GIBSON DUNN

Which Law Governs the Arbitration Agreement? UK Supreme Court Refuses to Enforce a Paris-Seated Award Already Upheld by the French Courts

Client Alert | February 18, 2022

Click for PDF

Where a contract specifies its governing law, but is silent as to the governing law of the arbitration agreement, the question arises as to which law governs the arbitration agreement – the governing law of the contract, or the law of the seat?

The UK Supreme Court recently delivered its second judgment in as many years on this question in *Kabab-Ji SAL (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)* [2021] UKSC 48.

In 2020, the Supreme Court in *Enka Insaat Ve Sanayi AS v OOO 'Insurance Company Chubb'* [2020] UKSC 38 ("**Enka**") held that where the parties have expressly or impliedly made a choice of law to govern a contract that contains an arbitration clause, that would generally be sufficient indication of the parties' choice of law to govern the arbitration agreement as well.

In its much-anticipated *Kabab-Ji* decision, the UK Supreme Court recently reached the same conclusion in the context of proceedings to enforce an arbitral award. In a decision that directly contradicted the findings of the Paris Court of Appeal in parallel annulment proceedings, the UK Supreme Court found that the arbitration agreement was governed by English law, being the governing law of the contract—not French law, being the law of the seat, as found by the Paris Court of Appeal. The Supreme Court found that the tribunal had wrongly asserted jurisdiction over the respondent on that basis. This decision is an example of "exceptional circumstances", where the English courts have refused the enforcement of an arbitral award under the New York Convention. Although the decision provides useful guidance on the process under English law for determining the law governing the arbitration agreement, it further entrenches the divide between the UK and French courts' approaches to the jurisdiction of arbitral tribunals.

The key takeaways for parties considering arbitration clauses in their transaction documents following these decisions are:

1. The English law approach to determining the law applicable to an arbitration agreement is now clear, as first confirmed by the *Enka* decision and now by the *Kabab-Ji* decision, having previously been unresolved for many years.

2. However, there remains uncertainty at the international level. The Paris Court of Appeal considered the same award that the English courts considered in *Kabab-Ji*, and reached the opposite conclusion on which governing law applied to the parties' arbitration agreement. In the underlying award, the English-qualified

Related People

Nooree Moola

Cyrus Benson

Penny Madden KC

arbitrator and the two civil law arbitrators had also reached different conclusions. An appeal is currently pending before the French *Cour de Cassation*, but it is expected that the Paris Court of Appeal's decision will be upheld.

3. In order to achieve certainty, contracting parties should ensure that they identify the law specifically governing their arbitration agreement, whether or not that is the same law that governs the main contract.

4. Stated differently, contracting parties should not assume that the law of the seat will govern the validity of the arbitration agreement, particularly as a matter of English law.

Background

The case related to a Franchise Development Agreement ("**FDA**") between Kabab-Ji SAL (Lebanon) ("**Kabab-Ji**") and Al Homaizi Foodstuff Company ("**AHFC**"), a subsidiary of Kout Food Group (Kuwait) ("**KFG**").

In 2015, following a dispute under the FDA, Kabab-Ji commenced arbitration proceedings against the parent company KFG (who was not a party to the FDA) but not its subsidiary AHFC. The FDA was expressly said to be governed by English law. The FDA also contained an arbitration agreement, which provided that the seat of arbitration would be Paris and that the ICC Rules would apply. The arbitration agreement did not specify the applicable governing law, but stated that "[t]*he arbitrator(s) shall also apply principles of law generally recognised in international transactions*",[1] which the parties agreed referred to the UNIDROIT Principles of International Commercial Contracts ("**UNIDROIT Principles**"). Notably, the FDA included 'no oral modification' clauses.

Arbitration Proceedings

Although KFG took part in the arbitration, it did so whilst maintaining that it was not a party to the FDA or the arbitration agreement it contained. Nevertheless, the tribunal issued an award in favour of Kabab-Ji in 2017. A majority of the tribunal decided that:

1. French law (the law of the seat of arbitration) was the governing law of the arbitration agreement;
2. Applying French law, KFG was a party to the arbitration agreement;
3. English law (the governing law of the FDA) was the relevant body of law to determine whether KFG had acquired substantive rights and obligations under the FDA; and
4. KFG was also a party to the FDA as there had been a novation and KFG was in breach of the FDA, with the result that the tribunal awarded USD 6,734,628.19 to Kabab-Ji.

Parallel proceedings were then commenced by KFG in France (to annul the award) and by Kabab-Ji in England (to enforce the award).

