

# Kluwer Arbitration Blog

## PRC Court Upholds ICDR Award Relating to International Franchise Agreement

Pan Huiwen (Xiamen Intermediate People's Court of People's Republic of China) · Thursday, January 10th, 2019

On 12 June 2018, the Xiamen Intermediate People's Court of PRC ("Court"), in *Subway International B.V. v Xiamen Woguan Enterprise Management Co., Ltd*, upheld an ICDR award made by sole arbitrator Charles J. Moxley Jr., Esq.<sup>1</sup> This case raised some important questions in the recognition and enforcement of arbitral awards in China, which have been previously covered on the [Blog](#): determination of arbitration agreement's foreign applicable law; application of international conventions and arbitration rules of foreign arbitration institutions; and above all, the arbitrability of contractual parties' tax disputes.

### Case Summary

On behalf of Subway International B.V. ("Subway"), two authorized directors Patrica Demarals and David Worroll from Subway signed two separate franchise agreements ("Agreements") with Xiamen Woguan Enterprise Management Co., Ltd ("Woguan") in October 2010. According to the Agreements, Woguan was obliged to pay royalty, advertisement fees and other fees to Subway. However, Woguan failed to pay and Subway applied for arbitration in accordance with the arbitration clause in the Agreements. The sole arbitrator found Woguan to have breached the Agreements. It granted RMB 76,823 in liquidated damages to Subway and ordered Woguan to pay arbitration fees and arbitrator's fees in the amount of USD 23,615.

Since Woguan failed to comply with the ICDR award, Subway applied to the Court for recognition and enforcement of the award.

In its pleadings, Woguan sought to have the arbitral award's recognition and enforcement be refused on various grounds: (?) Invalid arbitration clause; (?) Breach of due process by the arbitral tribunal; and/or (?) Breach of arbitrability principle by the arbitral tribunal in dealing with the issue of the taxes payable.

As regards the validity of the arbitral agreement, Woguan argued that Patrica Demarals and David Worroll were not authorized to sign the Agreements on behalf of Subway. Furthermore, although the Agreement provided for the intention to arbitration and arbitration rules, it did not mention the specific arbitral tribunal, so the arbitral agreement was invalid. The Court rejected Woguan's argument. It found that, according to commercial register from the Netherlands' Chamber of Commerce, Patrica Demarals and David Worroll are both Subway's directors with independent

authority to sign the Agreement. A Director's authority is a matter of legal fact, the existence of which is not affected by whether authority certificate was shown to Woguan or not. Moreover, by initiating the ICDR arbitration, Subway has confirmed its attitude towards the Agreements. Article 10 of the Agreement provides that contractual disputes should be referred to ICDR for arbitration and UNCITRAL Arbitration Rules should apply. The seat of arbitration should be New York. Thereby, the Court concluded that Woguan's argument was baseless both in fact and law, the arbitration agreement was valid indeed.

As regards breach of due process by the arbitral tribunal, Woguan argued that relevant persons did not have the authority from Subway to apply and submit materials to the tribunal. However, the Court found that Subway raised no objections as to this point. Woguan further argued that it was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case. The Court held that Woguan's argument was contrary to the Agreements it signed with Subway. According to article 10 of the Agreements, both parties agree to complete the arbitration proceeding as soon as possible. Unless one party wishes an oral hearing, at the request of the parties or with their consent, the arbitrator may hear and decide the case on the basis of documents only. Meanwhile, the procedural history section of the arbitral award found that when applying for arbitration, Subway requested for the case to be heard on the basis of documents only and Woguan raised no objections. The tribunal provided opportunity for both parties to request for an oral hearing. However, both parties waived the right. Furthermore, both parties had submitted a large amount of materials to support their respective positions and claims. During the arbitral hearing, Woguan even filed a counter-claim. In conclusion, the Court held that Woguan's breach of due process allegation is without factual basis. Woguan had received proper notices of the arbitration proceeding and presented his case accordingly.

