

# International Arbitration Alert

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## Fourth (and Final?) Act in the Kabab-Ji Saga— What Law Governs the Arbitration Agreement (Law of the Seat or Law of the Underlying Contract)?

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On 28 September 2022, the French *Cour de cassation*<sup>1</sup> upheld the French Court of Appeal's decision in *Kabab-Ji SAL v. Kout Food Group* that the law of the seat, rather than the law governing the underlying contract, governed issues of validity and interpretation of the arbitration agreement. The approach by the French *Cour de cassation* diverges from the UK Supreme Court's earlier decision in the same matter which confirmed that, under English law (absent express agreement by the parties), (i) a choice of law clause governing the whole of the contract will presumptively apply to questions as to the validity of the arbitration agreement; and (ii) that the choice of an arbitral seat is not an express agreement which would displace the choice of law clause.<sup>2</sup> What does this mean in practice for international arbitrations where there is no express agreement by the parties on the law of the arbitration agreement?

- Parties need to correlate possible causes of action with enforcement risk. Uncertainty is a natural by-product of not having an express agreement.
- The jurisdiction(s) in which assets are located become even more important. Certain jurisdictions will follow the approach adopted by the French Courts while others will follow the UK Supreme Court.
- Advocates for developing 'soft law' to confirm that the courts at the seat must have primacy (except where there is reason to suspect an unfair trial) will be happy with the French *Cour de cassation*.

### Factual Context

The dispute arose out of a Franchise Development Agreement (FDA) between Kabab-JI SAL (KJS), a Lebanese company, and Al Homaizi Foodstuff Company (AHFC), a Kuwaiti company, as licensee. The parties entered into a total of ten franchise outlet agreements (FOAs) in respect of individual outlets opened in Kuwait (collectively the FDA and FOAs are referred to as the "Franchise Agreements"). The Franchise Agreements were all expressly governed by English law but provided for Paris as the seat of arbitration. In 2005, following a corporate reorganization, AHFC became a subsidiary of a new holding company called Kout Food Group (KFG). However, the terms of the Franchise Agreements remained unchanged.

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KJS pursued international arbitration against KFG, not AHFC. In those proceedings, 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) and that 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. KFG filed an annulment application before the French courts while Kabab-Ji sought to enforce the Award in London.

### The challenge and the *Cour de cassation* decision

KFG challenged the Paris Court of Appeal’s decision which dismissed its application to set aside the arbitral award before the French *Cour de cassation*,<sup>3</sup> essentially arguing that the French Court of Appeal erred in its finding that:

- No express provision was actually agreed between the parties that would designate English law as governing the arbitration agreement.
- KFG did not provide evidence of circumstances unequivocally establishing the common intent of the parties to designate English law as governing the arbitration agreement.

In KFG’s view, the Franchise Agreements despite the choice of Paris as the seat of any arbitration did not demonstrate an intention of the parties to subject the existence and validity of the arbitration agreement to a law other than the one applicable to the contract.

The French *Cour de cassation* has now confirmed the Paris Court of Appeal’s decision and the “prevailing principle” that:

*According to a substantive rule of [French] international arbitration law, the arbitration clause is legally independent of the main contract which contains it directly or by reference, and its existence and validity are to be assessed, subject to the mandatory rules of French law and international public policy, on the basis of the common intent of the parties, without it being necessary to refer to a state law, unless the parties have expressly made the validity and the effects of the arbitration agreement itself subject to such law.*

As such, the Paris Court of Appeal’s finding that (i) “the choice of English law as the law governing the contracts [...] [was] not sufficient to establish the common intent of the parties to submit the validity of the arbitration agreement to English law” and that (ii) KFG did not provide evidence of any circumstance likely to establish unequivocally the common intent of the parties, justified its decision to assess the arbitration agreement in light of the French substantive rules of international arbitration.

### Conclusion

The *Cour de cassation*’s decision confirms clear divergence across jurisdictions as to the law governing the arbitration agreement. Domestic courts will therefore inevitably apply their own national principles raising additional uncertainty for contract drafters and users of international arbitration. The better path on this fundamental issue is for drafters to ensure that the law governing the arbitration agreement is expressly specified in addition to providing an express choice of the substantive law governing the remainder of the contract. This way, drafters may override any default domestic

rules of interpretation and ensure their contractual intentions are implemented in any international arbitration.

<sup>1</sup> Cass., 1<sup>ère</sup> ci., 28 Septembre 2022, n° 20-20.260.

<sup>2</sup> *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2021] UKSC 48.

<sup>3</sup> The French *Cour de cassation* is the highest court in the French judiciary. However it is not a “third level” of jurisdiction above the lower courts or courts of appeal: it is called upon not to decide on the merits of the case, but to say whether the rules of law have been correctly applied based on the facts sovereignly assessed in the lower courts’ decisions. Thus, the *Cour de cassation* does not, strictly speaking, rule on the disputes that gave rise to the decisions referred to it, but on the rulings themselves: its role is to say whether they have applied the law correctly in the light of the facts, determined by them alone, of the case submitted to them and the questions put to them.

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