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Supreme Court confirms principles for determining law of arbitration agreement in enforcement proceedings

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Introduction

In *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)*,[(1)] the Supreme Court affirmed the *Enka v Chubb* principles for determining the law of an arbitration agreement (the "AA law"). In upholding the Court of Appeal's decision that English law governed an arbitration agreement, the Supreme Court confirmed again that an express choice of law governing the main contract will generally also amount to a choice of AA law. The principles for determining the AA law will be the same both before and after an award is issued.

The Court also confirmed that reference in an agreement to both English law and the International Institute for the Unification of Private Law (UNIDROIT) principles of contractual interpretation did not mean that there was no choice of AA law for the purposes of enforcement of the New York Convention award under the Arbitration Act 1996. Finally, in enforcement proceedings, the Court confirmed that a determination on whether there was a valid, binding arbitration agreement may be heard on a summary basis without a full evidentiary hearing and trial of the issue.

This decision is a rare example of the English courts refusing enforcement of an arbitral award.

Background – *Enka v Chubb* principles on law of arbitration agreements

In its 2020 ruling in *Enka Insaat Ve Sanayi AS v OOO "Insurance Company Chubb"*,[(2)] the Supreme Court clarified the correct test for determining the AA law. In doing so, the Court reformulated the relative weight to be attached to the law of the seat where the main contract law and the law of the seat differ, or where the main contract does not include a choice of law. The first step is to consider whether there was an express choice of AA law. This is ascertained by construing the arbitration agreement and the main contract containing it as a whole, applying the ordinary principles of contractual interpretation.

The second step requires the court to consider whether there was an implied choice of AA law. The Supreme Court ruled that where there is a choice of law for the main contract, the parties have impliedly chosen the main contract law to govern the arbitration agreement as well, unless there is good reason to find otherwise. The Supreme Court went further and stated that this general rule applies where there is an implied choice of main contract, as well as an express choice.

In the absence of any express or implied choice of AA law, the court must decide with which system of law the arbitration agreement is most closely connected, irrespective of the parties' intentions. The Supreme Court held that the default rule is that the law most closely connected with the arbitration agreement will be the law of the seat (for further details please see "Supreme Court clarifies principles for determining law of arbitration agreement").

Facts

The appellant (Kabab-Ji) had entered into a franchise development agreement with Al Homaizi Foodstuff Company, which allowed Al Homaizi to operate Kabab-Ji's Lebanese restaurant franchise in Kuwait for 10 years. Kabab-Ji and Al Homaizi entered into a number of individual franchise outlet agreements for each restaurant that was opened. The dispute resolution clauses of the franchise development agreement and franchise outlet agreements (the franchise agreements) were expressly governed by English law and provided for Paris-seated International Chamber of Commerce arbitration. Subsequently, Al Homaizi became a subsidiary of the respondent (Kout) through a corporate reorganisation.

Arbitration proceedings

When disputes arose under the franchise agreements, Kabab-Ji referred the matter to arbitration pursuant to the arbitration agreement. Kabab-Ji brought those proceedings against Kout and not its original counterparty, Al Homaizi.

Kout participated in the subsequent arbitration under protest. It claimed that the arbitration agreement was invalid against it because it had never become party to the franchise agreements. It further contended that as a matter of English law (which was the governing law of the franchise agreements), the clauses of the franchise agreements that were said to have been breached were not binding on it because it was not a party to those contracts.

The majority of the Paris-seated tribunal found that the AA law was French law. As a matter of French law, the majority found Kout had become a party to the arbitration agreement. As to the substantive breaches complained of, the tribunal found that Kout had also become party to the franchise agreements as a whole as a matter of English law through a "novation by addition", and, on the merits, made an award against Kout. The dissenting arbitrator expressed the view that English law precluded Kout from becoming party to the franchise agreements.

Challenge and enforcement proceedings

Kout began set aside proceedings at the seat of arbitration, Paris, alleging that the tribunal lacked jurisdiction to issue an award against it.

