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A Second Look on Kabab-Ji v. Kout Food or Promoting a Formalist Transnational Contract Law Theory

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The landmark decision of the UK Supreme Court (the "Court") handed down in 2021 in the case *Kabab-Ji SAL v. Kout Food Group* has already attracted considerable attention. Thus far comments focused on the Court's construction of the New York Convention of 1958. Yet, the decision deserves a second look – which this post aims to do – because it also provides guidance on how international arbitral tribunals should interpret sophisticated contracts, in particular choice of law clauses and references to transnational contract laws or international standards.

Factual and Procedural Background

The Court had to rule on a request for exequatur. It decided the case based on the conclusion that English law applied to both, the contract as such and its arbitration clause. This is in sharp contrast to a recently published judgement of the French Cassation Court, which refers to the same arbitral award. However, it was delivered in an annulment suit. The French Court held that English law applies to the contract but French law to the arbitration clause. We focus on the Supreme Court's decision because it inspired our recently published book on "Contract Law in International Commercial Arbitration", where we propose a transnational contract law theory and interpretation methodology, that explain the dominance of English, New York, and Swiss contract law in cross-border transactions and arbitration.

The dispute arose out of a franchise contract which provided that:

> "the arbitrator(s) shall apply the provisions contained in the Agreement. The arbitrator(s) shall also apply principles of law generally recognized 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 (clause 14). This Agreement shall be governed by and construed in accordance with the laws of England (clause 15)."

The parties were agreed – and the Court accepted – that the reference to *'principles of law*

generally recognized in international transactions' was to be understood as a reference to the UNIDROIT Principles of International Commercial Contracts (para 31). When analyzing the normative quality of these principles the Court cited a passage of the preamble of the Principles, where their purpose and function are exhibited: *'they (the UNIDROIT Principles) shall be applied when the parties have agreed that their contract be governed by them and that they may be used to interpret or supplement domestic law'*. On this basis the Court concluded that the UNIDROIT Principles were not intended to have the force of law in their own right.

The Court's Qualification of the UNIDROIT Principles

The Court's qualification is correct in underlining the difference between the weight of classic law on the one hand and international principles and standards on the other. Only endorsement or ratification can lift transnational soft law on the level of national law in the strict sense; to put it differently, the products of the democratic law-making process have a distinct and superior normative quality. *Transnationalism cannot substitute democracy*.

The Court raised the question but did not finally decide whether the UNIDROIT Principles constitute law for the purposes of the New York Convention and the UK Arbitration Act. Yet, it emphasized the predominance of the parties' choice of law clause in favor of English law. Indeed, the parties established in the quoted passage of the contract a hierarchy of norms that arbitrators were to follow. Firstly, they were to apply the provisions of the franchise contract; secondly, English contract law, and thirdly, also the UNIDROIT Principles. Furthermore, the parties agreed that *'under no circumstances shall the arbitrator(s) apply any rule(s) that contradict(s) the strict wording of the Agreement'* (para 37).

The Court concluded that the contract's wording *'is absolutely clear and that there is no good reason to infer that the parties intended to except clause 14 from the choice of law to govern all the terms of their contract'* (paras 39 and 48). In fact, the systematic order of the contract confirms the UK Court's position, and therefore the French Court is wrong. The governing law clause follows the dispute resolution clause. Thus, it is clearly meant to be an umbrella clause which covers all other clauses of the contract, especially clause 14 on dispute resolution and the norms that arbitrators shall apply.

The following passage of the judgment is key to understating the Court's position:

> "In the present case the claimant is seeking to rely on the UNIDROIT Principles to contradict both the No Oral Modification clause and the minimum requirements set out in Rock Advertising which must, in English law, be satisfied if a party is to be precluded by its conduct from relying on such clauses. Such reliance on the UNIDROIT Principles is contractually impermissible" (para 72).

The passage illustrates that the Court values the choice of the applicable national contract law higher than the additional reference to international soft law (UNIDROIT Principles).

This priority corresponds to the preferences of sophisticated parties to business transactions. According to the statistics of the ICC parties almost always rely on a national contract law.[1)] Out of

all contracts which, in 2020, became subject to an ICC-arbitration, only 2% included a reference to rules or instruments other than national laws, such as the United Nations Convention on Contracts for the International Sale of Goods (hereinafter CISG), the UNIDROIT Principles, International Commercial Law, and the ICC Incoterms. Parties preferred the selection of a national contract law with English law sitting top of the table followed by New York and Swiss contract law. English law alone had a *market share* of 13%.

The Strength of the Formalist or Minimalist Approach

The dominant laws are characterized by a strong commitment to the wording of commercial contracts, reluctance to construct or create implied terms, and a narrow interpretation of general clauses and imprecise terms, such as 'good faith' and 'reasonable'. Thereby, they guarantee predictability of judgements and maximum party autonomy. The Court stated that *'it is not contrary to good faith to interpret the terms of the Agreement in accordance with their express wording'* (para 74).

Notably, the UNIDROIT Principles and especially the CISG are very detailed and packed with unprecise terms. Jonathan Morgan sounds the alert[2]: "The Convention is, by contrast (to English law), riddled with standards requiring discretion in their application (including over thirty uses of "reasonable" or "reasonableness"). Whatever their possible diplomatic usefulness, such vague terms have proved repellent to commercial contractors." In the same vein, Gary B. Born points out, there is a tendency of international investors to avoid laws from jurisdictions that are more *'likely to import general principles of good faith and reasonableness into contractual relations'*.[3]

Parties avoid such contract laws because they give adjudicators significant leeway and discretionary power to depart from the literal wording of the contract or to modify its content on grounds such as imbalance of contractual obligations or corrective justice. Thereby, such laws cause uncertainty as to the enforcement of the agreed risk allocation which underlies the pricing of each contract.

Even those who are more favorable to interference in the name of a balance of contractual obligations or corrective justice cannot deny that such an approach reduces the predictability of court decisions and arbitral awards. On the contrary, as Morgan stated in ringing tones, *'English contract law generally displays hostility to judicial discretion'*.[4] New York and Swiss contract follow this path which explains the quoted ICC statistics. Sophisticated parties prefer choosing a contract law, that is considered (in the market) as highly predictable, frequently selected (familiarity), and strongly committed to party autonomy. As the Supreme Court underlined English contract law satisfies these conditions. We conclude that CISG and UNIDROIT Principles do not, otherwise they would be more successful.

Conclusion

Consequently, international commercial arbitration should not focus on promoting transnational contract laws but rather promote the development of a contract law theory and a methodology for interpreting complex contracts and remedies for breach. Such a theory and methodology, if it is not

made solely for ivory tower discussions, must fit the preferences and expectations of sophisticated dealmakers and arbitration users. The setting and features of international arbitration justify a tailor-made transnational approach because tribunals with arbitrators, that hail from different jurisdictions, have more room for case specific solutions than courts do when they perform their slightly different mission, which includes consistency and development of "their" national contract law.

References

?1 According to ICC statistics for 2020, choice-of-law clauses were included in substantive contractual provisions in 95%; see *ICC Dispute Resolution Statistics: 2020* (ICC 2021).

?2 Morgan, *Contract Law Minimalism* (CUP 2013) 187.

?3 Born, *International Arbitration and Forum Selection Agreements* (6th edn, 2021) 167.

?4 Morgan, *supra* n. 5, 95.

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