ALERT MEMORANDUM

Confirmation of English Law Approach to Law Governing the Validity of the Arbitration Agreement

21 December 2021

In a recent judgment,[1] the UK Supreme Court in *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2021] UKSC 48 confirmed the English law approach to the determination of the applicable law governing the validity of an arbitration agreement, holding that English law governed the arbitration agreement despite the parties' choice of Paris as the arbitral seat.

On 27 October 2021, the Supreme Court unanimously refused the recognition and enforcement in England and Wales of an award rendered in a Paris-seated ICC arbitration, finding that the law governing the validity of the arbitration agreement was English law because the agreement contained an express choice of English law for the agreement generally. The majority of the tribunal in the underlying ICC arbitration had applied the approach generally adopted by the French courts as the law of the seat, according to which the existence and validity of the arbitration agreement must be determined in light of the parties' common intent. The Paris Court of Appeal upheld this reasoning in annulment proceedings challenging the award on this point.

The judgment reinforces the English law approach, following the decision of the UK Supreme Court in *Enka Insaat Ve Sanayi AS v OOO "Insurance Company Chubb"* [2020] UKSC 38 in late 2020, as discussed in our prior alert memorandum. It also widens the gap between the approach of the English courts, and the French courts, and confirms the lack of a clear consensus amongst member states of the New York Convention regarding the approach to determining a choice of law for the arbitration agreement where not made expressly.

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[1] *Kabab-Ji SAL (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)* [2021] UKSC 48, Judgment (27 October 2021) ("Judgment").

Background

The dispute arose out of a franchising arrangement relating to a chain of restaurants specializing in Middle Eastern cuisine. Kabab-Ji SAL, a Lebanese company (the claimant in the arbitration and the appellant before the UK Supreme Court), entered into a Franchise Development Agreement (the "FDA") in 2001 with Al Homaizi Foodstuff Company, a Kuwaiti company. Pursuant to the FDA Al Homaizi could operate a restaurant franchise in Kuwait for 10 years.[2] Kabab-Ji and Al Homaizi subsequently entered into a total of ten franchise outlet agreements for individual restaurant outlets. Both the FDA, and the franchise outlet agreements (together, the "Franchise Agreements"), were expressly governed by English law. The Franchise Agreements provided for ICC arbitration, seated in Paris, France.[3]

In 2005, the Al Homaizi Group underwent a corporate restructuring, which interposed a new entity, Kout Food Group ("KFG") – the respondent in the ICC arbitration and the UK Supreme Court proceedings – between Kabab-Ji and Al Homaizi, with Al Homaizi becoming KFG's subsidiary.[4] When a dispute arose under the Franchise Agreements, Kabab-Ji commenced ICC arbitration against KFG alone. KFG took part in the arbitration under protest, maintaining that it was not a party to the Franchise Agreements nor the arbitration agreements they contained.

The ICC Award

In a 2017 award, a Paris-seated tribunal chaired by French arbitrator Bruno Leurent, alongside Egyptian arbitrator Professor Dr. Mohamed Abdel Wahab and Irish-German arbitrator Klaus Reichert SC, found by a majority (Reichert SC dissenting) that it must apply the approach prescribed by French courts, according to which the existence and validity of the arbitration agreement was assessed in light of the common intention of the parties, applying this approach to the question of whether KFG was bound by it. The majority considered English law to apply to whether KFG had then acquired substantive rights and obligations under the Franchise Agreements. The majority held (a) according to the common intention of the parties, KFG was a party to the arbitration agreements, and (b) applying English law, KFG had become an additional party to the Franchise Agreement (alongside Al Homaizi) as a result of the parties' conduct. KFG was held to be in breach of the Franchise Agreements and the tribunal awarded Kabab-Ji USD 6.7 million in unpaid license fees, damages and legal costs.[5] Dissenting, Klaus Reichert SC (the only English-qualified lawyer on the tribunal) opined that applying English law, KFG never became a party to the Franchise Agreements, as the replacement of Al Homaizi by KFG or KFG's addition as a party to the contracts was precluded by the language of the contracts, and as a result KFG owed no obligations under the contracts.[6]

Annulment and Enforcement Proceedings

KFG subsequently filed an application before the French courts to annul the ICC award, including on the basis that the arbitrators lacked jurisdiction over KFG as it was not a party to the Franchise Agreements and the arbitration agreements contained therein. In parallel, Kabab-Ji commenced enforcement proceedings in England to recover on the award.[7]

It is the English enforcement proceedings that resulted in the recent Supreme Court decision. In January 2020, the Court of Appeal refused enforcement and recognition of the ICC award as a judgment in England.[8] The FDA contained an express governing law clause which selected English law as the law governing the "Agreement". The Court of Appeal held that that choice extended to the choice of law governing the arbitration agreement.[9] For the Court of Appeal, "[t]*hat express choice of English law as*

