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French idealism vs. English pragmatism: The Alternative endings of the *Kout Food* saga

by Aija Lejniece[98]

Resumen : *El 28 de septiembre de 2022, la Corte de Casación francesa puso fin a la disputa de* Kababji v Kout Food Group. *La disputa, pendiente en los tribunales franceses e ingleses desde 2017, ha revelado enfoques contrastantes para la interpretación de los acuerdos arbitrales en ambas jurisdicciones. La Corte de Casación francesa sostuvo que la ley aplicable al acuerdo de arbitraje no era necesariamente la ley aplicable al contrato, sino que la ley del acuerdo de arbitraje debía determinarse independientemente aplicando las reglas de la sede arbitral, es decir, las reglas francesas. Esta conclusión significaba que el laudo arbitral era ejecutable bajo la ley francesa, mientras que la Corte Suprema del Reino Unido ya había denegado el reconocimiento y la ejecución* del mismo laudo, considerando que era aplicable la ley inglesa, la ley que rige el contrato. *El caso de Kout Food es otro recordatorio de que la Convención de Nueva York no es un mecanismo de seguridad garantizado para su aplicación y todavía existen variaciones nacionales significativas.*

INTRODUCTION

Two jurisdictions, both alike in popularity as arbitral seats, have come to diametrically opposing decisions in the same case. At the end of 2022, the French Court of Cassation handed down its decision in the *Kabab-Ji v. Kout Food* case regarding the enforcement of a 2017 arbitral award. The judgment came almost a year after the UK Supreme Court had come to the exact opposite conclusion.

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The *Kabab-Ji v. Kout Food* arbitral award had been decided in 2017 by an ICC tribunal in Paris. Thereafter, both parties sought annulment and enforcement in France and the UK. The parties' arguments hinged on two legal issues:

1. What law is applicable to the arbitration clause if the parties have not made an explicit choice thereto, and
2. Whether and how an arbitration clause can be extended to third parties.

Based on the underlying contract, there were two candidates for law applicable to the arbitration clause – English law, which was the law governing the contract, and French law, which was the law of the seat. The choice of applicable law was crucial, as the French and English systems differ significantly on the extension of an arbitration clause to third parties.

A BRIEF PROCEDURAL HISTORY

In 2001, Kabab-Ji SAL ("**Kabab-Ji**"), a popular Lebanese restaurant chain concluded a 10-year Franchise Development Agreement ("**FDA**") with Kuwaiti company Al Homaizi Foodstuff Company ("**Al Homaizi**") pursuant to which Kabab-Ji granted Al Homaizi a license to operate a franchise using Kabab-Ji's restaurant concept in Kuwait for a period of ten years. The parties subsequently concluded multiple Franchise Outlet Agreements under the umbrella of the FDA (collectively – the "**Franchise Agreements**").

In the context of the ensuing arbitration and enforcement proceedings, the Franchise Agreements contained four relevant clauses:

- A governing law clause providing that the Franchise Agreements were to be "*governed by and construed in accordance with the laws of England*";
- A definition of contract clause in Article 1, which included all subsequent articles (including the arbitration clause) in the scope of the contract;
- The Arbitration clause, which provided for ICC arbitration with Paris as the seat;
- A clause specifying that the arbitrators could not apply "*any rule which contradicts the strict wording of the Contract*"; and
- A provision specifying that the contract could only be modified in writing.

In 2005, Al Homaizi underwent corporate restructuring and became a subsidiary of a newly founded holding company called Kout Food Groups ("**Kout Food**"). Kout Food never formally became a party to the Franchise Agreements but was nevertheless heavily involved in their performance.

In 2011, when the Franchise Agreements were up for renewal, Kout Food requested that the Franchise Agreements between its affiliate Al Homaizi and Kabab-Ji be terminated via agreement with appropriate releases. Kabab-Ji disagreed and commenced ICC arbitration proceedings against Kout Food (but not its subsidiary Al Homaizi), requesting damages.

