UK Supreme Court judgment provides further guidance on the governing law of arbitration agreements

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On 27 October 2021, the UK Supreme Court handed down judgment *in Kabab-Ji Sal (Lebanon) v Kout Food Group (Kuwait)* [2021] UKSC 48, delivering further guidance to commercial parties and arbitration practitioners on the issue of the governing law of arbitration agreements.

The Supreme Court upheld the decision of the Court of Appeal in finding that a general choice of law clause in a written contract containing an arbitration agreement will normally be a sufficient indication of the law governing that arbitration agreement. Applying English law, the court further held that the contract subject to the dispute had not been novated such as to make a third party subject to the arbitration agreement, in the light of the No Oral Modification clause in the contract. Lastly, the Supreme Court considered that the Court of Appeal was correct in refusing the recognition and enforcement of the arbitral award by way of summary judgment, and that the first instance judge had been wrong to adjourn the enforcement decision pending the outcome of an annulment application in the French courts concerning the same award.

Whilst the decision may initially appear to have more deeply ingrained the conflicting approaches of the English and French courts to the issue of governing law of arbitration agreements, the court's reasoning is based on a methodical analysis of the relevant choice of law rules. It also provides helpful confirmation of the English law approach to identifying the governing law of an arbitration agreement, following an earlier landmark decision by the Supreme Court on the same issue (discussed in our Law-Now here).

Factual background and the tribunal's decision

The underlying dispute arose out of a franchise agreement between Kabab-Ji SAL (Kabab-Ji), a Lebanese company, and Al-Homaizi Foodstuff Co WWL (AHFC), its Kuwaiti licensee. Following a corporate reorganisation, AHFC became a subsidiary of Kout Food Group (KFG), the respondent to the proceedings. The franchise agreement contained (i) an express choice of English law as the law of the main contract, (ii) an arbitration agreement providing for arbitration in Paris and (iii) a No Oral Modification clause.

Kabab-Ji referred its dispute with KFG to arbitration in Paris under the ICC Arbitration Rules. A majority of the tribunal decided that the question whether KFG was bound by the arbitration agreement was governed by French law, but that English law governed the question whether KFG had acquired substantive rights and obligations under the franchise agreement by a novation of the agreement from AHFC to KFG. The Tribunal then found that KFG was in breach of the franchise agreement and awarded Kabab-Ji damages.

KFG filed an annulment application with the French court (as the competent authority of the country in which the award was made). In the meantime, Kabab-Ji applied to the English court for the award to be recognised and enforced.

English High Court judgment

The judge at first instance decided that the choice of English law in the franchise agreement constituted an express choice of

law for the entire agreement, including the arbitration agreement. The judge also reached the provisional conclusion that, applying English law, the No Oral Modification Clause meant that there was no novation of the franchise agreement from AHFC to KFG, and Kabab-Ji had not satisfied the conditions for estoppel that would have precluded AHFC by its conduct from relying on the No Oral Modification Clause. However, the judge thought it was possible that further evidence might emerge in the course of the French proceedings that might alter this conclusion, and he therefore declined to make a final ruling on the point. He adjourned any further hearing until after the Paris Court of Appeal had decided KFG's application to annul the award. Both parties appealed.

The Court of Appeal judgment

The Court of Appeal agreed with the lower court that the parties' express choice of English law to govern the main contract was also an express choice of the same law to govern the arbitration agreement. Where there was no indication that the arbitration agreement was to be construed separately from the rest of the contract, the contract should be construed as a whole and the express choice of law applied to all its clauses. The express choice of Paris as the seat of the arbitration did not impliedly override this choice, since an implied provision cannot displace an express one.

The court also agreed with the judge at first instance that the contract had not been novated. However, it held that he had been wrong to refuse to make a final order. There was no real prospect that new evidence would come to light that would allow Kabab-Ji to satisfy the conditions for an estoppel. The recognition and enforcement of the award was refused. Kabab-ji appealed to the Supreme Court.

The French court judgment

In the meantime, in a conflicting judgment, the Paris Court of Appeal rejected KFG's application to annul the award. KFG had argued that the arbitral tribunal did not have jurisdiction because KFG was not a party to the franchise agreement. In refusing to annul the award, the court found that French law, not English law, was the governing law of the arbitration agreement.