French Annulment Proceedings

KFG brought an action in the French courts to annul the award on jurisdictional grounds, submitting that KFG was not a party to the arbitration agreement, which was to be governed by English law. The Paris Court of Appeal referred to principles of international substantive arbitration law and held that, under those principles: (i) an arbitration agreement is independent from the underlying contract, and (ii) the law of the seat is the appropriate governing law to determine the validity and existence of the arbitration agreement, unless the parties intended otherwise. There was no contrary intention suggesting that a governing law other than the law of the seat (French law) should be

applied. Jurisprudence from the French courts stated that a non-signatory party to an arbitration agreement "*should be deemed to have agreed to the [arbitration] clause if the arbitral tribunal finds that this party had the will to participate in the performance of the agreement*".[2] The Paris Court of Appeal therefore upheld the arbitral tribunal's finding that KFG was party to the arbitration agreement with reference to multiple factors, including that: (i) KFG's organisational chart included personnel in charge of the performance of the FDA, and (ii) KFG was involved in the performance of the FDA for a number of years, including in their termination and renegotiation.[3] The court therefore upheld the award, finding that French law (the law of the seat) was the governing law of the arbitration agreement and that KFG was a party to it. KFG appealed to the *Cour de Cassation*, whose decision is pending.

English Enforcement Proceedings

Alongside the French proceedings, proceedings were brought by Kabab-Ji in the English Commercial Court to enforce the award under s. 101 of the Arbitration Act 1996. At first instance, the court found that English law governed the validity of the arbitration agreement. The court considered it likely that under English law, KFG was not party to the FDA or, therefore, the arbitration agreement, but this was left open for further determination. The proceedings were stayed pending the annulment proceedings in the Paris Court of Appeal.

Both Kabab-Ji and KFG appealed. The English Court of Appeal dismissed Kabab-Ji's appeal and gave summary judgment in favour of KFG, finding that there was an express choice of English law as the governing law of the arbitration agreement. As a matter of English law, KFG could not have become a party to the FDA and its arbitration agreement without either consenting to this in writing (as required by the 'no oral modification' clauses in the FDA) or there being circumstances giving rise to an estoppel. This had not occurred, and the English Court of Appeal found that the judge at first instance should have made a final determination on this issue. On that basis, recognition and enforcement was refused.

UK Supreme Court Ruling

Kabab-Ji was given permission to appeal on various grounds, which the court condensed into the following issues:

(1) Which law governed the validity of the arbitration agreement?

(2) If English law was the applicable governing law, was there any real prospect that KFG had become a party to the arbitration agreement?

(3) Was the Court of Appeal justified in giving summary judgement refusing recognition and enforcement of the award, as a matter of procedure?

In a unanimous judgment, the Supreme Court found in favour of KFG and held that:

(1) English law governed the validity of the arbitration agreement;

(2) Under English law, there was no real prospect that a court would find KFG had become a party to the arbitration agreement; and

(3) Procedurally, the Court of Appeal was justified in giving summary judgement refusing recognition and enforcement of the award.

The Supreme Court's reasoning was as follows:

<u>Issue 1: Which law governed the validity of the arbitration agreement?</u>

The Supreme Court referred to the summary in *Enka* of Article V(1)(a) of the New York Convention[4] ("**Article V(1)(a)**"), which established that the validity of an arbitration agreement is governed by:

1. the law chosen by the parties; and
2. in the event no choice has been made, the law of the country where the award is made.[5]

In *Enka,* the Supreme Court found that where an arbitration agreement does not specify the applicable governing law, a choice of governing law in the contract containing the arbitration agreement would generally be sufficient indication of the governing law. Importantly, in *Kabab-Ji*, the Supreme Court confirmed that the principle in *Enka* applied not only prior to the issuance of the award but also at the enforcement stage. As such, the governing law specified in the FDA—English law—was the applicable law of the arbitration agreement.

Kabab-Ji unsuccessfully advanced arguments that the law of the seat (French law) should apply. The arbitration agreement stated that the UNIDROIT Principles were applicable. Kabab-Ji argued that when this was read alongside the governing law clause (which specified that English law governed the contract), there was "*no sufficient indication of the law which is to govern the validity of the arbitration agreement*"[6], as the blend of English law and UNIDROIT Principles did not qualify as "law" under Article V(1)(a) and s. 103(2)(b) of the Arbitration Act 1996. As the parties had not chosen a "law" to govern the arbitration agreement, Kabab-Ji argued that the law of the seat was to be applied pursuant to Article V(1)(a).[7] The court rejected this argument as "*illogical and inconsistent with the principle of party autonomy*",[8] as parties who opted for a certain governing law supplemented by additional principles would be denied their choice of both. Instead a different governing law (the law of the seat) would apply to their arbitration agreement, contrary to what the parties had chosen.

Kabab-Ji also sought to rely upon the 'validation principle'[9] to argue that the choice of English law as the governing law would not extend to the arbitration agreement if the application of English law would result in there being no valid arbitration agreement between Kabab-Ji and KFG. The Supreme Court noted that the validation principle was a method of contractual interpretation and Kabab-Ji's argument sought to "*extend the validation principle beyond its proper scope*".[10] The Supreme Court concluded that the principle does not apply to questions of validity where the court has to determine whether an arbitration agreement exists at all.