On 11 September 2017, an ICC tribunal[99] held that French law as the law of the seat was applicable to the arbitration clause and ruled by a majority[100] that Kout Food's extensive involvement in the performance of the Franchise Agreements had extended both the substantive obligations and the arbitration clause to Kout Food and awarded US$6,734,628.19 plus interest in unpaid license fees and damages for loss of opportunity to Kabab-Ji. On 13 December 2017, Kout Food applied for annulment before the Paris Court of Appeal, arguing that under Article 1520 of the French Code of Civil Procedure by extending the arbitration clause to Kout Foods the ICC tribunal had ruled outside the scope of its mandate and breached the principle of due process.[101]

In parallel, on 7 February 2018, Kabab-Ji obtained an order giving leave to enforce the award in England.[102] Kout Food objected. On 8 April 2019, the London High Court held that the law applicable to the extension of the arbitration clause was English, not French law; and, because under English law, the Franchise Agreements did not extend to Kout Food, the award was unenforceable.[103] The London Court of Appeal confirmed the judgment on 20 January 2020.[104]

On 23 June 2020,[105] the Paris Court of Appeal refused to set aside the award, even though recognition and enforcement had already been denied in the UK, holding that the ICC tribunal had correctly applied French law to the arbitration clause. The English proceedings culminated before the UK Supreme Court resulting in a 27 October 2021 judgment[106] refusing to recognize and enforce the award, deeming English law applicable and the arbitration clause non-extensible to Kout Food. On 28 September 2022, almost exactly a year after the UK Supreme Court's judgment, the case record was completed by a judgment from the French Court of Cassation,[107] confirming the Paris Court of Appeal's judgment and leading to diametrically opposed decisions by the highest courts of two major arbitral seats.

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99 Composed of Bruno Leurent (Chairman), Mr. Mohamed S. Abdel Wahab and Mr. Klaus Reichert.

100 The majority was composed of Messrs. Leurent and Wahab. The tribunal's decision with respect to the applicability of French law to the question of the validity and extension of the arbitration clause was unanimous. However, in his dissenting opinion, Mr. Reichert held that Kout Foods had not in fact become Kabab-Ji's co-contractor, so the latter's claims should have been rejected.

101 Paris Court of Appeal, 1, 1, 06-23-2020, n°17/22943.

102 *Kabab-ji SAL (Lebanon) v Kout Food Group (Kuwait)*, UK Court of Appeal, [2020] EWCA Civ 6 Case No. A4/2019/0944, para. 5.

103 *Kabab-ji SAL (Lebanon) v Kout Food Group (Kuwait)*, UK Court of Appeal, [2020] EWCA Civ 6 Case No. A4/2019/0944, para. 1.

104 *Kabab-ji SAL (Lebanon) v Kout Food Group (Kuwait)*, UK Court of Appeal, [2020] EWCA Civ 6 Case No. A4/2019/0944.

105 Paris Court of Appeal, 1, 1, 23-06-2020, n°17/22943. An English translation of the award prepared by Brown Rudnick is available on Jus Mundi: https://jusmundi.com/en/document/decision/en-kabab-ji-s-a-l-company-v-kout-food-group-company-judgment-of-the-paris-court-of-appeal-tuesday-23rd-june-2020.

106 *Kabab-Ji (Lebanon) v Kout Food Group (Kuwait)*, UK Supreme Court, [2021] UKSC 48.

107 French Court of Cassation, 28 September 2022, n° 20-20.260.

UK SUPREME COURT FINDS CHOICE OF GOVERNING LAW ENOUGH TO PROVE PARTIES' "INTENTION"

The UK Supreme Court held that the law governing the validity of the arbitration agreement was English law and confirmed the London Court of Appeal's refusal to recognize and enforce the arbitral award.