Indeed, the French courts have consistently held that the existence and validity of an arbitration agreement must be considered solely in the light of the requirements of international public policy, irrespective of any national law, even a law governing the form or substance of the main contract. The French courts instead apply substantive rules of international arbitration, including the "separability principle". In this case, the court held that as the parties had not expressly agreed that English law would govern the arbitration agreement specifically, the tribunal was instead bound to apply the substantive law of the place of the seat of arbitration (French law). Under French law, KFG was bound by the arbitration agreement.

The Supreme Court judgment

In the face of these diverging decisions, the Supreme Court was asked to decide on three issues, namely:

1. What law governs the validity of the arbitration agreement?

2. If English law governs, is there any real prospect that a court might find at a further hearing that KFG had become a party to the arbitration agreement contained in the franchise agreement?

3. As a matter of procedure, was the Court of Appeal justified in giving summary judgment refusing recognition and enforcement of the award?

The choice of law issue

The appeal was heard in June – July 2021, a few months after the Supreme Court handed down judgment in another significant case concerning the governing law of arbitration agreements, covered in our Law-Now here. In that case, the Supreme Court set out a series of English law principles to be methodically applied whenever the question arises as to what law governs an arbitration agreement.

However, in the present case, the Supreme Court noted that, in its previous case, the question of governing law arose before any arbitration had taken place, and therefore the English common law rules for resolving conflicts of laws applied. However, in *Kabab-ji*, an arbitral award had been made, so the rules to be applied were those set out in the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention), as transposed into English law by the Arbitration Act 1996. The relevant provision of the New York Convention - article V(1)(a) - can be found in section 103(2)(b) of the Arbitration Act, and states that "*the*

recognition or enforcement of the award may be refused if the person against whom it is invoked proves (…) that 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."

The Supreme Court noted that it would be desirable, given the international status of the New York Convention, if the rules for determining whether there is a valid arbitration agreement were not only given a uniform meaning but were applied by the courts of the contracting states in a uniform way – a nod, perhaps, to the existence of conflicting decisions such as those in the history of this case. The court was not troubled by this for long, noting that "*[i]t is apparent, however, that there is nothing approaching a consensus*" on the question whether or when a choice of law for the contract as a whole constitutes a sufficient indication of the parties' choice of law for the arbitration agreement, in particular where it differs from the law of the seat. The court considered that, therefore, "*the English courts must form their own view*."

The court had regard to commentary provided at the conference at which the New York Convention was adopted, which indicated that an express agreement as to the law that is to govern the arbitration agreement is not required and that any form of agreement will suffice. On that basis, the court found it "*difficult to resist*" the conclusion that a general choice of law clause in a written contract containing an arbitration clause will normally be a sufficient indication of the law to which the parties subjected the arbitration agreement.

The court also recalled the principles that it set out in its previous case, noting that it would be "*illogical*" if the law governing the validity of the arbitration agreement were to differ depending on whether the question was raised before or after an award had been made.

The Supreme Court concluded that the effect of the clauses in the franchise agreement was "*absolutely clear.*" The agreement contained a typical governing law clause, providing that "*this Agreement*" shall be governed by the laws of England. Even without any express definition, the court considered that that phrase is ordinarily and reasonably understood to denote all the clauses incorporated in the contract, including the arbitration agreement. The Supreme Court found there was no good reason to infer that the parties intended to except the arbitration agreement from their choice of English law to govern all the terms of their contract. Therefore, the law applicable to the arbitration agreement was English law.

Addressing two arguments against this conclusion raised by Kabab-ji, the court noted that a reference in the franchise agreement to the arbitrator applying "*principles of law generally recognised in international transactions*" (i.e. UNIDROIT Principles of International Commercial Contracts) was a reference to the rules of law to be applied to the merits of the dispute, not the validity of the arbitration agreement. The court also rejected Kabab-ji's contention that, as the parties should be presumed to intend that the arbitration agreement will be valid and effective, one should infer that the choice of English law does not extend to it if applying English law would invalidate it. This is the "validation principle", which is a principle of contractual interpretation which presupposes that an agreement has been made. The court appeared to restrict the validation principle slightly, noting that it does not apply to questions of validity in the expanded sense in which that concept is used in article V(1)(a) of the New York Convention and section 103(2)(b) of the Arbitration Act to include an issue about whether any contract was ever made between the parties to the dispute.

The "party" issue

Having established that English law applied, the court then considered whether KFG had become a party to the arbitration agreement. The Supreme Court referred to the decision in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* [2018] UKSC 24; [2019] AC 119, where the Supreme Court held that No Oral Modification clauses are legally effective. The court considered the various provisions and held that the clauses applied to termination of the franchise agreement (which was contemplated by Kabab-ji as part of the novation) as they did to amendments and modifications to the agreement. Yet such termination could only be effected in writing and if signed by or on behalf of both of the parties, which had not been done.

