

## Outside Counsel

# The Pitfalls of Conflicting Judicial Outcomes in International Arbitration

International contracting parties often turn to arbitration to avoid potentially biased national courts when disputes arise. However, even if they choose arbitration, disputants remain subject to the whims of domestic courts when they seek to enforce an arbitration award. In two recent cases arising from a single arbitration, the courts of England and France reached opposite results on what law governs the parties' agreement to arbitrate. These two divergent views led to two significantly different outcomes highlighting the pitfalls of international arbitration: The UK Supreme Court denied enforcement of the arbitration award while the French court upheld it. This article explores the circumstances that led to this awkward outcome and the key takeaways.

### Background

The case of 'Kabab-Ji v. Kout Food Group (KFG)' involves a Lebanese company, Kabab-Ji, that had entered into a series of franchise agreements (FAs) with a Kuwaiti company. Thereafter, the Kuwaiti counterpart underwent a corporate restructuring whereby it became a subsidiary of a new holding company,

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KFG. When a dispute arose under the FAs, Kabab-Ji initiated arbitration proceedings against KFG with the International Chamber of Commerce in Paris, in accordance with the FAs. However, KFG was not a party to any of the FAs and

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thus took part in the arbitration under protest. In deciding on KFG's argument that it was not subject to the arbitration agreement since it wasn't a party to the FAs, the Tribunal noted that the arbitration clause was silent as to the law governing the agreement to arbitrate. It rejected the argument that the law of the contract, namely English law, should therefore apply to the arbitration agreement. Instead, it concluded that the law

of the seat of the arbitration, in this case French law, should apply to the procedural matters. Applying French law, the Tribunal determined that KFG was bound by the FAs and ultimately found that it was in breach of its contractual obligations. It thus issued an award in favor of Kabab-Ji.

KFG subsequently filed an annulment application before the Paris Court of Appeal. It also sought to have the enforcement of the award set aside by the UK court to which Kabab-Ji had applied. Ultimately, the French court of appeal agreed with the Tribunal and thus concluded that KFG is bound by the arbitration agreement. The UK Supreme Court, however, determined that the Tribunal should have applied English law to the arbitration agreement, pursuant to which KFG is not bound by the FAs. It therefore found that enforcement of the award should be rejected.

**Take Away Number 1: Specify governing law in the arbitration clause.** The most obvious lesson from the Kabab-Ji case is that drafters should ensure that they spell out the law that should govern the agreement to arbitrate. Indeed, one should not assume that a governing law clause in the main contract will apply to an arbitration clause, even if such clause is part of the contract. Rather, when drafting an agreement to arbitrate, counsel should ensure that they

indicate which law the parties select to apply to the arbitration clause, even if the main contract includes a governing law provision. As *Kabab-Ji* shows, this is particularly important when parties agree to arbitrate in a jurisdiction that is different from that of the law of the contact.

**Take Away Number 2: Consider, and account for, the risk that courts may disregard a foreign court's decision relating to an arbitration matter.**

When considering the *Kabab-Ji* case, the UK Supreme Court acknowledged that the French court had opined on the very issue before it. However, not only did it not give any weight to the French ruling, it didn't even consider the legal analysis. In fact, the UK court went so far as to state in paragraph 90 of its decision that "[i]n such circumstances the risk of contrary judgments cannot be avoided ... [n]or would any French court decision be relevant to the determination of the questions which the English court had to decide." This is particularly perplexing given the UK court's statement when analyzing the grounds for vacatur under Article (V) (1) of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the Convention). Indeed, it conceded (in paragraph 15) that "[a]lthough article (V)(1) of the Convention ... specif[ies] the grounds on which recognition or enforcement of the award 'may' be refused, the circumstances in which it could be appropriate for the court to recognize or enforce an award where one of those grounds is made out are necessarily constrained by the principles and purposes underlying the Convention, a major object of which is the achievement of uniform international standards." Even in its discussion of the Convention's objectives and purposes, the UK court acknowledged the importance of uniformity, namely "the Convention's aim of estab-

lishing a single, uniform set of rules governing the recognition and enforcement of international arbitration agreements and awards" (paragraph 31). It further stated (in paragraph 32) that "[i]n keeping with that aim, it is desirable that the rules set out in article (V) (1)(a) ... should not only be given a uniform meaning but should be applied by the courts of the contracting states in a uniform way." And yet, this very court opted to disregard not only the Tribunal's analysis and conclusion but

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also the French court's endorsement of the Tribunal's decision.

This is a noteworthy example that must be considered by practitioners in the international arbitration arena going forward. It is an unfortunate precedent that can only lead to more conflicting rulings going forward.

**Take Away Number 3: The limitations of the 'Kompetenz-Kompetenz' principle.** The Kompetenz-Kompetenz principle is a key principle that is widely accepted in domestic and international arbitration. It refers to arbitrators' power to rule on their own jurisdiction to the extent it is contested. In the *Kabab-Ji* case, the UK Supreme Court didn't specifically address the Kompetenz-Kompetenz principle. However, pushed to its extreme, the court's reasoning shows the limitations of this long-standing principle. Indeed, by overruling the Tribunal's conclusion with respect to its jurisdiction to decide on matters

between *Kabab-Ji* and *KFG*, the UK Supreme Court, indirectly but firmly, brings into question the applicability of this long-standing, globally-accepted principle. One could have understood a reasoned decision pursuant to which a court recognizes the existence of the principle but determines that the facts of the case justify that it derogates from it. In this case, however, the UK court doesn't reference or even acknowledge the principle at all in its reasoning or in its conclusion. Its ruling, though, in effect, squarely quashes it.

At first glance, the *Kabab-Ji* case is a simple one: an alleged breach of a franchise agreement and a change of control of one of the parties. However, as is often the case in international disputes, the complexities of the matter arise not from the substantive matters at issue but rather from the procedural ones. This case has the unfortunate consequence of highlighting the detrimental impact of national courts ignoring the international components of the disputes brought before them in international arbitration matters. Ironically, the risk of such a narrow analysis by domestic courts is one of the key reasons parties turn to arbitration in the first place when transacting cross-border. Although the advantages of arbitration are incontestable in global affairs, the *Kabab-Ji* case points to the serious perils of an inadequate agreement to arbitrate when coupled with compartmentalized court reasonings and rulings. It reminds all practitioners of the importance of trying to mitigate the risk of insular court analyses when negotiating and drafting arbitration clauses.