Issue 2: If English law is the applicable governing law, had KFG become a party to the arbitration agreement?

The Supreme Court held that there was no real prospect of evidence being adduced that the KFG had become party to the arbitration agreement. In reaching this conclusion, particular attention was paid to the requirements in the FDA's 'no oral modification' clauses. These placed the burden on Kabab-Ji to prove that there was a sufficiently arguable case that KFG had consented to becoming a party to the arbitration agreement in writing, or that KFG was estopped from relying on the failure to comply with those requirements. No evidence was adduced by Kabab-Ji beyond evidence of an informal unwritten promise and so the Supreme Court held that Kabab-Ji had failed to discharge this burden.

Issue 3: Was the Court of Appeal justified in giving summary judgement refusing recognition and enforcement of the award, as a matter of procedure?

The Supreme Court held that Article V(1) of the New York Convention and s. 103 of the Arbitration Act 1996 did not prevent the Court of Appeal from giving summary judgment refusing recognition and enforcement of the award. The English courts will decide whether

determination should be made by summary judgment or a full evidential hearing in accordance with the Civil Procedural Rules. The Court of Appeal was therefore entitled to summarily determine the case, given it was in the interests of justice and the overriding objective to do so.

Commentary

The Supreme Court in *Kabab-Ji* confirmed the general principle established in *Enka* that, as a matter of English law, the governing law of a contract will govern an arbitration agreement within that contract where there is no express provision in the arbitration agreement itself. However, this has put the UK Supreme Court at odds with the French courts, with the Paris Court of Appeal having dismissed annulment proceedings against the award, finding that, under French law, the respondent was a party to the arbitration agreement. In its judgment, the Supreme Court emphasised that "*the risk of contradictory judgments cannot be avoided*"[11] and there is no universal consensus regarding the interpretation of Article V(1)(a) by the courts of contracting states

It remains to be seen what the French *Cour de Cassation* will decide. Kabab-Ji may also be inclined to attempt to enforce the Paris-seated award in another civil law jurisdiction, where a civil law court may find similarly to the French courts. This highlights that the international division in approach to Article V(1)(a) is unsatisfactory, and increases the risk of parallel proceedings in different jurisdictions and enforcement challenges. It may also prompt parties to 'shop' for arbitrators who will take a particular view of the governing law of arbitration agreements.

Perhaps the biggest lesson is for contracting parties to always incorporate an express choice of governing law of the arbitration agreement when drafting arbitration clauses. This is especially important when the seat of arbitration is in a different jurisdiction to that of the governing law. This is an oft-overlooked part of arbitration clauses, but one that can have serious consequences in international arbitration and enforcement. The experienced team at Gibson Dunn are well placed to assist on specific drafting queries.

Procedurally, the case also highlights the fact that the English courts will be prepared to use summary procedures in enforcement proceedings where appropriate, which saves both time and costs. The English courts will determine whether a case is suitable for summary determination on a case-by-case basis, having regard to procedural factors such as the overriding objective.

---

[1] [2021] UKSC 48, [37]

[2] Judgment of Paris Court of Appeal (23 June 2020), Kabab-Ji S.A.L Company v. Kout Food Group Company [36]

[3] Judgment of Paris Court of Appeal (23 June 2020), Kabab-Ji S.A.L Company v. Kout Food Group Company [33]-[48]

[4] Convention on the Recognition and Enforcement of Foreign Arbitral Awards adopted by the United Nations Conference on International Commercial Arbitration on 10 June 1958 ("**New York Convention**").

[5] The court noted that where the parties have chosen the seat of arbitration, the award will be deemed to be made at the place of the seat. See [2021] UKSC 48, [26].

[6] [2021] UKSC 48, [40].

[7] Kabab-Ji also relied on s. 103(2)(b) of the Arbitration Act 1996 which replicates Article V of the New York Convention

[8] [2021] UKSC 48, [44].

[9] The UKSC defined the validation principle 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*". See [2021] UKSC 48, [49].

[10] [2021] UKSC 48, [51].

[11] [2021] UKSC 48, [90].

The following Gibson Dunn lawyers assisted in the preparation of this client update: Cyrus Benson, Penny Madden QC, Nooree Moola, Michael Stewart and Sophia Cafoor-Camps.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's International Arbitration, Judgment and Arbitral Award Enforcement or Transnational Litigation practice groups, or any of the following practice leaders and members:

Cyrus Benson – London (+44 (0) 20 7071 4239, CBenson@gibsondunn.com) Penny Madden QC – London (+44 (0) 20 7071 4226, PMadden@gibsondunn.com) Jeff Sullivan QC – London (+44 (0) 20 7071 4231, Jeffrey.Sullivan@gibsondunn.com) Nooree Moola – Dubai (+971 (0) 4 318 4643, nmoola@gibsondunn.com)

Related Capabilities

International Arbitration

Judgment and Arbitral Award Enforcement

Transnational Litigation