[2] Judgment, ¶ 3.
[3] Judgment, ¶ 5.
[4] Judgment, ¶ 4.
[5] Judgment, ¶ 6.
[6] Judgment, ¶ 7.
[7] Judgment, ¶ 8.
[8] *Kabab-Ji S.A.L. (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6, Judgment (20 January 2020).
[9] *Kabab-Ji S.A.L. (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6, Judgment (20 January 2020), ¶ 62.

governing the entire FDA including the arbitration agreement is not affected by the fact that Article 14.5 [the arbitration agreement] *provides that the seat of the arbitration is to be Paris*", based on the explicit wording of the contract.[10]

Subsequently, and despite the decision of the English courts, the Paris Court of Appeal dismissed the annulment proceedings, on the basis that the autonomy of the arbitration agreement was well-established as a matter of international arbitral law,[11] and the question of the existence and validity of the arbitration agreement was to be assessed in light of the common intention of the parties, without reference to domestic law and subject only to the mandatory rules of the seat and to international public policy. For the Paris Court of Appeal, the general choice by the parties of English law to govern their agreement was not sufficient to establish a common intent of the parties that the arbitration agreement itself would be governed by English law and did not derogate from principles of international arbitral law that were applicable by virtue of the Paris seat expressly designated by the parties.[12]

An appeal against this decision is currently pending before the French Court of Cassation.[13]

The Supreme Court Decision

The UK Supreme Court considered three issues on appeal, namely:[14]

(i) what law governs the validity of the arbitration agreement;

(ii) if English law governs the validity of the arbitration agreement, whether there is any real prospect that a court might find at a further hearing that KFG became a party to the arbitration agreement in the FDA; and

(iii) as a matter of procedure, whether the Court of Appeal was justified in handing down summary judgment refusing recognition and enforcement of the ICC award.

Focusing on question (i), of most practical consequence for users of arbitration, the Supreme Court found that the law governing the question of

[10] *Kabab-Ji S.A.L. (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6, Judgment (20 January 2020), ¶ 68.

[11] Paris Court of Appeal, 23 June 2020, n°17/22943, p. 8 ("In international arbitration, the principle of the autonomy of the arbitration agreement is of general application, as an international substantive rule that enshrines the validity of the arbitration agreement, without any reference to a conflict of laws system") (unofficial translation) ("En matière d'arbitrage international, le principe de l'autonomie de la clause compromissoire est d'application générale, en tant que règle matérielle internationale consacrant la licéité de la convention d'arbitrage, hors de toute référence à un système de conflit de lois."). *See also* Art. 1447 of the French Code of Civil Procedure ("The arbitration agreement is independent of the contract to which it relates. It is not affected by the invalidity of said contract.") (unofficial translation) ("La convention d'arbitrage est indépendante du contrat auquel elle se rapporte. Elle n'est pas affectée par l'inefficacité de celui-ci.").

[12] Paris Court of Appeal, 23 June 2020, n°17/22943, p. 5 ("According to a substantive rule of international arbitration law, the arbitration agreement is legally independent of the main contract which contains it either directly or by reference, and its existence and validity are to be assessed, subject to the mandatory rules of French law and international public policy, in accordance with the parties' common intention, without the need to refer to domestic law...The choice of English law as the law generally governing the Agreements...cannot suffice...to establish the common intention of the parties to subject the arbitration agreements to English law and thereby to derogate from the substantive rules on international arbitration applicable in the seat of the arbitration expressly designated by the parties") (unofficial translation) ("En vertu d'une règle matérielle du droit international de l'arbitrage, la clause compromissoire est indépendante juridiquement du contrat principal qui la contient directement ou par référence, et son existence et son efficacité s'apprécient, sous réserve des règles impératives du droit français et de l'ordre public international, d'après la commune volonté des parties, sans qu'il soit nécessaire de se référer à une loi étatique….La désignation du droit anglais comme régissant de manière générale les Accords…ne sauraient suffire … à établir la volonté commune des parties de soumettre les clauses compromissoires au droit anglais et de déroger ainsi aux règles matérielles en matière d'arbitrage international, qui étaient applicables au siège de l'arbitrage expressément désigné par les parties").

[13] Judgment, ¶ 9.

[14] Judgment, ¶ 22.

whether KFG became a party to the arbitration agreement is English law.[15]

The framework applied by both the English and French courts is that set out in the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), which has been transposed into both sets of national laws. Under the English Arbitration Act 1996, recognition or enforcement of an award may be refused if "*the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made*."[16]

The Supreme Court considered there to be "*nothing approaching a consensus*" of national courts regarding the question of whether or when a choice of law for the contract as a whole constitutes "*a sufficient indication of the law to which the parties subjected the arbitration agreement, in particular where it differs from the law of the seat*."[17] The Court concluded that it must therefore form its own view on first principles.