Soon after, Kabab-Ji began enforcement proceedings in the London Commercial Court, with Kout applying for enforcement to be refused under section 103(2)(b) of the Arbitration Act. In the Commercial Court, Sir Michael Burton decided that the AA law was English law. Subject to a matter left open, the Court ruled that Kout had never become party to the franchise agreements or the arbitration agreement as a matter of English law. A final decision on enforcement was postponed pending the outcome of annulment proceedings before the Paris Court of Appeal.

The English Court of Appeal affirmed the Commercial Court's decision but went one step further. It ruled that the judge should have decided the case finally and refused enforcement on the basis that there was no prospect of success for Kabab-Ji, given the conclusions that Kout was a party to neither the franchise agreements nor the arbitration agreement. This, the Court of Appeal ruled, was a case in which summary judgment was appropriate.

After the English Court of Appeal handed down judgment, the Paris Court of Appeal rejected Kout's application for annulment, agreeing with the majority of the tribunal that the AA law was French law. Kabab Ji's appeal of that decision to the French Court of Cassation is yet to be determined.

Decision

The UK Supreme Court upheld the Court of Appeal's judgment. In doing so, the Court considered three questions:

- What was the AA law?
- Was there a real prospect of the Court finding that Kout had become a party to the arbitration agreement?
- Was the Court of Appeal right to give summary judgment refusing recognition and enforcement of the award?

AA law

In *Enka v Chubb*, the Supreme Court applied common law rules in order to determine the AA law before an arbitration commenced. In the present case, the Court had to consider the principles applicable to determining the AA law at the stage of enforcement, pursuant to the New York Convention.

Section 103(2)(b) of the Arbitration Act transposes article V(1)(a) of the New York Convention and provides that recognition or enforcement of a New York Convention 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 thereof, under the law of the country where the award was made. As such, it was necessary to determine the AA law.

In *Enka*, the Court held that a general choice of law to govern a contract containing an arbitration clause would normally amount to a choice of AA law. In *Kabab-Ji*, the Court determined that the general considerations of law that it had applied in *Enka* were just as applicable in the context of enforcement proceedings under the New York Convention; applying the same principles before and after enforcement would promote "consistency and coherence in the law".[(3)]

As the parties had explicitly elected English law to govern the main contract containing the arbitration agreement and there were no factors (as outlined in *Enka*) that would support the interpretation that the arbitration agreement should be governed by the law of the seat, English law was held to be the AA law.

Kabab-Ji argued that a clause obliging the arbitrators to "apply principles of law generally recognised in international transactions" – understood to mean the UNIDROIT principles – meant that the AA law comprised both national law and international principles. This, it was argued, would not be a "law" within the meaning of article V(1)(a) of the New York Convention or the implementing provisions of the Arbitration Act, which refer only to the law of a country. If the parties had failed to subject the arbitration agreement to a national law, the law of the seat (ie, French law) would have had to apply. The Court dismissed this argument, observing that the relevant clause set out the law that the arbitrators were required to apply in the arbitration, but it did not determine the AA law.

Even if the arbitration agreement had been explicit that the AA law was to be English law and the UNIDROIT principles, the Court held that this would not have led to a conclusion that the AA law was French law.[(4)] Were the reference to the UNIDROIT principles to mean that only the law of the seat could be the AA law, that would be illogical and inconsistent with the principle of party autonomy.

The Court also rejected Kabab-Ji's argument that the validation principle meant that English law could not be the AA law. The principle requires that contractual provisions be interpreted to give effect to the parties' intention to make a valid and effective agreement. Kabab-Ji argued that if English law being the AA law meant that Kout was not a party to the arbitration agreement, the validation principle would prevent English law from applying. The Court held that Kabab Ji's argument would extend the validation principle beyond its proper scope, from a principle of contractual interpretation to one of contract formation as well.

Was there a real prospect that a court might find that Kout became a party to the arbitration agreement?

Kabab-Ji's case had been that Kout became party to the arbitration agreement by novation as a result of the parties' conduct.