The court also found that the requirements for estoppel from relying on No Oral Modification clauses as laid out in *Rock Advertising* had not been satisfied, and even if there was evidence supporting an estoppel against AHFC, that would not necessarily extend to KFG.

Accordingly, the court agreed with the Court of Appeal that as a matter of English law, there

was no real prospect that a court might find at a further hearing that KFG had become a party to the arbitration agreement in the franchise agreement.

The procedural issue

Finally, the Supreme Court turned to the question whether the Court of Appeal was justified in giving summary judgment refusing recognition and enforcement of the award. The New York Convention provides that the recognition and enforcement of an award may only be refused if the party against whom it is invoked proves one or more grounds set out in article V(1)(a) to (e). The Supreme Court found that there is nothing in the New York Convention or the Arbitration Act which prescribes how the party is to prove the ground is satisfied, and it is for the English courts to decide how the ordinary judicial determination should be made in accordance with its own procedural rules, including the overriding objective under the Civil Procedure Rules. In some cases, this may involve a full evidential hearing and in others, where appropriate, a summary determination.

In fact, the Supreme Court suggested that summary determinations may be an entirely preferable way of achieving a speedy resolution, since in many cases the nature and extent of the relevant evidence will already be clear from the hearing before the arbitral tribunal. Using this procedure would be entirely consistent with the pro-enforcement policy of the New York Convention and its equivalent provisions in the Arbitration Act. Whether or not it is suitable will depend on the specific facts of the case.

As to whether the judge at first instance was correct to adjourn the decision on enforcement pending the decision of the French Court of Appeal, the Supreme Court evaluated situations in which it would be reasonable and favourable to adjourn a decision pending that of a court in another jurisdiction, and found that since the French Court of Appeal was deciding the matter on the basis of a different body of law (French law) and therefore its decision would have no bearing on that of the English courts (which would be applying English law), there was no valid reason to adjourn pending the decision of the French court.

Accordingly, the Supreme Court held that the Court of Appeal was justified in overturning the first instance decision to grant an adjournment and in giving summary judgment refusing recognition and enforcement of the award. The appeal was dismissed.

Comment

The decision in *Kabab-Ji* provides further reassuring clarity on how the governing law of the arbitration agreement is to be determined under English law where the governing law is not expressly stated in the arbitration agreement itself. The Supreme Court's reasoning is consistent with its earlier decision on the same issue, albeit in the context of enforcement pursuant to the New York Convention, rather than considering the arbitration agreement before an award is rendered. These two cases reflect the commercial reality that in practice, when negotiating a contract, parties rarely distinguish between the arbitration agreement and the contract as a whole when deciding which governing law to choose for their agreements.

Commercial parties and arbitration practitioners should nonetheless bear in mind the diverging approach of the French courts (and indeed of other jurisdictions, as discussed in our article here), and err on the side of caution by expressly stating the governing law of the arbitration agreement, specifically, in their contracts.

The Supreme Court also confirmed how the English courts will construe the scope of No Oral Modification clauses following *Rock Advertising*. Its refusal to recognise a novation by conduct, where the contract so clearly called for all amendments, modifications and any termination to be agreed in writing, provides a useful reminder to parties of the importance of adhering to the express provisions of their contract when seeking to amend its terms.

The indication of the Supreme Court as to the usefulness of the summary judgment procedure for deciding the recognition and enforcement of an arbitral award also helpfully recognises the fact that arbitration users often want a speedy enforcement process, and that a summary judgment is most likely to achieve that.

The Supreme Court's decision on the procedural issue of adjournment is also noteworthy as a potential test to the doctrine of comity. However, the implications of this aspect of the decision should not be overstated. If the court had been required to consider Article V(1)(e) of the New York Convention (which provides a defence to enforcement where an award has been set aside by the courts of the seat of the arbitration) whilst such a set-aside application was pending before the French courts, the court would have been likely to grant an adjournment pending the decision of the French courts.

However, the Supreme Court was presented only with an Article V(1)(a) defence, regarding the validity of the arbitration agreement, and was required only to apply English law.

As KFG has appealed the rejection of its set-aside application in the French Court of Appeal to the Court of Cassation, it will be interesting to see whether and the extent to which France's highest court now seeks to bridge the gap.

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