Recalling its conclusions in *Enka v Chubb*, the Supreme Court noted its prior holding that "[w]*here the law applicable to the arbitration agreement is not specified, a choice of governing law for the contract will generally apply to an arbitration agreement which forms part of the contract*" and that "[t]*he choice of a different country as the seat of the arbitration is not, without more, sufficient to negate an inference that a choice of law to govern the contract was intended to apply to the arbitration agreement.*"[18]

The Supreme Court in *Kabab-Ji* recognized the different context of the Enka decision, in which the question regarding the applicable law governing the arbitration agreement arose before any arbitration agreement, and common law principles were applied to determine the law governing the arbitration agreement in the absence of any choice of law governing either the contract or the arbitration agreement. In *Kabab-Ji*, the issues arose following the conclusion of the arbitration proceedings, and applying the framework established by the New York Convention and the Arbitration Act 1996 rather than common law principles, but the Supreme Court considered the same principles to apply in both cases, noting that "*it would be illogical if the law governing the validity of the arbitration agreement were to differ depending on whether the question is raised before or after an award has been made.*"[19]

Confirming the approach in *Enka v Chubb*, the UK Supreme Court held that as a matter of English law, an express choice of law to govern the contract as a whole "*will normally be a sufficient 'indication' of the law to which the parties subjected the arbitration agreement*."[20] Under Section 103 of the Arbitration Act 1996 (implementing the New York Convention), it is only in the absence of any indication of the law to govern the contract as a whole that the law of the seat would be deemed to apply to govern the arbitration agreement.

The UK Supreme Court also considered arguments made by Kabab-Ji in respect of the validation principle, which the Court defined as "*the principle that contractual provisions, including any choice of law provision, should be interpreted so as to give effect to, and not defeat or undermine, the presumed intention that an arbitration agreement will be valid and effective*,"[21] an approach to determining choice of law under the New York Convention which is adopted in various jurisdictions. The UK Supreme Court rejected its application in *Kabab-Ji*, considering that such validation principle does not operate to create an agreement where no such agreement would otherwise exist, and therefore would not apply to assessing the

[15] Judgment, ¶ 53.
[16] Arbitration Act 1996, Section 103.
[17] Judgment, ¶ 32.
[18] Judgment, ¶ 28.
[19] Judgment, ¶ 35. *See also Enka Insaat Ve Sanayi AS v OOO "Insurance Company Chubb"* [2020] UKSC 38, Judgment (9 October 2020), ¶ 136.
[20] Judgment, ¶ 35.
[21] Judgment, ¶ 51.

question in this case of whether the parties actually entered into a valid arbitration agreement.[22]

Considering the explicit wording of the contract, the UK Supreme Court held that the generic governing law clause "*is ordinarily and reasonably understood (for the reasons given …* [in] *our judgment in* Enka*) to denote all the clauses incorporated in the contractual document, including therefore clause 14* [the arbitration agreement]."[23] In so doing, the Court considered that the wording in the FDA that the agreement "*consists of … the terms of agreement set forth herein below*" was evidence that the parties did not intend to exclude the arbitration agreement from their choice of English law to govern all the terms of their contract, including the arbitration agreement.[24] Users of arbitration should consider how the inclusion of similar contractual wording may impact their arbitration agreements.

The Supreme Court therefore upheld the Court of Appeal's decision, finding that English law governed the arbitration agreement and therefore applied to the question of its validity. Under English law, KFG had not become a party to the FDAs, and therefore, the arbitration agreement could not extend to KFG.[25] As a result, the Supreme Court refused the recognition and enforcement of the ICC award.

Takeaways for Users of Arbitration

The UK Supreme Court's decision confirms the English law approach to determining the question of the law governing the validity of the arbitration agreement, and the conflict of law question under the New York Convention.

In the UK Supreme Court's October 2020 decision in *Enka v Chubb*, the applicable contract did not expressly specify the governing law of either the contract or the arbitration agreement, simply providing for ICC arbitration with a London seat. The UK Supreme Court in that case concluded that while the choice of a seat could, in certain cases, support an inference that the parties intended for the law of the seat to govern their arbitration agreement, "*the content of the Arbitration Act 1996 does not support such a general inference where the arbitration has its seat in England and Wales*."[26]

In short, while the *Kabab-Ji* decision has reinforced the English law approach to determining the validity of arbitration agreements, internationally (as the UK Supreme Court expressly recognised) no such certainty or consensus exists. While annulment proceedings are pending before the French Court of Cassation, French arbitral and court practice remains committed to the concept of the autonomy of the arbitral agreement, and to applying the common intention of the parties to determine the law governing its validity.

Users of arbitration should note the divergence in approaches of the French and English courts with caution, especially given the preponderance of arbitrations seated on both sides of the English Channel, and the frequency with which arbitral awards are enforced in both "arbitration-friendly" jurisdictions.

To avoid any potential uncertainty, and hurdles to enforcement, the most prudent course is to specify expressly in contracts the law applicable to the arbitration agreement in addition to the law governing the substantive obligations under the contract.

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[22] Judgment, ¶¶ 49-52.
[23] Judgment, ¶ 39.
[24] Judgment, ¶ 39.
[25] Judgment, ¶¶ 53, 75.
[26] *Enka Insaat Ve Sanayi AS v OOO "Insurance Company Chubb"* [2020] UKSC 38, Judgment (9 October 2020), ¶ 94.