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Kabab-Ji: The Effect Of No Oral Modification Clauses On Non-Signatories Of Arbitration Agreements Under English Law

Joe Rich (WilmerHale) · Friday, February 21st, 2020

On 20 January 2020, the Court of Appeal delivered its judgment in *Kabab-Ji SAL (Lebanon) v. Kout Food Group (Kuwait)* [2020] EWCA Civ 6. This post will focus on the Court's findings on "no oral modification" ("NOM") clauses and the impact that such clauses have on whether non-signatories to a commercial contract can be bound by an arbitration agreement.

The case arose out of a dispute between the parties under a Franchise Development Agreement ("FDA"). The FDA was entered into by the appellant ("KJ"), a Lebanese company, and Al Homaizi Foodstuff Company ("AHFC"), a Kuwaiti company. The FDA contained two provisions which effectively constitute NOM clauses: Article 17, which prohibited any waiver of any term or condition of the Agreement without signed in writing, and; Article 26, which provided that the FDA could only be amended or modified by a written document executed by a duly authorised representative of both parties. The FDA also contained an entire agreement clause and a provision stating that the rights granted under it were intended to be strictly personal in nature and could not be assigned or transferred without prior written approval of the counterparty.

Following a corporate reorganization, AHFC became a subsidiary of the respondent ("KFG"). A dispute arose under the FDA which the appellant referred to arbitration in Paris pursuant to Article 14 of the FDA. For reasons that remain unclear, that arbitration was commenced only against KFG, not AHFC, giving rise to the issues described in this post.

The Arbitration

In the arbitration award (KJ's application to bifurcate having been rejected), the majority (Professor Dr Mohamed Abdel Wahab and Mr Bruno Leurent) concluded that under English law a novation 'by addition' could be inferred by conduct, adding KFG as a further party to the franchise arrangement. The dissenting arbitrator, Mr Klaus Reichert S.C., concluded, contrary to the Majority, that under English law KFG never became a party to the FDA, meaning that it owed no obligation to KJ to arbitrate any dispute. Mr Reichert held at paragraph 66 of his dissenting opinion that KJ had "*clearly sued the wrong party*".

Having ruled that KFG was bound by the FDA under the principle of novation, the tribunal found in favour of KJ in respect of the substantive dispute. The award was then ordered ex parte by

Popplewell J to be enforced as a judgment on 7 February 2019.

High Court

In March 2019, Sir Michael Burton in the English High Court heard cross-applications by KJ and KFG. KJ, as the award creditor, was seeking an adjournment of enforcement pursuant to s.103(5) of the Arbitration Act 1996 pending resolution of a challenge by KFG to the award. The award had been made on 11 September 2017 and the challenge was due to be heard by the Paris Court of Appeal in February 2020. KJ also sought security under s.103(5) for its award debt of USD$6.7m. KFG was applying for the enforcement order to be set aside.

With reference to paragraphs [103] and [106] of *Dallah Real Estate v. The Ministry of Religious Affairs* [2010] UKSC 24, the parties agreed that the Court was bound to revisit the question of the tribunal's ruling on jurisdiction, with the effect that the application would amount to a complete re-hearing on the point.

On the question of whether KFG had become a party to the FDA and thereby to the arbitration agreement in spite of the NOM clause, Sir Michael Burton referred to Articles 17 and 26 of the FDA, as well as the entire agreement and exclusivity provisions and the Supreme Court's ruling in *Rock Advertising v MWB Business Exchange* [2018] UKSC 24 that no oral modification clauses are enforceable. In light of these, he concluded that it would be "*extremely difficult*" for KJ to rely upon some actions or statements as constituting implied consent or conduct capable of amounting to an agreement to the joinder of KFG to the FDA. In respect of the novation arguments advanced before the tribunal in arbitration, English law does not recognize the concept of novation by addition and any novation would in any event be an amendment of the contract and therefore subject to the NOM provisions in the FDA.