The Supreme Court rejected this argument. There were a number of provisions that meant that the agreement between Kabab-Ji and Al Homaizi could not be amended other than in writing. "No oral modification clauses", such as those in the contract at hand, have been the subject of a previous Supreme Court decision, *MWB Business Exchange Centres Ltd v Rock Advertising Ltd*,[(5)] in which the Court upheld their effectiveness. Where part of the parties' bargain is the certainty that such clauses give, the courts are generally unwilling to obstruct that intention.

Further, Kabab-Ji's attempts to rely on a purported estoppel, good faith or the UNIDROIT principles to overcome the no oral modification clause were unsuccessful. The Supreme Court ruled that the Court of Appeal was right to conclude that there was no realistic prospect of further evidence being put forward that Kout had become party to the arbitration agreement.

Summary procedure for refusing recognition and enforcement

Kabab-Ji sought to rely on the language of the New York Convention and the Arbitration Act to argue that nothing less than a full evidential hearing was required to give a final judgment on enforcement. The Supreme Court had little trouble in dismissing this argument, notwithstanding that the English court must determine for itself whether there was a valid and binding arbitration agreement for the purposes of section 103 of the Arbitration Act. In *Dallah Real Estate and Tourism Holding Co v Ministry of Religious Affairs of the Government of Pakistan*,[(6)] the Supreme Court noted that nothing in section 103(2)(b) of the Arbitration Act or article V(1)(a) of the New York Convention hints at any restriction on the nature of the investigation that the court must make when considering the validity of the arbitration agreement, and that the language points strongly to an "ordinary judicial determination" of that issue. In the present case, the

Supreme Court noted that a summary procedure would be suitable if it was appropriate and proportionate in the circumstances and ruled that this principle extended to section 103. As such, the Court of Appeal was justified in dismissing the application for enforcement of the award on a summary basis.

Finally, the Supreme Court considered whether the Court of Appeal was justified in overturning the first-instance judge's decision to grant an adjournment, pending the outcome of the Paris Court of Appeal proceedings. Section 103(5) of the Arbitration Act gives the court a discretion to adjourn enforcement proceedings if it considers it "proper" to do so, pending a decision by a court of the seat on whether to set aside the award. Here, the English courts and the French courts would each be applying their own (substantively different) national law to determine the existence and validity of the arbitration agreement. In those circumstances, the risk of contradictory judgments could not be avoided and an adjournment was not justified.

Comment

The decision of the Supreme Court in *Kabab-Ji* provides further certainty on the *Enka v Chubb* principles that the courts should apply to determine the AA law. Those principles will apply whether the court is determining the AA law before an award is made, or in the context of enforcement of an award. The weight that the Supreme Court gave to party autonomy and applying a consistent approach to determining the AA law at all stages of the dispute will be reassuring for parties.

However, the uncertainty for the parties in the present case remains. The Paris Court of Appeal, considering the same award, reached the opposite conclusion to that of the UK Supreme Court, and ruled that the AA law was that of the seat. An appeal is pending before the French Court of Cassation. If the Paris Court of Appeal's decision is maintained, the award will be recognised and enforced in France, while enforcement has been refused in England.

These conflicting enforcement decisions highlight the consequences of failing to specify the AA law where the law governing the contract differs from the law of the seat. The decision in *Kabab-Ji* serves as an important reminder that parties should consider including an express governing law choice for both the underlying contract and the arbitration agreement (and should always do so where the governing law of the underlying contract and the law of the seat are different). As in this case, failing to draft with clarity may give rise to lengthy and costly challenge proceedings – possibly in multiple jurisdictions – once an award has been made.

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Endnotes

(1) [2021] UKSC 48.

(2) [2020] UKSC 38.

(3) *Kabab-Ji*, at [35].

(4) *Kabab-Ji*, at [47].

(5) [2018] UKSC 24; [2019] AC 119.

(6) [2008] EWHC 1901 (Comm); [2009] 1 All ER (Comm) 505, at [28].