectification costs of the 31 items of defects based on information contained in the PowerPoint slides that were included in the owner's submissions. The contractor's submissions had also referred to the slides and made comments in relation thereto and the contractor had concluded that the extent of the alleged loss, including cost of rectification, was not proven.

Given these, the court found that the arbitrator, in finding that the building had sustained diminution in value and awarding damages on that basis, did not go beyond what parties had submitted before him and therefore did not act in excess of jurisdiction.

Breach of natural justice point

On the question of whether there had been a breach of natural justice, there were four limbs to the contractor’s attacks. The first two limbs were the same points as those raised in the jurisdictional challenge.

The contractor argued that anyone reading the award would not be able to understand the basis on which the arbitrator reached his decision since the award was so bereft of reasons, "completely out of the ballpark and arbitrary". The arbitrator had asked for submissions on the sub-contract tender price but ended up using the final sub-contract sum. The contractor argued that "neither party made submissions on the final sub-contract sum being taken as the first value"or that a percentage of the final sub-contract cum could be taken as the quantum of damages for diminution in value of the building. In addition, there was no evidence to support the award; the contractor had not been given the opportunity to respond to the "new case" based on doctrine of abatement raised in the owner's May 2014 submissions and there was a lack of reasons for the award, which reinforced the startling and unexpected outcome of the arbitration.

On the allegation that the contractor was not given an opportunity to respond to the owner's "new case"that was raised in the owner’s May 2014 submissions, the court noted that the contractor had sought leave from the arbitrator to reply. The leave was not granted. The arbitrator made a clear decision that he did not require further assistance and submissions from the contractor. That was the end of the discussion as far as the arbitrator was concerned. [The writer notes that what was not explained as clearly in this part of the judgment was that in applying for leave, the contractor had stated the grounds of its proposed reply submissions. Having considered these, the arbitrator decided not to grant leave. The contractor therefore had responded but the arbitrator decided he did not wish to hear a “fuller” response.]

Even if this were wrong, the fact remained that the contractor had not suffered any prejudice. The contractor submitted that had it been given the opportunity, there were seven points which it would have made in reply. This was the “prejudice” it had suffered. The court did not agree.

On the point that the values of diminution in value of the sub-contract works and diminution in value of the building are different and cannot be equated and the point that evidence of diminution in value of the building was required to show that the defects in the sub-contract works affected the value of the property, the court noted that the contractor had made its counter submissions to the owner's case (that the arbitrator should use the evidence on the rectification

costs with a discount for betterment to derive the quantum of damages for diminution in value of the building). The contractor's counter submissions were not accepted by the arbitrator. In reality, the contractor's case for setting aside was that the arbitrator was wrong in not accepting its submissions. At the highest, this is an allegation that the arbitrator made an error of law or fact, and does not provide grounds for the setting aside of the award.

A related objection was the fact that the owner had sought in its pleadings diminution in value of the building, and not diminution in value of the sub-contract works. There was no failure of due process or breach of natural justice here because the arbitrator had given both parties a chance to comment on an award for diminution in value of the sub-contract works pursuant to his April 2014 directions. Even at that stage, the contractor had already made the argument that diminution in value of the building could not be equated with diminution in value of the sub-contract works (which in fact contradicted its earlier submissions that "in many cases, diminution in value of the work may be equal to diminution in value of the building"). In contrast, the owner took the position that diminution in value of the sub-contract works could amount to and would be equivalent to diminution in value of the building. Further, the contractor's distinction between diminution in value of the *sub-contract works* and of the *building* was superficial insofar as it relates to any and all relevant evidence presented in this regard, given that the sub-contract works are part of the building and parties were arguing about diminution in value as a consequence of the same defects. Hence, the contractor's objection on this count was a matter that was squarely before the arbitrator, and the arbitrator had already the benefit of submissions from both parties. The arbitrator awarded damages based on diminution in value of the building, and not the sub-contract works, which was in line with the owner's submissions. The fact that he preferred and decided to adopt these submissions could not be said to be a breach of natural justice, and indeed a contrary finding would be an unwarranted and impermissible intrusion into the merits of the decision. As stated, misconduct in s 17(2) of the 1985 Act was about due process, and errors of fact or law on the face of the award are not indicative of misconduct of the arbitral process.