As suggested by Lord Sumption at [16] of *Rock*, KJ would in such circumstances need to establish an estoppel arising from unequivocal representations by KFG that the transfer of the rights and obligations under the FDA was valid. Unless KJ could produce evidence to establish such an estoppel, Sir Michael Burton held that KJ had not become a party to the FDA or, consequently, the arbitration agreement. In the circumstances, he resolved to adjourn KJ's enforcement and stay its judgment until after the outcome of the hearing in Paris.

Court of Appeal

The Court of Appeal similarly found that, following *Rock*, the NOM clauses in the FDA prevented an oral or conduct-based modification of the contract that had the effect of binding KFG under the FDA or the arbitration agreement. However, the Court disagreed with the judge's decision to adjourn the enforcement of the award. Flaux LJ held that, on the material that had been put before the High Court, KFG did not have a real prospect of successfully establishing the estoppel necessary to bind KFG to the FDA, and there was no more than a remote prospect that further evidence would be produced. As such, the Court of Appeal refused the enforcement and recognition of the Award as a judgment.

Good Faith Obligations

The FDA provided that English law as the governing law of the contract could be supplemented by principles of law generally recognized in international transactions insofar as such principles did not contradict the strict wording of the agreement. In reliance on this, counsel for KJ argued that the UNDROIT principles concerning good faith, inconsistent behaviour and modification (*see* Articles 1.7, 1.8, 2.1.1 and 2.1.18) should apply in conjunction with a good faith duty at Article 2 of the FDA (which required the Parties to act in good faith in carrying out and interpreting the agreement) to override the formality of the NOM Clauses. It was noted by the High Court that the tribunal had relied on the UNIDROIT principles in its conclusory paragraphs on jurisdiction.

Unsurprisingly, the Court of Appeal found at [74] that there was little difference between the UNIDROIT approach and the English approach through the doctrines of estoppel, and that even if the UNIDROIT principles did enunciate some broader test for preclusion than the doctrine of estoppel as summarized in *Rock*, the fact that the FDA only applied such principles insofar as they did not contradict the strict wording of the agreement meant that they could not override the express NOM provisions. In respect of the good faith provision within the FDA, the Court found that this applied to the parties to the contract and could not join a party to the contract, nor could it dilute the strict wording of the NOM clauses.

Conclusions

The decisions of the High Court and Court of Appeal in *Kabab-Ji* show that, in the absence of a strong estoppel case, it will be difficult to establish that a non-signatory is bound by a contract which contains a NOM clause. Good faith obligations, whether contractual or under the UNIDROIT principles, are unlikely to alter this analysis.

However, there may be some hope for parties who wish to pursue arbitration in such circumstances.

First, neither the High Court nor the Court of Appeal was satisfied by the evidence advanced by KJ that an estoppel arose. However, in circumstances where a party asserting estoppel is able to demonstrate that it has relied on unequivocal representations to the effect that the other party will be bound by the relevant contract, NOM clauses will not prevent modification of a contract to join a third party and bind it to a commercial agreement.

Second, Sir Michael Burton noted at [21] of his judgment in the High Court that the matters on which KJ relied related to the conduct of the parties with regard to the FDA so no argument had been advanced that KFG had become a party to the arbitration agreement otherwise than by becoming a party to the FDA. English courts have favoured a restrictive approach to the doctrine of separability in cases such as *Sulamerica* [2012] EWCA Civ 638 (where the Court of Appeal noted at [26] that the purpose of the concept was "*not to insulate the arbitration agreement from the substantive contract for all purposes*") and it is difficult to see how a separable arbitration agreement could apply to a dispute that does not arise under the underlying contract. However, the judge's comment implies that there may be circumstances in which an English court would be willing to find that the words or conduct of non-signatories would be sufficient to consent to the arbitration clause as a separable agreement from the underlying contract, whether by the operation of an estoppel or otherwise.

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