International Arbitration Alert

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The Law of an Arbitration Agreement: Is it the law of the seat or the law of the underlying contract?

January 30, 2020

If there is no express law of the arbitration agreement, the law with which that agreement has its closest and most real connection is either the law of the underlying contract or the law of the seat of the arbitration. The English Court of Appeal judgement in *Kabab-Ji SAL v. Kout Food Group*, handed down on January 20, 2020, looked at the law of an arbitration agreement where the seat was Paris and where the underlying contract was governed by the law of England and Wales and contained a 'No Oral Modification' provision. The Court of Appeal held that the award was not enforceable, deciding:

- Governing law clauses do not necessarily cover the arbitration agreement. However, in *Kabab-Ji* the proper construction of the underlying contract and the arbitration agreement concluded that English law did govern the arbitration agreement. In contrast, all three arbitrators had decided that French law applied to the issue of validity of the arbitration agreement.
- The concept of the separability of an arbitration agreement (enshrined, for example, in Section 7 of the Arbitration Act of 1996) ensures that the dispute resolution procedure chosen by the parties survives the main agreement becoming unenforceable for example because of fraud or misrepresentation. Separability does not preclude an arbitration agreement being construed with the remainder of the main agreement as a whole.
- The effectiveness of so-called 'No Oral Modification' clauses, as held by the Supreme Court in MWB Business *Exchange Centres Limited v. Rock Advertising Limited* [2018] UKSC 24; [2019] AC 119, can be circumvented by doctrines of estoppel (and clarified that Lord Sumption JSC set out how English law interprets the UNIDROIT principles and was not saying anything different from UNIDROIT).

The Court of Appeal did not need to consider an implied choice of law. This means that the need for business efficacy before a term can be implied was not tested where there is a fallback position of either the law of the country with which the arbitration agreement has its closest and most real connection or the law of the country where the award is made.

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Kabab-Ji SAL v. Kout Food Group is also noteworthy since the Court of Appeal refused to stay the English recognition proceedings while annulment proceedings at the seat in front of the Paris Cour d'appel are pending. This judgement sets the stage for potentially rival inconsistent judgements in England and Wales and France.

The Facts

In 2001, Kabab-JI SAL ("KJS"), a Lebanese company, entered into a franchise development agreement ("FDA") with Al Homaizi Foodstuff Company ("AHFC"), a Kuwaiti company, as licensee. In 2005, following a corporate reorganization, AHFC became a subsidiary of a Kout Food Group ("KFG"). A dispute arose under the FDA which KJS referred to arbitration before the International Code Council (ICC) in Paris pursuant to Article 14 of the FDA against KFG, not AHFC.

Article 14 of the FDA stated:

> Article 14: Settlement of Disputes
>
> …
>
> 14.2. Except for those matters which specifically involve the Mark, any dispute, controversy or claim between LICENSOR and LICENSEE with respect to any issue arising out of or relating to this Agreement or the breach thereof, …shall, failing amicable settlement, on request of LICENSOR or LICENSEE, be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.
>
> 14.3. The arbitrator(s) shall apply the provisions contained in the Agreement. The arbitrator(s) shall also apply principles of law generally recognised in international transactions. The arbitrator(s) may have to take into consideration some mandatory provisions of some countries i.e. provisions that appear later on to have an influence on the Agreement. Under no circumstances shall the arbitrator(s) apply any rule(s) that contradict(s) the strict wording of the Agreement.
>
> 14.4. Nothing contained herein shall in any way deprive LICENSOR of its rights to seek and obtain a temporary restraining order, preliminary/permanent injunction or other equitable relief from a court of competent jurisdiction under any applicable law. All remedies provided in this Agreement are cumulative and not exclusive of any remedies provided by law.
>
> 14.5. The arbitration shall be conducted in the English language, in Paris, France.

The arbitral tribunal had to consider the threshold jurisdictional issue of whether KFG had become an additional party to the FDA and thus the arbitration agreement (which was contained in Article 14 of the FDA). The majority of the tribunal found that the question of whether KFG was bound by the arbitration agreement was a matter of the law of the seat (French law), but the issue of whether a transfer of substantive rights and obligations took place was governed by English law. The majority concluded that as a matter of English law, despite the No Oral Modifications clause, a "novation" was to be inferred by the conduct of the parties thereby replacing KFG as the main

franchisee and binding it to the arbitration agreement. The tribunal also determined that, on the merits, KFG was in breach of the FDA.