To determine whether French or English law applied to the arbitration clause, the UK Supreme Court used a conflict of laws approach, referring to Article V(1)(a) of the New York Convention as enacted in the 1996 English Arbitration Act:

> "*As discussed in our judgment in Enka, at para 128, Article V(1)(a) of the Convention establishes two uniform international conflict of laws rules. The first, and primary, rule is that the validity of the arbitration agreement is governed by 'the law to which the parties subjected it' – in other words the law chosen by the parties. The second, default rule, which applies where no choice has been indicated, is that the applicable law is that of 'the country where the award was made'. Where the parties have chosen the seat of arbitration, the place where the award was made will be (or be deemed to be) the place of the seat.*"[108]

The UK Supreme Court referred to its own judgment in *Enka v. Chubb*,[109] according to which the law governing the arbitration agreement, in the absence of an express choice, is the implied choice of law by the parties; furthermore, the implied choice of law is the applicable law to the substantive law of the contract.

The court paid special attention to the wording of Article V(1)(a) of the New York Convention, holding that the word "indication" "*signifies that something less than an express and specific agreement will suffice.*"[110] In other words, the parties' choice of a governing law is enough "indication" that the same law should be applied to the arbitration clause:

> "*Once it is accepted that an express agreement as to the law which is to govern the arbitration agreement is not required and that any form of agreement will suffice, it seems 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.*"[111]

The court was likewise swayed by the text of the Franchise Agreements, which specified that "*any dispute* […] *relating to this Agreement* […] *shall be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce.*"[112] The definition of "Agreement" included "*the terms of agreement set forth herein below*" and therefore included the arbitration clause as well. For the UK Supreme Court, "[t]*here is*

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108 *Kabab-Ji (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)*, UK Supreme Court, [2021] UKSC 48, para. 26.

109 *Kabab-Ji (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)*, UK Supreme Court, [2021] UKSC 48, paras. 28, 33; *Enka Insaat Ve Sanayi A.S. (Respondent) v OOO Insurance Company Chubb (Appellant)*, UK supreme Court, [2020] UKŠC 38, para. 170.

110 *Kabab-Ji (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)*, UK Supreme Court, [2021] UKSC 48, para. 33.

111 *Kabab-Ji (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)*, UK Supreme Court, [2021] UKSC 48, para. 35.

112 *Kabab-Ji (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)*, UK Supreme Court, [2021] UKSC 48, para. 37.

no good reason to infer that the parties intended to except [the arbitration clause] *from their choice of English law to govern all the terms of their contract.*"[113]

The UK Supreme Court therefore confirmed the London Court of Appeal's Judgment that the law governing the question of whether Kout Food became a party to the arbitration agreement was English law, as a matter of which the Franchise Agreements and the arbitration clause could not be deemed to have been extended to Kout Food.

FRENCH COURT OF CASSATION STRESSES INDEPENDENCE OF ARBITRATION CLAUSE AND REQUIRES UNEQUIVOCAL EXPRESSION OF PARTIES' WILL

The approach and conclusions of the French Court of Cassation were the exact opposite – the court held that the law applicable to the arbitration clause was French law as the law of the seat, pursuant to which the Franchise Agreements and the arbitration clause could be extended to Kout Food.

Unlike the UK Supreme Court, the French Court of Cassation did not refer to conflicts of law rules, instead applying substantive rules:

> "*Pursuant to a substantive rule of international arbitration law, the arbitration clause is legally independent from the underlying contract in which it is included either directly or by reference, and its existence and validity are interpreted, subject to the mandatory rules of French law and international public policy, according to the common will of the parties, without the need to refer to any national law.*"[114]

The French approach of the application of substantive rules to determine the law applicable to the arbitration agreement can be summarized as follows:

> "*The method of* [determining the law applicable to an arbitration agreement via] *substantive rules consists, for a State or its judges, in elaborating special substantive rules intended to govern an international situation.*
>
> *The judge of the legal order from which such a rule emanates will then apply it directly to the target question, without seeking the law applicable to this matter under the rules of conflict of laws. A strong doctrinal current, particularly in France, considers that this method should, in general, replace the conflictual method to determine the legal regime of an international arbitration agreement.*
>
> *This would make it possible to shield this legal regime from the vagaries of the conflict of laws rules, to subject it to rules specially drawn up* […], *and which are intended to ensure the effectiveness of the agreement. The authority seized – judge or arbitrator as the case may be –, applying these substantive rules specially 'designed' for the international arbitration agreement, would thereby neutralize any obstacles to the validity and effectiveness of the arbitration agreement posed by State law that could be designated by conflict of laws rules.*"[115]

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113 *Kabab-Ji (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent)*, UK Supreme Court, [2021] UKSC 48, para. 39.

114 French Court of Cassation, 09-28-2022, n° 20-20.260, para. 7. *See also* Judgment in the *Dalico* case, French Court of Cassation, 1re civ., 12-20-1993, JDI 1994, p. 432; Judgment in *Unikod* case, French Court of Cassation, 1re civ. 03-30-2004, RTD com. 2004, p. 443.

115 Ch. Seraglini, J. Ortscheidt, Droit de l'Arbitrage Interne et International, 2e édition, LGDJ, 2019, para. 591.

The Court of Cassation therefore applied the "default rule" – absent a choice of the parties, the law of the seat of arbitration will govern its validity.[116] According to the Court of Cassation, the fact that the parties had selected a governing law for the contract itself had no effect on the law applicable to the arbitration clause, which was a distinct issue:

> "[T]*he choice of English law as the law governing the contracts* […] *is not sufficient to establish the common will of the parties to submit the effectiveness of the arbitration agreement to English law, in derogation of the substantive rules of the seat of arbitration expressly designated by the contracts.*"[117]

As the question before it related to the correct law applicable to the arbitration clause, having decided that the Paris Court of Appeal had correctly applied French law, the Court of Cassation did not expressly delve into the issue of whether it could be extended to Kout Food under French law. This analysis was carried out by the ICC tribunal and the Paris Court of Appeal:

> "*In the event where a party to the arbitration is non-signatory of the arbitration clause, the jurisprudence of the Court of Cassation and of the Court of Appeal of Paris is thus that this party should be deemed to have agreed to the* [arbitration] *clause if the arbitral tribunal finds that this party had the will to participate in the performance of the agreement.*"[118]

Accordingly, the French Court of Cassation's judgment directly contradicted the judgment of its counterpart across the Channel.

LESSONS FROM THE *KOUT FOOD* SAGA

The *Kout Food* case is yet another reminder that the New York Convention is not a guaranteed fail-safe for enforcement, and significant national variations still exist. Ill-thought-out contractual provisions may come back to bite the parties later on. To maximize the chances of enforcement, in addition to the seat and the governing law, parties should clearly specify the law applicable to the arbitration clause itself.

Ironically, Kabab-Ji and Al Homaizi actually seem to have put in a lot more consideration in their contract than most. Compared to hastily drawn up or copy pasted arbitration clauses one often sees in commercial contracts, the provisions of the Franchise Agreements seemed though-out and deliberate. Evidently, for jurisdictions like France, this will not be sufficient to constitute a valid choice of law applicable to the arbitration clause.

Clearly, there is a need for closer collaboration between arbitration practitioners and our corporate and transactional law colleagues who are often the ones drafting the underlying contracts in the first place.

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116 *See* L. Kazimi, *Can't Budge: The Curious Case of Kabab-Ji and the New York Convention*, 15 November 2021, Kluwer Arbitration Blog: https://arbitrationblog.kluwerarbitration.com/2021/11/15/cant-budge-the-curious-case-of-kabab-ji-and-the-new-york-convention/; New York Convention, Article V(1)(a).

117 Paris Court of Cassation, 09-28-2022, n° 20-20.260, para. 8.

118 Paris Court of Appeal, 1, 06-23-2020, n°17/22943, para. 36, citing to para 129 of the ICC award.