On the point on the appropriate discount for betterment and submission of evidence of betterment, the fact was that the contractor had known in the course of earlier submissions that the owner was proposing to the arbitrator that he should apply a "betterment discount" on the rectification costs adduced in evidence to arrive at a value for damages for diminution in value. The contractor had in fact addressed the issue of betterment in its September 2013 submissions. It was open to the contractor at all material times to make submissions on the appropriate discount to be applied for betterment. Having taken a strategic decision not to do so, the contractor cannot be heard to allege that procedural injustice had occurred. To the extent that the contractor sought leave to press home the point that there was no evidence that related to the market value of the building, this was not a point that was disputed by the owner, and was a point which the arbitrator had already been informed of umpteen times.

On the argument that abatement could never be used as a sword but is only relevant as a defence, the court stated this was not entirely correct. Abatement had been allowed to be used as a sword in at least two previous Singapore High Court decisions. Moreover, this was a belated point raised which may not have been raised during the arbitration given that no mention was made of this point in the contractor’s letter seeking leave to reply. Moreover, the arbitrator did not rely on either the *Multiplex case* or the extracts from *Keating on Construction Contracts* (these being the authorities cited by the owner on the abatement point) in his award.

The two remaining limbs of the breach of natural justice attack were on the award on legal costs and interest.

The contractor argued that it had not been given the opportunity to make arguments on the arbitrator’s decision to award interest on the damages awarded to the owner. The court, however, noted that the contractor had made submissions on the interest to be awarded in respect of its counterclaim in at least four separate submissions. Yet, it did not make submissions on the interest to be awarded to the owner in the event the owner succeeded on its claim. Having not done so (and it does not appear that the contractor had reserved its right to make submissions on interest), it was now too late for the contractor to complain about want of procedural fairness. The contractor raised a

host of potential arguments it might have made before the arbitrator, which it posited might have brought about a different outcome. Practically all of these "potential"arguments go back to the contractor's submission that there was no evidence for the award. They were all arguments which had been made before the arbitrator and he had rejected them. This ground of breach of natural justice therefore failed.

On the costs award, both parties had asked in the arbitration to be heard further when the award was issued. The arbitrator, when issuing his award, went ahead to deal with the issue of costs without hearing further submissions from the parties. The contractor submitted that it had been denied the opportunity to argue that (a) Calderbank letters (ie offers of settlement) had been issued which offered a figure higher that the figure awarded to the owner and therefore should have been taken into account in the arbitrator’s decision on costs, (b) costs awarded to the owner should take into account the fact that owner pursued a claim for cost of rectification for most of the arbitration and only raised diminution in value late in the day; and (c) damages for diminution in value was found to be 40% of the final sub-contract sum; there was no reason why the costs order should not have followed the same percentage.

On the Calderbank letters, the Court opined that where valid Calderbank letters exist, and the arbitrator is asked to hold over the costs hearing, there would be a procedural misstep that would justify remitting a costs award under s16 of the 1985 Act, if the arbitrator makes a final award on costs without hearing parties. In the present case, the arbitration was one that did not, on its face, appear to present "potentially complex costs issues", and by the parties seeking a reservation to be heard on costs, the arbitrator ought to have been mindful of the fact that there could be Calderbank offers that might have a bearing on the eventual costs award. However, in the present case, remission was unnecessary. The court analysed the Calderbank letters in question and concluded that these had either been withdrawn before the award was issued (and therefore no longer operative) or unlikely to have led to a different outcome in respect of costs.