As regards arbitrability relating to the tribunal's dealing of taxes payable, Woguan asserted that taxes payable in the Agreements was not arbitrable. The Court did not agree with Woguan in this point, holding that it was contractual parties' agreement as to the burden of taxes payable which did not involve or impact the exercise of administrative right by China's tax authority. The Court ruled that the tribunal's founding was consistent with the principle of arbitrability. As to the burden of arbitration fees and arbitrator's fees, according the Agreements and UNCITRAL Arbitration Rules, the Court ruled that it was within the scope of the tribunal's authority to determine on this point. Woguan's argument was rejected accordingly.

## **Analysis**

The ruling once again shows PRC court's approach of minimal intervention in judicial review of foreign arbitral award. It gives effect to party autonomy and that of arbitral tribunals empowered by the will of the parties. International commercial and arbitration community may make positive reference from the ruling when assessing Chinese court's attitude towards judicial review of foreign arbitral award.

The ruling by the Xiamen Intermediate People's Court of PRC touches on one contentious issue in international arbitration: the degree of judicial review over tax burden agreed by parties in commercial contract. Arguments do exist to suggest that tax issues should remain beyond the reach of private adjudicators. However, arbitration of tax-related disputes proves very much a reality despite the doctrinal objections. Arbitrators routinely address problems of taxation in the context of ordinary commercial contracts. The arbitrability of tax disputes remains highly fact-intensive.<sup>2)</sup> Although no hard-and-fast rule prohibits all tax arbitration per se, the Court 's ruling clarifies that

if contractual parties' agreement as to tax burden does involve or impact the exercise of administrative right by China's tax authority, relevant disputes will not be arbitrable. Through prudent review, the limit between exercise of administrative right in public law and freedom of contract in private law was drawn, excessive judicial review of foreign arbitral award was avoided and substantial rights of both parties were legally protected under New York Convention ("Convention").

It is worth mentioning that Subway's application to the Court was to have the award recognized and enforced. According to the Notice concerning Relevant Issues of Centralized Handle over Cases of Judicial Review of Arbitration issued by the Supreme People's Court ("SPC Notice") in 2017, division specialized in the trial of foreign-related lawsuits is responsible for handling cases of judicial review of arbitration in China, including the judicial review of application for recognition and enforcement of foreign arbitration award. In judicial practice, according to research on court judgments published on <https://wenshu.court.gov.cn/>, most courts do comply with the SPC Notice recognizing and enforcing foreign arbitration award by the same division and in one proceeding and ruling. However, the Court opined that Subway should file the enforcement application with other competent authority (i.e. the Court's enforcement division). The Court confined its finding to the conditions upon which recognition was satisfied or not. Not only would such practice result in conflicting rulings by different court divisions when handling recognition and enforcement separately, but also lead to unnecessary delay in the enforcement of arbitration award which may discourage business people from choosing Xiamen as the seat of enforcement.

National courts are required under Article III of the Convention to recognize and enforce foreign awards in accordance with the rules of procedure of the territory where the application for recognition and enforcement is made and in accordance with the conditions set out in the Convention. However, the competent court/court division to be seized with the enforcement application is not regulated by the Convention and thus regulated by national law. Hopefully, with the further implementation of the SPC Notice, court practice of judicial review of arbitration award in China will be more efficient and harmonized to further strengthen the pro-arbitration position of Chinese courts.

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## References

?1 *The author would like to thank Judge Chen Yanzhong of Xiamen Maritime Court for his comments on the earlier drafts of the piece.*

William W. Park, Part II Substantive Rules on Arbitrability, Chapter 10 – Arbitrability and Tax in

?2 Loukas A. Mistelis and Stavros L. Brekoulakis (eds), *Arbitrability: International and Comparative Perspectives*, (Kluwer Law International 2009) pp. 179.

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