Following the publication of the Award, on December 13, 2017, KFG filed an annulment application before the French courts, as Paris was the seat of the arbitration. That application is due to be heard by the Cour d'appel de Paris in February 2020. On December 21, 2017, the claimant and award-creditor filed for enforcement of the Award as a judgment in London under section 101 of the Arbitration Act 1996. On March 1, 2018, KFG applied under Section 103(2)(a) and (b) of the Arbitration Act of 1996 for an order that recognition and enforcement of the Award as a judgment be refused on the ground that the "arbitration agreement was not valid under the law to which the parties subjected it."

The English Court of Appeal had to decide the governing law of an arbitration agreement which provides for arbitration in Paris but which is contained in a main agreement which is expressly governed by English law and whether the KFG became a party to the main agreement and/or the arbitration agreement notwithstanding the presence of No Oral Modification provisions in the main contract. KJS submitted that there was no express choice of English law as the governing law of the arbitration agreement for a number of reasons, including:

- The express choice of a governing law in the main contract was no more than a starting assumption that the Parties intended the whole of their relationship to be governed by that law.
- The concept of separability of the arbitration agreement from the main contract indicates that the arbitration agreement should be interpreted in a self-standing manner.
- The main contract referred to the UNIDROIT principles meaning that such additional requirements were a contra-indication by the Parties to English law being the express governing law.
- The fact that the seat of the arbitration was in a different country from the country whose law governed the main agreement prevents any implied choice of English law as the governing law.

The Court of Appeal disagreed and found that Articles 1 and 15 of the FDA in themselves provide for the express choice of English law to govern the arbitration agreement in Article 14. The Court found it compelling (at paragraph 62) that:

> Article 1 makes it clear that "This Agreement" (capitalised) includes all the terms of agreement then set out, which include Article 14. Because Article 15 provides that: "This Agreement [again capitalised] shall be governed by and construed in accordance with the laws of England" it is making clear that all the terms of the Agreement, including Article 14, are governed by English law. The answer to the suggestion that, if this analysis were correct, there would be an express choice of governing law of the arbitration clause in every contract which contains a governing law clause is essentially that given by Andrew Smith J in Arsanovia at [22]. Governing law clauses do not necessarily cover the arbitration agreement. This one does because of the correct construction of the terms of Articles 1 and 15 taken together.

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The Court of Appeal specifically rejected the notion that separability can be relied upon to divorce the arbitration agreement from the main agreement for interpretative purposes. It further concluded that because there was an express choice of English law as the governing law of the arbitration agreement, it was not necessary to consider the alternative case that there was an implied choice of English law.

Governing Law Provisions -- Express or Implied Choices of Law?

The main question before the court was whether the governing law provision stating that English law governed the contract was an express or implied choice of the law governing the arbitration agreement in the FDA. The cases can be summarized as follows:

- *Arsanovia v. Cruz City 1 Mauritius Holdings*[1] and the High Court of Singapore case *BCY v. BCZ*[2] found that the governing law clause would be a "**strong indicator**" of the law which the Parties had chosen to govern the arbitration agreement.
- *C v. D*[3] and *Black Clawson v. Papierwerke*[4] tended the other way if the courts were not persuaded there was an express choice of law governing the arbitration agreement. Longmore LJ's finding in *C v. D* explained the situation as follows: "The question then arises whether, if there is no express law of the arbitration agreement, the law with which that agreement has its closest and most real connection is the law of the underlying contract or the law of the seat of the arbitration. It seems to me that …the answer is more likely to be the law of the seat of the arbitration than the law of the underlying contract."
- In *Sulamerica v. Enesa Engelharia*[5] Moore-Blick LJ found that an express choice of law governing the substantive contract is "an important factor to be taken into account [and] likely…to lead to the conclusion that the parties intended the arbitration agreement to be governed by the same system of law as the substantive contract, unless there are other factors present which point to a different conclusion." However, Moore-Blick LJ also explained that the fact that the seat of the arbitration was in a different country from the country whose law governed the main agreement was an "important factor" pointing away from the law governing the main agreement being an implied choice of law governing the arbitration agreement.[6]

A clash between London and Paris?