The contractor's submissions on the percentage of costs were without merit (it argued that it should be made to pay the owner’s costs of its claim in full). A claim for damages for diminution in value of the building was a claim which remained on the owner's pleadings at all times, and it was within the arbitrator's jurisdiction to make an award of damages on that basis. The fact that the award of damages was 40% of the final sub-contract sum did not detract from the fact that the arbitrator found that: (a) the contractor was liable for the defects in the sub-contract works; and (b) the building suffered diminution in value of a more than nominal sum. The owner was therefore successful on its claim against the contractor. It was also pertinent to note the owner had succeeded on the issue of liability. Although the arbitrator did not award damages on the basis of cost of cure, the arguments and material presented in respect of that measure of damage in the arbitration were nonetheless necessary and featured in the arbitrator's finding on liability, the finding on diminution in value and the quantum of the diminution in value. It was therefore well within the arbitrator's wide discretion as to costs and the established principle that costs follow the event to decide that he did not need further assistance or arguments on the issue of costs and to award the owner costs on its claim. As for the decision on liability for the arbitrator’s costs, the arbitrator's costs award reflected in percentage terms the value of the work as performed being 60% of the final sub-contract sum. Crucially, the contractor had, at all material times, contested its liability to the owner on its claims for breach of contract while the owner had, at an early stage, admitted liability on the contractor's counterclaim. Furthermore, the total sum awarded to the owner inclusive of interest in the award amounted to approximately S$5.9 million. The contractor was awarded a total sum, inclusive of interest, of S$3.4 million. Setting off the awards on the claim and the counterclaim, the net sum payable from the contractor to the owner under the award was S$2.5 million. Taking all these into account, it was well in line with the arbitrator's "wide discretion" under the 1985 Act and the principle that costs follow the event for the arbitrator hold that the contractor should bear 60% of the arbitrator's fees and expenses. Thus, any complaint would pertain to an error in the application of the arbitrator's discretion, which, put at the highest, would amount to only an error of law or fact for which neither setting aside nor remission would be granted.

Consequently, the contractor failed on its application to set aside the award on the ground of breach of natural justice.

Appeal on question of law

As for the application for leave to appeal on a question of law, the two questions formulated by the contractor were:

1. The First Question: Whether the arbitrator was entitled to make the award on the quantum of diminution in value without any evidence to support it?
2. The Second Question: Whether interest is payable on an award for damages based on diminution in value?

Given that in considering the setting aside application the court found that there had been evidence to support the finding on the quantum of the diminution value, the First Question was not a question of law arising out of the award.

On the Second Question, the owner submitted that the contractor was unable to show that there was a *strong prima facie* case that the arbitrator was wrong or that he had misdirected himself in law, or that his decision was one that no reasonable arbitrator could reach. The contractor has not referred to any authority which specifically states that the court should not award interest on damages for diminution in value. In contrast, the owner referred to the case of *Watts v Morrow* where the English Court of Appeal awarded interest on damages for diminution in value of the property in question from the date of payment to the date of judgment. Another case relied on by the owner was *Chong Ah Kwee* where Justice Chan Sek Keong (as he then was) awarded interest on the plaintiff's claim (made by way of proportionate abatement on the purchase price) from the date of completion of the sale up to the date of judgment. From the authorities cited, the arbitrator had not committed an error of law. In mounting a claim for diminution in value, the plaintiff takes the position that he obtained less than what he bargained for as a result of the defendant's breach of contract. If successful, the plaintiff would have shown that he was kept out of use of the sum awarded as damages and an award of interest for diminution in value appears appropriate. A “question of law” must necessarily be a finding of law which the parties dispute, that requires the guidance of the court to resolve. When an arbitrator does not apply a principle of law correctly, that failure is a mere “error of law” (but more explicitly, an *erroneous application of law*) which does not entitle an aggrieved party to appeal.

Conclusion

In a decision which necessarily had turned on its particular facts, the court demonstrated an unwillingness to entertain arguments that parties had been caught by surprise even when at first blush there seemed to be merit in the argument. The court was prepared to delve into the complicated procedures of the arbitration and the voluminous documentary record to satisfy itself that when examined in detail, the complaint was not meritorious. In particular, the court was extremely mindful that what were actually attempts to argue errors of fact or law would not be allowed to pass in the guise of arguments on procedural fairness.

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