Litigation & Arbitration Group

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Arbitration case law update:

Court of Appeal refuses Kabab-Ji enforcement

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Arbitration case law update: Court of Appeal refuses Kabab-Ji enforcement

Kabab-Ji S.A.L. v Kout Food Group [2020] EWCA Civ 6

In a recent judgment, the Court of Appeal refused to recognise and enforce an arbitral award in a decision which addressed two key issues: (1) what law governs arbitration agreements and (2) the effectiveness of "no oral modification" clauses.

In summary, the Court of Appeal held that:

- the governing law of an arbitration agreement is a matter of construction and that, on interpretation of the relevant express terms, the arbitration agreement in dispute was governed by English law (which was the governing law of the underlying agreement), notwithstanding that the seat of the arbitration was Paris.

- applying the judgment of the Supreme Court in Rock Advertising,[1] a "no oral modification" clause was effective. Since there had been no written variation of the relevant franchising agreement, nor conduct amounting to an estoppel, the respondent had not become a party to the franchising agreement and was thus not bound by its terms or the terms of the arbitration agreement.

Background

The arbitration

Kabab-Ji (a Lebanese company) began arbitration proceedings in Paris against Kout Food Group ("**KFG**") (a Kuwaiti company) pursuant to an arbitration agreement in a Franchise Development Agreement ("**FDA**") between Kabab-Ji and KFG's subsidiary. The FDA was governed by English law. However, a jurisdictional

[1] MWB Business Exchange Centres Limited v Rock Advertising Limited [2018] UKSC 24; [2019] AC 119.

issue arose as to whether KFG had become a party to the FDA (and thus to the arbitration agreement), despite a "no oral modification clause" in the FDA.

The arbitral tribunal found that the governing law of the arbitration agreement, which provided that the seat of an arbitration would be Paris, was French law. However, the tribunal held that it was a question of English law whether KFG's subsidiary had transferred its rights and obligations under the FDA to KFG (and, therefore, whether KFG was bound by the FDA). Applying English law, the tribunal found (by a majority) that, despite the lack of any written modification, a "*novation*"[2] adding KFG as a party to the FDA could be inferred from the parties' conduct and that, on the facts, KFG was in breach of the FDA.

The applications

KFG filed an application in France for annulment of the arbitral award. This application is due to be heard in February 2020. Shortly after KFG's filing, Kabab-Ji commenced proceedings in England to enforce the award, and this order was granted *ex parte* by Popplewell J. KFG then applied to the English courts for an order that the recognition and enforcement of the arbitral award be refused and for Popplewell J's order to be set aside.

The High Court's decision

At a trial of preliminary issues, the High Court found that, "*irrespective of the approach of the arbitrators*",[3] English law, not French law, was the governing law of the arbitration agreement.[4] Further, it held that, under English law, the "no oral modification" clause meant that KFG had not become a party to the FDA or the arbitration agreement. However, the High Court then refused to make a final determination, instead ordering that the applications before the English courts be stayed pending the outcome of the French annulment proceedings.

The Court of Appeal's Decision

On appeal by Kabab-Ji, the Court of Appeal considered the following questions:

1. What law governs the arbitration agreement?

2. Despite the "no oral modification" clause, did KFG become a party to the FDA and thus to the arbitration agreement?

3. Should the arbitration award be recognised and enforced as a judgment?

Governing law of the arbitration agreement

The Court of Appeal held that, as a matter of construction, the parties had expressly chosen English law to govern the arbitration agreement.[5] The governing law clause of the FDA stated that "[t]*his Agreement shall be governed by and construed in accordance with the laws of England*"[6] and that, as defined in the FDA,

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[2] Kabab-Ji S.A.L. v Kout Food Group [2020] EWCA Civ 6 at [3].
[3] Ibid at [17].
[4] The enforcement court is entitled to determine this pursuant to the terms of the New York Convention (as applied in section 103(2) Arbitration Act 1996) notwithstanding what the tribunal or the supervisory court has previously held.
[5] Interestingly, the FDA also stated that the arbitrators should apply "*principles of law generally recognised in international transaction*" (namely, UNIDROIT principles), and that the arbitrators "*may have to take into consideration some mandatory provisions of some countries*" (Kabab-Ji at [8]). However, the Court of Appeal found that this did not undermine its conclusion that English law governed the arbitration agreement.
[6] Kabab-Ji at [8].

the "*Agreement*" included the clause containing the arbitration agreement. The Court held that it did not matter that the choice of law was "*not spelt out expressly*"[7] in the arbitration agreement itself.