Though the English Court of Appeal discussed the possibility of staying proceedings until the French court rules on the annulment application, it ultimately decided a stay was not necessary.[7] This is important because French law approaches the questions of the law governing an arbitration agreement differently.

The French courts seek to give maximum legal effect to agreements to arbitrate. French courts have held that international arbitration agreements are "autonomous" from any national legal system and, as a consequence, are directly subject to general principles of international law. For example, the French Cour de cassation's landmark *Dalico* decision[8] held:

> according to a substantive rule of international arbitration law, the arbitration cause is legally independent from the main contract in which it is included or which refers to it and, provided that no mandatory provision of French law or international public policy (ordre public) is affected, that its existence and its

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validity depends only on the common intention of the parties, without it being necessary to make reference to a national law

In other words, the French Supreme Court chose not to apply a conflicts of law analysis when considering the validity of an arbitration agreement, but to turn to the relevant facts and examine the common intent of the parties, i.e., to apply the French substantive rules of international arbitration to the arbitration agreement.

However, some authors believe that the *Unikod* decision[9] announced an evolution of French law because it seemed to reserve the application of a law specifically chosen by the parties to govern the arbitration agreement.[10] Commentators further state that "to avoid undermining the Unikod's approach, it could reasonably be considered that, in the absence of provisions indicating a contrary opinion of the Parties, the choice of law generally expressed by the parties, must be deemed to apply to all contractual provisions, including the Arbitration Agreement. (…) in fact, despite being autonomous, the Arbitration Agreement has an obvious link with the host contract since it is intended to govern the disputes arising from that contract."[11] Yet, in the *Unikod* decision, the court, referring to the principle of separability, in fact *disregarded* the choice of a law to govern the main contract as an indication of the parties' choice as to the law applicable to the arbitration agreement. The French approach is unpredictable.

If the Paris Cour d'Appel follows this path and decides to apply French substantive rules, there will be a risk of inconsistency of the two judgements. French case law tends to suggest that an arbitration agreement can extend to all companies in a group, including those which are not signatories.[12]

It therefore remains to be determined whether the French Cour d'appel will be receptive to an argument that the arbitration agreement was null and that a reasoned award which upheld the arbitration agreement was also null.

[1] *Arsanovia v. Cruz City 1 Mauritius Holdings* [2012] EWHC 3702 (Comm); [2013] 1 Lloyd's Rep 235 at [21] finding that "the governing law clause is, at the least, a strong pointer to their intention about the law governing the arbitration agreement, and there is no contrary indication other than choice of a London seat for arbitration."

[2] High Court of Singapore in *BCY v. BCZ* [2016] at [65] finding that "the governing law of the main contract is a strong indicator of the governing law of the arbitration agreement unless there are indications to the contrary. The choice of a seat different from the law of the governing contract would not in itself be sufficient to displace that starting point."

[3] *C v. D* [2007] EWCA Civ 1282; [2008] All ER (Comm) 1001 at [22].

[4] *Black-Clawson v. Papierwerke* [1981] 2 Lloyds Rep 446, 483 finding that "it would be a rare case in which the law of the arbitration agreement was not the same as the law of the place (or seat) of the arbitration."

[5] *Sulamerica v. Enesa Engelharia* [2012] EWCA Civ 638; [2013] 1 WLR 102 at [26].

[6] *Sulamerica v. Enesa Engelharia* [2012] EWCA Civ 638; [2013] 1 WLR 102 at [29].

[7] Judgment, at [81].

[8] Judgement of 20 December 1993, Municipalité de Khoms El Mergeb v. Société Dalico (Cour de cassation chambre civile).

[9] Judgement of 30 March 2004, *Société Unikod contre Société Ouralkali* (Cour de cassation, première chambre civile).

[10] J-F Poudret & S. Besson, *Comparative Law of International Arbitration*, Sweet & Maxwell, 2007 - Arbitration (International law) at p. 147.

[11] Christophe Seraglini & Jérôme Ortscheidt, *Droit de l'arbitrage interne et international*, Domat droit privé, Montchrestien 2013 at para. 591.

[12] Christophe Seraglini & Jérôme Ortscheidt, *Droit de l'arbitrage interne et international*, Domat droit privé, Montchrestien 2013, at para. 711-712.

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