As the Court of Appeal considered that the parties had made an express choice based on the language in the FDA, it did not offer a view on whether there had been an implied choice to follow the governing law of the FDA rather than the seat of arbitration. This is possibly because of the potential difficulty of reconciling any such decision with the principles that the Court of Appeal had previously set out in Sulamérica v Enesa Engelharia.[8] In that case, the parties had expressly agreed that an insurance policy, which contained an agreement to arbitrate, was to be governed exclusively by Brazilian law. The Court of Appeal held that while the starting assumption is that the "*parties intended the same law to govern the whole of the contract, including the arbitration agreement, specific factors may lead to the conclusion that that cannot in fact have been their intention*."[9] In Sulamérica the court found that the arbitration agreement was in fact governed by English law, and in so doing, it gave great weight to the fact that the parties had chosen England as the seat of the arbitration:

> "[t]*his tends to suggest that the parties intended English law to govern all aspects of the arbitration agreement, including matters touching on the formal validity of the agreement…*"[10]

In Kabab-Ji, the Court of Appeal stated that whatever the impact of the parties' choice of arbitral seat, it could not overcome the express provision in the FDA that English law governed the entire "*Agreement*", including the arbitration agreement. The Court of Appeal therefore affirmed the judgment of the High Court on this point.

No oral modification

Applying the Supreme Court's decision in MWB Business Exchange Centres Limited v Rock Advertising Limited,[11] the Court of Appeal held that, under English law, "no oral modification" clauses were effective to prevent informal variations of agreements, unless there were grounds for an estoppel. Kabab-Ji argued that, given the FDA required the arbitrators to take into account the UNIDROIT principles,[12] it was not sufficient to consider only English law in this regard. Applying those UNIDROIT principles, Kabab-Ji argued that KFG was precluded by its (and/or its subsidiary's) conduct from asserting a "no oral modification clause" to the "*extent that the other party has reasonably acted in reliance on that conduct.*"[13] However, the Court of Appeal, relying on the judgment of Lord Sumption JSC in Rock Advertising,[14] held that there was little difference between the UNIDROIT approach and the English doctrine of estoppel.

The Court of Appeal further noted that, even if the UNIDROIT principles were broader than estoppel, those principles could not be used to override the express "no oral modification" clause. To do so would be to apply rules that contradicted the strict wording of the FDA, which was expressly prohibited by a clause in the FDA.[15] The Court of Appeal interpreted this clause to mean that the strict wording of the FDA could only be overridden so far as permitted by English law (as the governing law of the FDA). In doing so, the Court gave short shrift to Kabab-Ji's "*misconceived*" argument that the FDA was in fact governed by "*English law plus*" such that broader UNIDROIT principles could override the "no oral modification" clause.[16]

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[7] Ibid at [67].
[8] Sulamérica Cia Nacional de Seguros SA and others v Enesa Engelharia SA and others [2012] EWCA Civ 638; [2013] 1 WLR 102.
[9] Ibid at [31].
[10] Ibid at [29]. The Court of Appeal also noted that the assertion by the insured that a choice of Brazilian law would render the arbitration agreement enforceable only with their consent was, if correct, a powerful factor to be taken into account when considering the choice of Brazilian law.
[11] MWB Business Exchange Centres Limited v Rock Advertising Limited [2018] UKSC 24; [2019] AC 119.
[12] Under article 14.3 of the FDA.
[13] Kabab-Ji at [74].
[14] Ibid at [73] to [74], and Rock Advertising at [16].
[15] Under article 14.3 of the FDA.
[16] Ibid at [76].

Given the lack of a formal, written modification of the FDA, the Court of Appeal found that KFG could not become a party to the FDA (or the arbitration agreement) unless there were "*(i)…some words or conduct unequivocally representing that the variation was valid notwithstanding its informality; and (ii) something more would be required than the informal promise itself*."[17] On the facts, the Court held that KFG's conduct did not meet this test.

Final Determination

Interestingly, despite the fact that the annulment proceedings were still pending before the French court (as the supervisory court), the Court of Appeal held that it was nevertheless appropriate for it to make a decision on Kabab-Ji's application for enforcement (which the judge at first instance had refused to do). Having found that Kabab-Ji had no real prospect of satisfying the Rock Advertising test so as to bind KFG under the arbitration agreement, the Court of Appeal made an order refusing enforcement of the arbitral award as a judgment and setting aside Popplewell J's prior enforcement order.

Lessons learned

This case illustrates the primacy of express contractual language when interpreting arbitration agreements. In order to best avoid the risk of 'satellite' disputes, parties to arbitration agreements should ensure that the governing law of an arbitration agreement, as well as the governing law of the underlying agreement itself, are both set out expressly in their contracts. This is particularly important where the governing law of the main agreement differs from the seat of the arbitration. Similarly, the Court of Appeal's decision makes it clear that parties will need to ensure that any amendments to agreements are clearly formalised in writing in circumstances where their contracts contain a "no oral modification" clause.

It is also interesting to note that the English courts (in marked similarity to the well-known decision of the Supreme Court in Dallah),[18] at the enforcement stage, were willing to re-assess the validity of an arbitration agreement despite the tribunal's decision and the fact that the supervisory court's decision on an annulment action was pending.

[17] Ibid at [79], applying the test set down by the Supreme Court in Rock at [16].

[18] Dallah Real Estate and Tourism Holding Company v The Ministry of Religious Affairs, Government of Pakistan [2010] UKSC 46. In Dallah, the Supreme Court refused to recognise and enforce an award on the basis that the respondent was not a proper party to the arbitration agreement. The Supreme Court's decision was controversial because the question was pending in the highest French courts (being the supervisory courts of the arbitration) and, in making its ruling, the Supreme Court disagreed with the French courts on a matter of French law.

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